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OCT 16 2014

PUBLIC SERVICE
COMMISSION

October 16, 2014

Via Hand-Delivery
Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

RE: *Case No. 2013-00365; Application of Delta Natural Gas Company, Inc. for an Order Declaring That it is Authorized to Construct, Own and Operate a Compressed Natural Gas Station in Berea, Kentucky*

Dear Mr. Derouen:

Please find enclosed the original and twelve (12) copies of Interstate Gas Supply Inc.'s and Clean Energy Fuel Corp.'s post-hearing brief in the above-referenced case.

Please place the documents of file.

Regards,

Matthew Malone

C: File; Parties

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

Application of Delta Natural Gas Company, Inc. for An Order Declaring That it is Authorized to Construct, Own and Operate a Compressed Natural Gas Station in Berea, Kentucky	)))	**Case. 2013-00365**

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Post Hearing Brief of IGS Energy and Clean Energy

I. INTRODUCTION

In this proceeding the Delta Natural Gas Company ("Delta") has requested that the Public Service Commission of Kentucky ("Commission") approve its application ("Application") to construct own and operate a compressed natural gas ("CNG") vehicle refueling station in Berea Kentucky ("Berea Station"). Delta has requested that the costs of constructing owning and operating the Berea Station be recovered from Delta distribution ratepayers. IGS Energy and Clean Energy (collectively "CNG Parties") do not object to Delta building the Berea Station if it is done by an unregulated affiliate of Delta and the costs and risk of building the Berea Station is borne by Delta shareholders. However, Delta's request to build the Berea Station through its regulated distribution company with ratepayer dollars, is unreasonable, unlawful and should be rejected.

First, Kentucky law does not allow for the approval of Delta's Application. There is no Kentucky statute that authorizes a local distribution company ("LDC") to expand its regulated monopoly into the vehicle refueling business. Moreover, Kentucky statute expressly prohibits a LDC from utilizing ratepayer dollars to subsidize an unregulated business. Kentucky law defines CNG vehicle refueling as an unregulated business, and Delta is asking Delta ratepayers to subsidize this business, expressly contradicting Kentucky law.

Second, the Application submitted by Delta overstates the economic benefit and understates the risk of building the Berea Station to Delta ratepayers. As explained in the expert testimony of witness Mrowzinski, Delta's Application relies on a number of faulty assumptions and significantly understates the cost components required to supply CNG.[1] Further, given the geographic location of the proposed station, and limited work done by Delta to drive business to the station, it is highly unlikely that Delta will achieve the revenue requirement necessary for the station to break even. This means that Delta ratepayers would be required to subsidize the Berea Station for the life of the project.

Finally, even *if* Berea Station were economically viable and permitted by law, Delta's Application still should not be approved. Vehicle refueling is not a "natural monopoly" business nor does the policy rationale exist to provide Delta with an authorized rate of return on vehicle refueling assets. Rather there a number of competitive, non-utility entities in the market place that are building and investing in

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[1] Direct Testimony of Dave Mrowzinski at 4

CNG stations with shareholder dollars.[2] Subsidizing the Berea Station through distribution rates would thwart the development of a robust market for non-utility CNG development in Kentucky. This is particularly so given that if approved, Delta hopes that the Berea Station is used as a model for CNG development in its service territory and for other LDCs in Kentucky.[3]

CNG Parties do believe that CNG is a promising vehicle fuel. But CNG development is also a risky endeavor. As noted by Mr. Mrowzinski at hearing, in the 1990s there were many CNG stations built throughout the country, but ultimately almost every one of those stations failed.[4] If CNG is going to succeed this time around, there will need to be a robust market of private CNG developers willing to invest capital and take on the risk of station development. But these costs and risks should not be borne Delta ratepayers. Doing so would allow Delta shareholders to earn a rate of return on the CNG station even if the station fails. This may be a heads I win tails you lose proposition for Delta shareholders, but it is a bad bargain for Delta ratepayers and the CNG market over the long run.

II. ARGUMENT

A. Kentucky Law Does not Allow Delta to Subsidize its CNG Station Costs Through Distribution Rates

[2] Video Transcript (9-14-14) at 5:017:15 PM -5:17:30 PM

[3] Direct Testimony of John Brown at 2-3; stating "Delta hopes this proposed project can be used as a model of partnership between the state, the Commission and the utility which will encourage Delta and other investor-owned utilities in Kentucky to build the infrastructure that will enable compressed natural gas to become a viable transportation fuel choice across this state."

