

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

In the Matter of:

AN ADJUSTMENT
OF RATES OF DELTA NATURAL
GAS COMPANY, INC.

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CASE NO. 2004-00067

REBUTTAL TESTIMONY OF

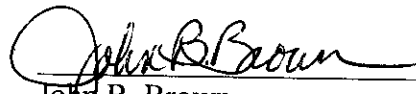
JOHN B. BROWN

August 9, 2004

AFFIDAVIT

The affiant, John B. Brown, being duly sworn, deposes and states that the prepared testimony attached hereto and made a part hereof, constitutes the prepared rebuttal testimony of this affiant in Case No. 2004-00067, in the Matter of: An Adjustment of Rates of Delta Natural Gas Company, Inc. and that if asked the questions propounded therein, this affiant would make the answers set forth in the attached prepared rebuttal testimony.

Affiant further states that he will be present and available for cross-examination and for such additional examination as may be appropriate at the hearing in Case No. 2004-00067 scheduled by the Commission, at which time affiant will further reaffirm the attached prepared testimony as his rebuttal testimony in such case.

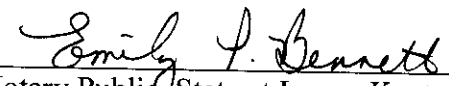


John B. Brown

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Subscribed and sworn to before me by John B. Brown, this the 5th day of August, 2004.

My Commission Expires: 6/20/2008



Notary Public, State at Large, Kentucky

1 Q. Please state your name and business address.

2 A. John B. Brown, Delta Natural Gas Company, Inc., 3617 Lexington Road,
3 Winchester, Kentucky 40391.

4 Q. Have you previously filed direct testimony in this proceeding?

5 A. Yes.

6 Q. What is the purpose of this testimony?

7 A. The purpose of this testimony is to review and rebut the direct testimony of
8 Robert J. Henkes and to discuss a change to the Capital Structure.

9 Q. Do you agree with the recommendation of Mr. Henkes to reduce test year
10 accounting expenses by \$80,000 related to the Company's compliance with the
11 Sarbanes Oxley legislation?

12 A. No.

13 Q. What will be the recurring expense level for outside services – accounting
14 (Account 1.923.02)?

15 A. \$260,000 of the \$343,748 booked in the test year will recur annually, as detailed
16 in the responses to data requests AG 1-9, AG 1-48 and PSC 2-25(u).

17 Q. What amount of the \$260,000 of recurring expenses is allocated to maintaining
18 Sarbanes-Oxley compliance?

19 A. \$157,000 (\$77,000 internal audit resources and \$80,000 for required external
20 audit and independent auditors' report) are incurred for compliance with Sarbanes
21 Oxley.

1 Q. Do you agree with Mr. Henkes's recommendation to exclude \$80,000 of the
2 \$157,000 as a "selective post-test year expense" on page 25 of Henkes Direct
3 Testimony?

4 A. No. Delta incurred \$240,272 in Sarbanes-Oxley project expenses during the test
5 year. Approximately \$157,000 of the test year Sarbanes Oxley compliance
6 expenses will be recurring expenses. However, Delta has already incurred an
7 additional \$111,617.66 of Sarbanes-Oxley expenses during the first six months of
8 calendar 2004 that were not included in the test year. Beginning with the July
9 2004 close, Delta will begin accruing the costs of maintaining Sarbanes-Oxley
10 compliance during the 2004-2005 fiscal year at a level of \$13,100 per month.
11 Thus, the total annual accrual will be \$157,200. The expenses of maintaining
12 Sarbanes-Oxley compliance are currently being incurred as required and the
13 company's calculation of the necessary recurring annual expenses of \$157,000 is
14 conservative. Therefore, Mr. Henkes's recommendation to reduce this amount by
15 \$80,000 is not appropriate. The expense adjustment to this account should be to
16 reduce test year expenses by \$83,748, as proposed on AG 1-9.

17 Q. Do you agree with Mr. Henkes's recommendation that Outside Services –
18 Computer Services Expense should be reduced by \$42,404?

