



COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL

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ATTORNEY GENERAL

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July 29, 2004

Beth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

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JUL 29 2004

PUBLIC SERVICE
COMMISSION

Re: An Adjustment of the Rates of Delta Natural Gas Company, Inc., PSC Case No.
2004-00067

Dear Ms. O'Donnell,

Pursuant to Commission Order dated July 16, 2004, the Original and 8 true copies of the Attorney General's Responses to the data requests contained in that Order are hereby filed with the Commission. Copies of these responses have been served on the parties this same day.

Pursuant to Commission Order dated April 23, 2004, seven copies of the Attorney General's Responses to the data requests of Delta Natural Gas Company, Inc. are hereby filed with the Commission. One copy has been treated as an original for the purposes of including voluminous materials not included in the remaining copies. Copies of these filings have been served on the parties this same day.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Elizabeth E. Blackford".

Elizabeth E. Blackford
Assistant Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204
(502) 696-5453

cc: Robert Watt III
Leslye Bowman
John Hall
Marian Carpenter
Connie King



COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:
AN ADJUSTMENT OF THE RATES)
OF DELTA NATURAL GAS) CASE NO. 2004-00067
COMPANY, INC.)

ATTORNEY GENERAL'S RESPONSE TO
COMMISSION ORDER OF JULY 16, 2004

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PUBLIC SERVICE
COMMISSION

**Attorney General's Response to
Commission Order of July 16, 2004
Delta Natural Gas Company
Case No. 2004-00067**

**Witness Responding:
Robert J. Henkes**

1. Refer to the Direct Testimony of Robert J. Henkes ("Henkes Testimony"), pages 19 and 20. Would Mr. Henkes agree that in previous general rate cases the Commission has generally amortized rate case expense over a 3-year period, as was done in Case Nos. 2000-00080¹ and 2001-00092?²

Response: While it is true that the Commission used a 3-year rate case expense amortization period in the two referenced recent rate cases, Mr. Henkes understands that the guiding principle underlying the PSC's determination of the rate case amortization period for any particular utility is the time interval between that utility's rate filings. This was clearly enunciated in the PSC's Orders in Delta's prior two rate cases, Case Nos. 99-176 and 97-066, in which the PSC ordered 5-year and 3-year rate case amortization periods based on this principle.

¹ Case No. 2000-00080, The Application of Louisville Gas and Electric Company to Adjust Its Gas Rates and to Increase Its Charges for Disconnecting Service, Reconnecting Service and Returned Checks, final Order dated September 27, 2000.

² Case No. 2001-00092, Adjustment of Gas Rates of The Union Light, Heat and Power Company, final Order dated January 31, 2002.

**Attorney General's Response to
Commission Order of July 16, 2004
Delta Natural Gas Company
Case No. 2004-00067**

**Witness Responding:
Robert J. Henkes**

2. Refer to Henkes Testimony, page 23.

- a. Was Mr. Henkes aware that Delta increased the monthly retainers for directors effective June 1, 2003?
- b. Did Mr. Henkes normalize the directors' monthly retainer to reflect the monthly retainer in effect at test-year end?
- c. Does Mr. Henkes agree that the directors' monthly retainer should be normalized to reflect the monthly retainer in effect at test-year end? If no, explain why not.
- d. Concerning the March 2004 increase in the monthly retainer authorized by Delta's Nominating and Compensation Committee, does Mr. Henkes believe the increase represents a known and measurable change? Explain the response.

Response:

- a. Yes, Mr. Henkes was aware that Delta increased the monthly retainers for directors effective June 1, 2003 as follows:

| | <u>Pre-6/1/03</u> | <u>Post-6/1/03</u> |
|------------------|-------------------|--------------------|
| Crowe | 900 | 1,100 |
| Hall | 900 | 1,100 |
| Green | 800 | 900 |
| Jennings | 1,000 | 1,000 |
| Peet | 4,000 | 4,200 |
| Walker, Jr. | 900 | 1,100 |
| Melton | 800 | 900 |
| Greer | 800 | 900 |
| Whitley | 800 | 900 |
| Kistner | 800 | <u>900</u> |
| Monthly Total | | 13,000 |
| Annualized Total | | <u>\$156,000</u> |

- b. No. Mr. Henkes could have used this suggested approach, but the resulting pro forma directors fees (without the non-recurring bonuses of \$51,440 and \$22,820 common stock compensation – see response to AG-2-14a.) would have been \$156,000 (see part a. above) To be conservative, Mr. Henkes used the approach shown on his Schedule RJH-10, recommending a pro forma directors fee level of \$173,243.