[4] Video Transcript (9-14-14) at 5:00:56 PM -5:02:00 PM

In its Application Delta does not identify any statute that allows it to recover the costs of CNG stations through distribution rates. Rather Delta seeks authority from the Commission to construct a CNG station pursuant to KRS § 278.508.[5] The pertinent part of KRS § 278.508, states "the rates, terms, and conditions of service for the sale of natural gas to a compressed natural gas fuel station, retailer, or to any end-user for use as a motor vehicle fuel, shall not be subject to regulation by the Kentucky Public Service Commission (emphasis added)." Nothing in KRS § 278.508, however, discusses or contemplates an LDC building or owning a CNG station; the statute merely indicates that *if* an LDC sells natural gas to a CNG station, the sale of that natural gas shall not be regulated. Thus, KRS § 278.508 cannot be used as a basis for granting Delta approval to build a CNG station.

Delta then states in its Application, in the alternative to receiving approval via KRS § 278.508, "that it be granted a certificate of public convenience and necessity authorizing it to construct such compressed natural gas station pursuant to KRS § 278.020(1)." While § 278.020(1) mentions a number of items for which a public convenience and necessity may be granted, a vehicle refueling station is not one of those items. Moreover, in order to receive a certificate under § 278.020(1) a utility must demonstrate that "public convenience and necessity require the service or construction (emphasis added)." Therefore, even if a vehicle refueling station is contemplated under KRS § 278.020(1), Delta certainly has not demonstrated, nor could it demonstrate, that public necessity requires that a CNG refueling station be built in Berea Kentucky.

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[5] Delta Application at 1

Further, KRS § 278.2201 states that "(a) utility shall not subsidize a nonregulated activity provided by an affiliate or by the utility itself." And as already noted, KRS § 278.508 clearly labels the sale of CNG as a vehicle fuel as a nonregulated activity. Thus, in its Application Delta is asking that Delta ratepayers subsidize a nonregulated activity.

While Delta may have rosy projections for the success of the Berea Station, nothing in the application limits Delta ratepayers from covering the cost of the Berea Station if Delta does not meet its revenue requirements. And even if the Commission caps the dollar amount that Delta can recover through ratepayers, approval of Delta's Application would amount to Delta ratepayers subsidizing a nonregulated activity. Almost all of the Berea Station costs will be incurred up-front in the construction phase of the project. Thus, Delta could be receiving a rate of return on the CNG station assets before Delta even makes a single sale of CNG to the public.

At a very minimum, approval of the Application will amount to a short term subsidy to prop the CNG station while sales increase enough to meet Delta's revenue requirement. Further, as discussed more fully herein, given the location of the Berea Station and the limited fleets in area, it is highly likely that the Berea Station will even meet its revenue requirement.[6] Thus, the Berea Station would require a subsidy from Delta ratepayers throughout the life of the project. Authorizing Delta to receive a rate of return on station assets, regardless of whether Delta meets its revenue requirements on those assets is a direct subsidy of a nonregulated activity. The only way to ensure

[6] Direct Testimony of Dave Mrowzinski Testimony at 11

Delta is not in violation of § 278.2201 is for the Commission to reject the Application altogether.

In its Application Delta points to the State of Utah as an example of a state that authorizes utilities to recover the costs of CNG stations through the rate base.[7] As Mr. Mrowzinski points out, Utah should not be viewed as a successful CNG market because although there may be several utility owned stationed in Utah, there is very little, if any, non-ratepayer funded stations.[8] That said, at least in Utah there is a state statute that allows for utilities to recover CNG station costs through distribution ratepayers.[9] In Kentucky no such statute exists. Absent a statute authorizing ratepayer recovery of CNG stations in Kentucky, it would be unlawful for the Commission to approve Delta to recover CNG station costs from ratepayers.

B. Approval of Delta's Application Will Put Undue Risk and Cost on Delta's Ratepayers

In its Application Delta makes a number of unsupportable economic assumptions about the proposed Berea Station. As noted by witness Mrowzinski, Delta "grossly underestimates the costs of providing CNG to customers. As a result of these questionable assumptions, Delta overstates the benefits of building a CNG station for Delta customers and understates the risk."[10]

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[7] Direct Testimony of John Brown at 3-4.