19 A. No, I do not.

20 Q. What will be the recurring expense level for professional services – computers
21 (Account 1.923.05)?

22 A. The level of expenses during the test year in this account of \$155,951 is probably
23 a little lower than the expected annually recurring expense level. The budget in

1 the current fiscal year for this account is \$160,200. This total reflects specifically
2 detailed expenses that we are contracted to incur on an annual basis to maintain
3 the software we use to run the Company. These specifically identified amounts
4 are \$135,200 for the current year with a \$25,000 budgeted allowance for
5 outsourcing/consulting. Since the budget was prepared, we have contracted for an
6 additional \$10,000 of annual expense to maintain our Sarbanes-Oxley software,
7 so that totals \$145,200 of annual contracted costs, leaving only \$10,800 for
8 outsourcing on an annual basis (Test year expenses of \$156,000 less contracted
9 expenses of \$145,200).

10 Q. Will outsourced projects exceed \$10,800 on an annual basis?

11 A. Yes, as evidenced during the test year. We undertook one special project with
12 Source Imaging which totaled \$42,404 in the test year. We are committed to
13 utilize outside resources more in order to complete internal control and
14 accounting related system projects. We plan to further enhance our gas
15 accounting system. We are evaluating a \$9,000 quote to make a change to our
16 payroll system. We are also evaluating an estimate of \$30,000 to \$70,000
17 (depending on the extent of services) to purge old customer history from the
18 AS400 computer, and develop a program of purging data on an annual basis. We
19 need a new system for calculating unbilled revenue and are currently receiving
20 quotes to enhance the usefulness of our scanning/imaging systems. The \$10,800
21 that the test year level allows for such projects will be significantly inadequate,
22 and in no case should any outsourced expenses (including those for Source
23 Imaging) in the test year be removed.

1 Q. Have you made a change to the Company's Capital Structure to be utilized for
2 ratemaking purposes in this case?

3 A. Yes. We made an error when we originally submitted this information and, in
4 addition, the Capital Structure needs to be corrected to reflect the proper treatment
5 of Minimum Pension Liability. The Commission's correct interpretation of SFAS
6 No. 130 in the orders in Case No. 2003-00433 and Case No. 2003-00434, the
7 recent rate cases of Louisville Gas and Electric Company and Kentucky Utilities
8 Company, would require Delta to add the \$2,050,636 of "Accumulated other
9 Comprehensive Income" (caused by Minimum Pension Liability) back to
10 common equity, resulting in test year capitalization including subsidiaries of
11 \$46,080,957 and excluding subsidiaries of \$44,915,682.

12 Q. Did Delta file the case with a test year capitalization of \$46,080,957 (including
13 subsidiaries)?

14 A. No. We originally inadvertently used \$44,030,321, which is net equity for GAAP
15 financial reporting purposes.

16 Q. Did you subsequently correct this error?

17 A. Yes. We first used the corrected amount when computing Average Rates of
18 Return in response to PSC 1-35. We submitted the correction in response to AG
19 1-1, explaining it on page 2 and attaching a schedule reconciling the Regulatory
20 Balance Sheet with the GAAP Balance Sheet. We submitted the letter from the
21 Federal Energy Regulatory Commission regarding Minimum Pension Liability
22 dated March 29, 2004 in Docket No. A104-2-000 with the response to AG 2-11
23 and interpreted it relating to Delta. We submitted a corrected Capital Structure in

1 response to PSC 3-12(b). The corrected Capital Structure is also filed with the
2 rebuttal testimony of John Hall.

3 Q. Does the Attorney General Testimony reflect the corrected capital structure?

4 A. No. Schedule RJH-2 was prepared from the original Delta Filing Schedule 9
5 rather than from the corrected Capital Structure provided in the response PSC 3-
6 12(b), which is the one that should be used for ratemaking purposes in this case.

7 Q. Does this conclude your rebuttal testimony at this time?

8 A. Yes.