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**Witness Responding:
Robert J. Henkes**

- c. Mr. Henkes agrees that this would be an appropriate approach for ratemaking purposes in this case. This approach would result in pro forma directors' monthly retainer fees of \$156,000, which expense level is lower than the expense level of approximately \$173,000 recommended by Mr. Henkes.
- d. The monthly retainer authorized by Delta's Nominating and Compensation Committee in March 2004 represents a known and measurable change that has occurred outside of the test year used for ratemaking purposes in this case

**Attorney General's Response to
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**Witness Responding:
Robert J. Henkes**

3. Refer to the Henkes Testimony, page 23.
 - a. On page 27 there is a discussion of the American Gas Association ("AGA") dues. Explain how Mr. Henkes determined that the AGA advertising activities are institutional and promotional in nature. Include copies of any descriptions of expense activity categories.
 - b. In discussing several of his proposed adjustments, Mr. Henkes cites that the expense does not provide a material benefit to ratepayers. Provide Mr. Henkes' definition of the term "material benefit."

Response:

- a. Based on his experience in other gas rate cases, it is Mr. Henkes' understanding that AGA advertising involves nationwide advertising of which the primary purposes are (1) to enhance the image for the gas industry; (2) promote the use of natural gas over other resources; and (3) promote gas-fired equipment and appliances. Mr. Henkes was not able to locate copies of descriptions of expense activity categories.
- b. "Material benefit" could be defined as a meaningful and substantial benefit accruing to the ratepayer.

In this regard, Mr. Henkes considers any expense associated with activities that have nothing to do with the provision of safe, adequate and reliable gas service or are otherwise inappropriate for inclusion in rates as "not producing a material benefit to the ratepayers." This is consistent with 807 KAR 5:016, Section 4, which states with regard to disallowed advertising:

Advertising Disallowed. (1) Advertising expenditures for political, promotional, and institutional advertising by electric or gas utilities shall not be considered as producing a material benefit to the ratepayers and, as such, those expenditures are expressly disallowed for rate-making purposes.

**Attorney General's Response to
Commission Order of July 16, 2004
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**Witness Responding:
Michael J. Majoros Jr.**

4. Refer to the Direct Testimony of Michael J. Majoros, Jr. ("Majoros Testimony"), page 21 of 23.
- a. In preparing his Geometric Mean Turnover analysis for Account No. 376 – Distribution Mains, was the type of material used for the main (plastic, steel, cast iron) considered?
 - b. Would it be reasonable to consider the type of material used for the main when determining the service life?

Response:

- a. Mr. Majoros used the data provided by the Company in response to PSC 2-17 in the preparation of his GMT analyses. This data did not differentiate between types of materials used. As such, Mr. Majoros did not consider type of material in his analysis of mains. Furthermore, Delta did not make this distinction in their calculations of depreciation rates.
- b. It might be reasonable to consider the type of material used for the main in determining service. Several companies do that in their depreciation studies. However, it should be remembered that what is studied in statistical life studies is the dollars invested in a functional account. Thus, if all dollars invested in mains, regardless of the technology, are studied, it

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**Witness Responding:
Michael J. Majoros Jr.**

is not clear that the technology matters. Mains serve a function. Mr. Majoros is not certain that the disaggregation contemplated in the question really adds to the value of the result.