[8] Direct Testimony of Dave Mrowzinski Testimony at 15

[9] See Utah Code §§ 54-4-13.1 and 54-4-13.4

[10] Direct Testimony of Dave Mrowzinski at 3

In his initial testimony Delta Witness Wesolosky estimates that the variable cost of providing one gasoline gallon equivalent ("GGE") from the Berea Station will be 30 cents per GGE.[11] Based on this cost estimates Mr. Wesolosky estimated that a $2.00 per GGE price at the pump will yield a $1.70 per GGE that will go back to Delta ratepayers for all GGE sold.[12] It his rebuttal testimony, Mr. Wesolosky acknowledged that he made an error in his CNG conversion ratio and he revised his estimate upwards to approximately 48 cents per GGE.[13]

Notwithstanding Mr. Wesolosky' s error, Mr. Mrowzinski identified multiple cost components that Mr. Wesolosky did not include in his GGE cost estimates including state and federal road tax, electric compression costs, insurance, maintenance costs, credit card reader costs and natural gas transportation costs.[14] As a result of excluding these costs for his estimates Mr. Mrowzinski testified that the actual variable cost of GGE is approximately $1.84 per GGE; over $1.50 per GGE more than Mr. Wesolosky estimates.[15]

In his rebuttal testimony, Mr. Wesolosky largely does not dispute that he failed to include these significant cost components in variable cost calculations; rather, he simply explained Delta will add those costs to the price at the pump that Delta plans to charge

[11] Direct Testimony of Matthew Wesolosky at 5

[12] Id at 6

[13] Rebuttal Testimony of Matthew Wesolosky at 5-6

[14] Direct Testimony of Dave Mrowzinski at 6-7

[15] Id at 9

at the Berea Station.[16] However, if Delta simply chose to add on these costs to users of CNG, Delta would have to charge a price higher than $2.00 per GGE that Delta estimates in its application. In fact the additional costs Delta excluded to the price at the pump would result in Delta charging customers over $3.50. Thus Delta would either have to charge customers *more than* they are already paying for the price of gasoline to earn the $1.70 per GGE, or as is more likely to happen, Delta simply will not be able to earn $1.70 per GGE.

Given Delta's overly optimistic projections on the revenue it can recover per GGE sold, Mr. Mrowzinski testified that 107,000 GGE in sales Delta estimates are required for the Berea Station to break even is a gross underestimate. Rather, Mr. Mrowzinski estimates that the Berea Station would need 500,000 GGE or more in sales per year for the station to meet its revenue requirements.[17]

Further, Mr. Mrowzinski testified at hearing that commercial fleets currently are by far the biggest users of CNG.[18] But at hearing Delta's witness Brown admitted that there are very few large commercial fleets in the Berea area.[19] Thus, given the location of the Berea Station and the lack of fleets likely to use the station, Mr. Mrowzinski concluded that "it is highly unlikely that Delta will achieve the revenue requirements it needs to cover the cost of building the CNG station. This means that Delta ratepayers

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[16] Rebuttal Testimony of Matthew Wesolosky at 4, 6

[17] Direct Testimony of Dave Mrowzinski at 9

[18] Video Transcript (9-14-14) at 5:05:34 PM -5:08:10 PM; See also Video Transcript (9-14-14) at 11:16:43 AM-11:18:42 AM

[19] Id at 11:13:00 AM -11:14:20 AM

will perpetually be paying to subsidize the ownership and operation of Delta's CNG station."[20]

Further, the fact that no other company or entity (including Delta shareholders, the City of Berea or Berea College) is willing to put its own capital at risk to invest in the Berea Station demonstrates that the Berea Station is likely not a good investment. As noted by Mr. Mrowzinski at hearing, private entities are perfectly willing to invest in CNG stations.[21] But in order to invest, a CNG station must have a reasonable chance at being economically viable. Unfortunately, despite Delta's unreliable estimates to the contrary, the Berea Station simply is not an economically viable project unless it receives significant subsidies from Delta ratepayers.

It is the obligation of the Commission to approve rates that are just and reasonable.[22] It is not just and reasonable to commit Delta ratepayers to subsidizing a CNG station that it is highly unlikely to meet its revenue requirements. Thus, the Commission should reject Delta's Application.