**Attorney General's Response to
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**Witness Responding:
Michael J. Majoros Jr.**

5. Refer to the Majoros Testimony, page 22 of 23 and Exhibit MJM-2, pages 1 and 2 of 7.
 - a. Explain why Mr. Majoros did not mention the positive net salvage shown on Exhibit MJM-2 for Account Nos. 383, 391, and 397 in his testimony on page 22.
 - b. Explain in detail why Mr. Majoros believes it is necessary to separate the net salvage component from Delta's depreciation rates.
 - c. Provide a version of Exhibit MJM-2, pages 1 and 2 of 7, that modifies the "Snaveley King Recommended" columns to reflect the inclusion of the net salvage component in the determination of the overall depreciation rate for each plant account.

Response:

- a. Mr. Majoros did not mention those accounts because even though Mr. Seelye proposed positive ratios, they do not reflect the overall positive net salvage that Delta has experienced. Delta experiences overall positive net salvage as a result of transportation equipment, which Mr. Seelye goes on to subtract from depreciation expense.

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**Witness Responding:
Michael J. Majoros Jr.**

- b. See Mr. Majoros' testimony at page 22 lines 15-18. It is not necessary to separate the net salvage component from depreciation rates. It is, however, necessary to separate the net salvage component within the depreciation rate and accrual.

- c. Attached

DELTA NATURAL GAS COMPANY
Calculation of Depreciation as of December 31, 2002
In Response to Staff Data Request No. 5c

| Account No. (a) | Description (b) | Plant Balance (c) | Book Reserve (d) | Seelye Proposed | | | | | | | | | | Shavely King Recommended | | | | | Capital Recovery & Net Sal. Allowance | |
|---------------------------------|-------------------------------------|-------------------|------------------|-----------------|---------------|-----------------|---------------------|-------------------------------|--------------------|---------------|---------------------|-----------------------------|----------|---|----------|------------------------------------|----------|--|---------------------------------------|--|
| | | | | ASL/ Curve (e) | Rem. Life (f) | Net Salvage (g) | Future Accruals (h) | Calculated Annual Accrual (i) | Survivor Curve (k) | Rem. Life (l) | Future Accruals (m) | Capital Recovery Amount (n) | Rate (o) | Average Annual Net Salvage Allowance Amount (p) | Rate (q) | Capital Recovery Annual Amount (r) | Rate (s) | | | |
| | | | | (e) | (f) | (g) | (h) | (i) | (k) | (l) | (m) | (n) | (o) | (p) | (q) | (r) | (s) | | | |
| Gathering Plant | | | | | | | | | | | | | | | | | | | | |
| 305 | Structures & Improvements | 60,604 | 33,544 | | 27,060 | 1,333 | 2.20% | 27,060 | 1,333 | 2.20% | 3/ | 0.00% | 2.20% | 1,333 | 2.20% | 1,333 | | | | |
| 325 | Gathering Land & Rights | 75,976 | 43,153 | | 32,823 | 2,279 | 3.00% | 32,823 | 2,279 | 3.00% | 3/ | 0.00% | 3.00% | 2,279 | 3.00% | 2,279 | | | | |
| 331 | Well Equipment - Fully Depr | 7,795 | 7,795 | | | 312 | 4.00% | | 312 | 4.00% | 3/ | 0.00% | 4.00% | 312 | 4.00% | 312 | | | | |
| 332 | Gathering Lines | 1,906,022 | 1,015,554 | | 890,468 | 42,811 | 2.25% | 890,468 | 42,811 | 2.25% | 3/ | 0.00% | 2.25% | 42,811 | 2.25% | 42,811 | | | | |
| 333 | Gathering Compressor Stations | 818,994 | 531,087 | | 287,907 | 32,760 | 4.00% | 287,907 | 32,760 | 4.00% | 3/ | 0.00% | 4.00% | 32,760 | 4.00% | 32,760 | | | | |
| 334 | Gathering Meas & Reg Station Equip. | 107,270 | 54,580 | | 52,690 | 2,922 | 2.72% | 52,690 | 2,922 | 2.72% | 3/ | 0.00% | 2.72% | 2,922 | 2.72% | 2,922 | | | | |
| | Total Gathering Plant | 2,976,661 | 1,685,713 | | 1,290,948 | 82,417 | | 1,290,948 | 82,417 | | | | | 82,417 | | 82,417 | | | | |
| Storage & Processing | | | | | | | | | | | | | | | | | | | | |
| 351 | Structures & Improvements | 275,274 | 31,314 | | 243,960 | 6,882 | 2.50% | 243,960 | 6,882 | 2.50% | 4/ | 0.00% | 2.22% | 6,099 | 2.22% | 6,099 | | | | |
| 352 | Storage Wells | 380,553 | 60,404 | | 320,149 | 10,579 | 2.78% | 320,149 | 8,893 | 2.34% | 4/ | 0.00% | 2.34% | 8,893 | 2.34% | 8,893 | | | | |
| 35201 | Storage Rights | 850,395 | 243,324 | | 607,071 | 23,641 | 2.78% | 607,071 | 16,863 | 1.98% | 4/ | 0.00% | 1.98% | 16,863 | 1.98% | 16,863 | | | | |
| 35202 | Storage Reservoirs | 1,861,730 | 578,675 | | 1,283,055 | 51,756 | 2.78% | 1,283,055 | 35,640 | 1.91% | 4/ | 0.00% | 1.91% | 35,640 | 1.91% | 35,640 | | | | |
| 35203 | Nonrecoverable Nat Gas | 294,307 | 92,707 | | 201,600 | 8,182 | 2.78% | 201,600 | 5,600 | 1.90% | 4/ | 0.00% | 1.90% | 5,600 | 1.90% | 5,600 | | | | |
| 353 | Storage Lines | 5,024,283 | 1,099,896 | | 3,924,387 | 139,675 | 2.78% | 3,924,387 | 109,011 | 2.17% | 4/ | 0.00% | 2.17% | 109,011 | 2.17% | 109,011 | | | | |
| 354 | Storage Comp Stat Equip | 1,767,800 | 745,637 | | 1,022,163 | 49,145 | 2.78% | 1,022,163 | 28,393 | 1.61% | 4/ | 0.00% | 1.61% | 28,393 | 1.61% | 28,393 | | | | |