C. Approval of Delta's Application Will Hinder Development of CNG Stations in Kentucky Over the Long Run

The CNG Parties do agree with Delta on one aspect of the Application –that there are many benefits derived from using CNG as a vehicle fuel. That is why the CNG Parties are committed to expanding CNG refueling infrastructure in Kentucky and throughout the region. But as Mr. Mrowzinski testifies, "allowing a (LDC) to recover

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[20] Direct Testimony of Dave Mrowzinski at 10.

[21] Video Transcript (9-14-14) at 5:017:15 PM -5:17:30 PM

[22] See Kentucky Revised Statutes ("KRS") 278.030(1); KRS 278.270

CNG station costs through rate base will discourage the development of a robust CNG marketplace over the long run."[23]

Mr. Mrowzinski testifies that allowing an LDC to recover CNG station costs through the rate base is an anti-competitive advantage given to the LDCs.[24] A station built with private capital must recover through its pricing variable costs to produce CNG plus enough money to recoup the substantial upfront capital costs required to build a station. On the other-hand, there is no requirement for the Berea Station proposed by Delta to recover its infrastructure cost –ratepayers will continue to backstop the station even if the Berea Station does not have enough sales to recoup projects costs. Further, the price charged for CNG at the Berea Station will not be regulated, so there is nothing prohibiting Delta from pricing CNG significantly below the market price.[25] This pricing advantage (that only exists because of ratepayer subsidies) would make it very unlikely a private developer will build a CNG station in the Berea market area if the Berea Station project is approved.[26]

As Mr. Mrowzinski notes, CNG developers are not likely to enter into a market where a CNG refueling station is owned by the LDC, especially if the pricing on that station is not regulated.[27] The LDC could simply undercut the price of all competing stations because it will be able recover its investment capital and variable costs through

[23] Direct Testimony of Dave Mrowzinski at 11

[24] Id. at 12

[25] Video Transcript (9-14-14) at 4:58:10 PM- 5:00:56 PM

[26] Id. at 12-13

[27] Id at 13

distribution rates regardless of the price charged to customers. So in the short run, if Delta's Application is approved *a single* CNG station may be built in Berea, but it would be built at the cost of driving out other private investment in CNG infrastructure in Kentucky.[28]

Mr. Mrowzinski also testified that owning and operating vehicle stations is not the same as investing in natural gas pipeline.[29] LDCs are able to earn an authorized rate of return on natural gas pipeline in exchange for being highly regulated by state utilities commission including the regulation of prices that LDCs can charge customers. Vehicle refueling has never been considered a natural monopoly service, nor is Delta asking for price regulation.[30] Further, there are CNG developers who are currently willing to invest in CNG stations so the policy rationale to allow Delta cost recovery on CNG station assets, and a rate of return, simply does not exist. As Mr. Mrowzinski notes at hearing there are approximately 15-20 new CNG stations being built throughout the country *each month.*[31]

Delta appears to believe Delta ratepayers should be forced to pay for a CNG station, simply because a CNG station is yet to be built in the City of Berea. In fact Delta CEO Glen Jennings testified that he doesn't care who builds the CNG station, he just wants one in the City of Berea.[32] But just because Delta's CEO wants a business

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[28] Id. at 12

[29] Id. at 13

[30] Id

[31] Video Transcript (9-14-14) at 5:17:15 PM -5:17:30 PM

[32] Video Transcript (9-14-14) at 3:59:03 PM -4:00:02 PM

in the City of Berea doesn't mean Delta ratepayers should foot the bill for that investment. A close look at Delta's financial statements reveals that Delta has a number of unregulated affiliates that engage in unregulated competitive businesses. If Delta believes that a CNG refueling station in the City of Berea is such a good investment, it should use one of its unregulated affiliates to build a station with shareholder dollars.

III. CONCLUSION

In this proceeding Delta has not met the burden of demonstrating that approval of its Application is just or reasonable. The CNG Parties have demonstrated that approval of Delta's Application would contradict Kentucky law, is a bad bargain for Delta ratepayers, and will hinder the development of CNG over the long run. For these reasons the CNG Parties respectfully request that the Commission deny Delta's Application.

Respectfully Submitted

/s/Matthew White
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CERTIFICATE OF SERVICE

Comes Interstate Gas Supply, Inc. and Clean Energy Fuel Corp., by counsel, and hereby certifies that an original and twelve (12) copies of the attached were served via hand-delivery upon Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40602-0615; furthermore, it was served by mailing a copy by first class U.S. Mail, postage prepaid, on the following, and by electronic mail where available all on this 16th day of October 2014.

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