| 355 | Storage Meas & Reg Equip | 361,994 | 68,548 | | 293,446 | 10,063 | 2.78% | 293,446 | 8,151 | 2.25% | 4/ | 0.00% | 2.25% | 8,151 | 2.25% | 8,151 | | | | |
| 356 | Purification Equipment | 342,123 | 75,955 | | 266,170 | 9,511 | 2.78% | 266,170 | 7,394 | 2.16% | 4/ | 0.00% | 2.16% | 7,394 | 2.16% | 7,394 | | | | |
| 357 | Storage Other Equipment | 47,208 | 30,856 | | 16,352 | 1,572 | 3.33% | 16,352 | 545 | 1.15% | 4/ | 0.00% | 1.15% | 545 | 1.15% | 545 | | | | |
| | Total Storage & Processing | 11,205,667 | 3,027,314 | | 8,176,353 | 311,006 | | 8,176,353 | 226,590 | | | | | 226,590 | | 226,590 | | | | |
| Transmission | | | | | | | | | | | | | | | | | | | | |
| 3652 | Rights Of Way | 163,626 | 161,844 | | 1,782 | 4,091 | 2.50% | 1,782 | 4,091 | 2.50% | 3/ | 0.00% | 2.50% | 4,091 | 2.50% | 4,091 | | | | |
| 3653 | Land Rights Cvtl | 173,215 | 82,663 | | 90,552 | 3,464 | 2.00% | 90,552 | 3,464 | 2.00% | 3/ | 0.00% | 2.00% | 3,464 | 2.00% | 3,464 | | | | |
| 366 | Structures & Improvements | 31,532,952 | 10,387,168 | | 21,145,784 | 699,265 | 2.22% | 21,145,784 | 699,265 | 2.22% | 3/ | 0.00% | 2.22% | 699,265 | 2.22% | 699,265 | | | | |
| 367 | Transmission Mains | 1,413,310 | 1,099,553 | | 313,757 | 28,266 | 2.00% | 313,757 | 28,266 | 2.00% | 3/ | 0.00% | 2.00% | 28,266 | 2.00% | 28,266 | | | | |
| 368 | Compressor Stat Equipment | 2,017,415 | 500,967 | | 1,718,190 | 63,826 | 3.16% | 1,718,190 | 40,809 | 2.02% | 3/ | 0.00% | 2.02% | 40,809 | 2.02% | 40,809 | | | | |
| 369 | Meas & Reg Stat Equipment | 550,019 | 454,078 | | 95,941 | 11,000 | 2.00% | 95,941 | 11,000 | 2.00% | 3/ | 0.00% | 2.00% | 11,000 | 2.00% | 11,000 | | | | |
| 371 | Other Equip | 35,850,537 | 12,686,273 | | 23,366,006 | 809,913 | | 23,366,006 | 786,895 | | | | | 786,895 | | 786,895 | | | | |
| | Total Transmission | 35,850,537 | 12,686,273 | | 23,366,006 | 809,913 | | 23,366,006 | 786,895 | | | | | 786,895 | | 786,895 | | | | |
| Distribution | | | | | | | | | | | | | | | | | | | | |
| 375 | Structures & Improvements | 113,441 | 57,435 | | 56,006 | 3,122 | 2.75% | 56,006 | 3,122 | 2.75% | 3/ | 0.00% | 2.75% | 3,122 | 2.75% | 3,122 | | | | |
| 376 | Distribution Mains | 55,253,257 | 17,850,403 | 5/ | 37,402,854 | 1,381,331 | 2.50% | 37,402,854 | 879,240 | 1.59% | 3/ | 0.00% | 1.59% | 879,240 | 1.59% | 879,240 | | | | |
| 378 | Meas & Reg Stat - General | 1,137,407 | 310,481 | | 940,667 | 34,457 | 3.03% | 940,667 | 30,290 | 2.68% | 3/ | 0.00% | 2.68% | 30,290 | 2.68% | 30,290 | | | | |
| 379 | Meas & Reg Stat - City Gate | 398,371 | 170,030 | | 268,178 | 11,783 | 2.96% | 268,178 | 10,033 | 2.52% | 3/ | 0.00% | 2.52% | 10,033 | 2.52% | 10,033 | | | | |
| 380 | Services | | | | | | | | | | | | | | | | | | | |
| 381 | Meters | 6,611,333 | 2,248,421 | | 4,362,912 | 148,803 | 2.25% | 4,362,912 | 148,803 | 2.25% | 3/ | 0.00% | 2.25% | 148,803 | 2.25% | 148,803 | | | | |
| 382 | Meter & Reg Installation | 2,773,387 | 853,929 | | 3,167,492 | 115,602 | 4.17% | 3,167,492 | 55,636 | 2.01% | 3/ | 0.00% | 2.01% | 55,636 | 2.01% | 55,636 | | | | |
| 383 | House Reg | 2,570,545 | 809,873 | | 1,632,145 | 99,764 | 3.88% | 1,632,145 | 107,621 | 4.19% | 3/ | 0.00% | 4.19% | 107,621 | 4.19% | 107,621 | | | | |
| 385 | Industrial Meter Sets | 1,348,030 | 356,706 | | 1,126,127 | 32,083 | 2.38% | 1,126,127 | 28,243 | 2.10% | 3/ | 0.00% | 2.10% | 28,243 | 2.10% | 28,243 | | | | |
| | Total Distribution | 70,205,771 | 22,657,278 | | 48,956,371 | 1,826,945 | | 48,956,371 | 1,262,987 | | | | | 1,262,987 | | 1,262,987 | | | | |

DELTA NATURAL GAS COMPANY
Calculation of Depreciation as of December 31, 2002
In Response to Staff Data Request No. 5c

| Account No. | Description | Seeley Proposed | | | | | Snavely King Recommended | | | | | Capital Recovery & Net Sal. Allowance | | | | | |
|-------------|---------------------------|------------------|-----------------|--------------------------|---------------|-----------------|--------------------------|-------------------------------|--------------------|---------------|---------------------|---------------------------------------|----------|--|----------|-------------------------|-----------|
| | | Plant Balance 1/ | Book Reserve 2/ | ASL / Survivor Curve (e) | Rem. Life (f) | Net Salvage (g) | Future Accruals (h) | Calculated Annual Accrual (i) | Survivor Curve (k) | Rem. Life (l) | Future Accruals (m) | Capital Recovery Accrual (n) | Rate (o) | Average Annual Net Salvage Allowance (p) | Rate (q) | Annual Accrual Rate (r) | |
| | | | | | | | | | | | | | | | | | Amount |
| | General | | | | | | | | | | | | | | | | |
| 389 | Land and Land Rights | 1,038,741 | - | 17 L0 | 9.9 | 5% | 1,038,741 | - | | 1,038,741 | - | 0.00% | (5,455) | -0.53% | | (5,455) | |
| 390 | Structures & Improvements | 4,536,749 | 1,130,926 | 17 L0 | 9.9 | 5% | 3,405,823 | 90,735 | 3,405,823 | 3,405,823 | 90,735 | 2.00% | (6,131) | -0.14% | 1.86% | 84,604 | |
| 391 | Office Furn & Equip | 644,923 | 470,640 | | | | 142,037 | 14,347 | 174,283 | 17,604 | 2,733 | 2.73% | (484) | -0.08% | 2.65% | 17,120 | |
| 393 | Stores Equipment | 49,526 | 42,436 | | | | 7,090 | 2,476 | 7,090 | 2,476 | 5,009 | 5.00% | - | 0.00% | 5.00% | 2,476 | |
| 394 | Tools & Work Equipment | 584,283 | 450,798 | | | | 133,485 | 29,214 | 133,485 | 29,214 | 5,009 | 5.00% | (116) | -0.02% | 4.98% | 29,098 | |
| 395 | Laboratory Equipment | 187,689 | 113,913 | | | | 73,776 | 13,816 | 73,776 | 13,816 | 7,367 | 7.36% | - | 0.00% | 7.36% | 13,816 | |
| 397 | Communication Equip | 547,343 | 291,789 | | | | 228,187 | 35,935 | 255,554 | 40,245 | 7,359 | 7.35% | (2,430) | -0.44% | 6.91% | 37,815 | |
| 398 | Miscellaneous Equipment | 93,747 | 81,847 | | | | 11,900 | 4,687 | 11,900 | 4,687 | 5,009 | 5.00% | (78) | -0.08% | 4.92% | 4,609 | |
| 3981 | Mapping Costs | 662,043 | 522,473 | | | | 139,570 | 66,204 | 139,570 | 66,204 | 10,000 | 10.00% | - | 0.00% | 10.00% | 66,204 | |
| 3982 | Computer Software | 1,773,888 | 1,513,343 | | | | 260,545 | 354,778 | 260,545 | 354,778 | 20,000 | 20.00% | - | 0.00% | 20.00% | 354,778 | |
| 3993 | Computer Hardware | 1,491,322 | 1,078,628 | | | | 412,694 | 298,264 | 412,694 | 298,264 | 20,000 | 20.00% | (1,139) | -0.08% | 19.92% | 297,125 | |
| | Total General | 11,610,254 | 5,696,793 | | | | 5,853,848 | 910,457 | 5,913,461 | 918,024 | 3,276,914 | 20.00% | (15,833) | | | 902,191 | |
| | Total Depreciation | | | | | | | 3,940,739 | | | | | | 11,274 | | | 3,288,188 |

1/ Study Appendix B
2/ Response to AG 52, pages 362 and 363.
3/ No objection to Seeley life proposal.
4/ Seeley estimated remaining lives but calculated whole-life rates. Snavely King calculated remaining life rates using Seeley estimates.
5/ Account 380 Services Reserve and average annual net salvage allowance added to Account 376 because that is where the Account 380 investment is.
6/ Staff Data Request No. 5c only asked for pages 1 and 2 of MJM-2, but pages 3-7 are critical to full disclosure because they show the elimination of Transportation and Power Operated Equipment. Since only pages 1 and 2 were requested, Transportation and Power Operated Equipment have been excluded. Also, Accounts 389 (Land & Land Rights) and 399.3 (Computer Hardware) were added because they are shown on the original pages 1-2, and net salvage relating to these accounts was included in the \$11,274 net salvage allowance.

**Attorney General's Response to
Commission Order of July 16, 2004
Delta Natural Gas Company
Case No. 2004-00067**

**Witness Responding:
David H. Brown Kinloch**

6. Refer to the Direct Testimony of David H. Brown Kinloch, page 18.

a. Mr. Brown Kinloch states that he is unaware of money for research, funded by other utilities, which is collected from customers through a separate tariff rider on a bill. Is Mr. Brown Kinloch unaware of the stipulations the Attorney General entered into with Columbia Gas of Kentucky, Inc. ("Columbia") and Atmos Energy Corporation ("Atmos") in those companies' most recent rate cases which allow them to collect money for research through riders on their customers' bills?

Response:

Mr. Brown Kinloch was aware that the Attorney General had entered into stipulations with Columbia Gas and Atmos Energy that allowed for the collection of money from ratepayers for research. He was unaware that this money was being collected through a separate rider.

b. Columbia's tariff applies its research rider to all rate schedules. In light of this, does Mr. Brown Kinloch still contend that Delta must include the research expense in its base rates in order to apply the charge to customers other than sales customers? Explain the response.

Response:

If collection of this research fee is allowed by the Commission, Mr. Brown Kinloch believes that it is important it should be collected from all customers whether that is done through base rates or by modifying the Delta proposal to apply to all customers.

c. Mr. Brown Kinloch suggests that money for research should be collected through base rates. Columbia's and Atmos's tariffs allow them to terminate their riders by filing a notice of rescission with the Commission. Given that the only way to remove an expense item from base rates is through a general rate case, is Mr. Brown Kinloch still of the opinion that it would be beneficial to include this charge in base rates? Explain the response.

Response:

Mr. Brown Kinloch is opposed to single issue ratemaking. Carving customer rates into a number of individual riders allows utilities to raise a part of customer rates, without accounting for other costs in customer rates that may have decreased. Keeping all customer costs in a single base rate allows for some costs to increase and others to decrease and thus avoid the need to change customer rates. Placing research expenses in a separate rider may allow the Commission to terminate the expense outside a rate case, but it also allows Delta to apply to raise this fee separately, without the examination of other Delta expenses that may have decreased.

**Attorney General's Response to
Commission Order of July 16, 2004
Delta Natural Gas Company
Case No. 2004-00067**

**Witness Responding:
Charles King**

7. Refer to the Direct Testimony of Charles W. King ("King Testimony"), page 7 and Exhibit CWK-1. Mr. King used an average of his estimated 2004 and 2005 dividends in his discounted cash flow analysis. Explain why it is appropriate to use an average dividend for these two years rather than the 2005 estimated dividend.

Response:

The intention is to reflect the dividend during the next period. Since I am preparing this testimony in the summer of 2004, the appropriate next period is the last half of 2004 and the first half of 2005. The average of 2004 and 2005 dividends captures this period.

**Attorney General's Response to
Commission Order of July 16, 2004
Delta Natural Gas Company
Case No. 2004-00067**

**Witness Responding:
Charles King**

8. Refer to the King Testimony, page 9. Mr. King excludes two companies from his comparison group because Value Line rates them below a "B" for financial strength. Explain why Mr. King chose to exclude companies with a financial strength rating below "B."

Response

As explained in the testimony, we do not want to examine companies that are financially weak. To do so would overstate the required rate of return because these companies experience risks not borne by a financially healthy utility such as Delta.

**Attorney General's Response to
Commission Order of July 16, 2004
Delta Natural Gas Company
Case No. 2004-00067**

**Witness Responding:
Charles King**

9. Refer to the King Testimony, page 19. Mr. King uses the rate on a Treasury security with a maturity of one year as the risk-free rate in his CAPM analysis. Provide any articles from financial literature, textbook chapters, or other authoritative sources that support using a security with a maturity of one year in the CAPM model.

Response

I have not conducted a literature search on the issue of risk-free rates for the CAPM analysis. However, I am confident that no one recommends a one-year Treasury bond as the risk free rate. I do so only because one year appears to be the investment horizon of the average purchaser of stock on the New York Stock Exchange. The risk-free rate to such an investor would be the one Treasury bond yield.