COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF DELTA NATURAL GAS COMPANY, INC.) CASE NO. 9331

O R D E R

On December 6, 1985, Delta filed a petition for rehearing on nine issues: right-of-way clearing expense, rate case expense, depreciation expense, amortization of acquisition costs of Peoples Gas Company, amortization of organization and compensation study, normalized revenues, transportation revenues, income taxes and excess tax deferrals.

On December 19, 1985, the Commission issued an Order in which it granted Delta Natural Gas Company, Inc., ("Delta") additional annual revenues of $77,484 on the issues of amortization of acquisition costs of Peoples Gas Company, amortization of the costs of an organization and compensation study, and the federal income tax surtax exemptions.

This Order discusses the Commission's finding on the issues of right-of-way clearing expense, rate case expense, depreciation expense, excess tax deferrals, normalized revenues and transportation revenues.

Right-of-Way Clearing Expense

In its petition for rehearing, Delta argued that $44,000, or 1/2 of $88,000 expended in a recent 12-month period, is a reasonable amount of right-of-way clearing expense and should be allowed for rate-making purposes in this case. Delta stated further that from June through November 1984 $63,000 was spent on right-of-way clearing and $37,000 was spent from July through October 1985. Delta also contends that its budget calls for right-of-way clearing expenses for the summer and fall of each year of $50,000 annually.

During the original proceedings in this case, Delta had several opportunities to express its viewpoint on this issue through two interrogatories, cross examination, and through its response to data requested at the hearing. However, nowhere in the evidence of record does Delta explain why 1/2 of the $88,000 expensed over a recent 12-month period is an expected on-going cost of service. Nowhere in the case record, as submitted on November 15, 1985, does Delta discuss a right-of-way budget. Furthermore, it is apparent, from the past years' annual expenditures for right-of-way clearing and the monthly expense summaries on file, that both the annual amount and the timing of right-of-way clearing is highly variable. Therefore, the Commission affirms its prior decision and denies rehearing on this issue.

Rate Case Expense

Delta states that there are two problems with the Commission's allowance of $30,883 in rate case expense for rate-making purposes.

First, Delta questioned the amount of previously recovered rate case expense used in the determination of the allowable rate case expense. The Commission based the amount recovered on a monthly recovery of $2,453 for 14 months, whereas only approximately 11 months had lapsed since Delta's last rate case, resulting in an approximate $7,359 under-recovery. The Commission does not disagree with Delta's assessment of the calculation of the difference in the amount of previous recovery. However, the Commission does not agree that a change in the calculation is appropriate since the difference in calculation is approximately two-hundredths of a percent of the revenues found reasonable in this case and is approximately one-tenth of a percent of the net operating income found reasonable; and, more importantly, due to the non-recurring nature of rate case expenses, recovery and under-recovery of rate case expense fluctuates significantly over time.

In its allowance of $30,883 in rate case expense, the Commission used a 12-month amortization period. The amortization was a conservative estimate of time interval between Delta's rate case applications. However, the time interval between Delta's rate cases fluctuates greatly. The fluctuation can be noted from the dates when final rate Orders were issued: in this case, November 1985; in Case No. 9059, An Adjustment of Rates of Delta Natural Gas Company, Inc., December 1985; in Case No. 8528, An Adjustment of Rates of Delta Natural Gas Company, Inc., December 1982; and in Case No. 8256, An Adjustment of Rates of Delta Natural Gas Company, Inc., December 1981. The time interval between rate cases varies between 1 and 3 years, thus making exact predictions of an amortization period for rate case expenses impossible. It is the Commission's opinion that the amount of recovery inherent in the assumption of an amortization period far outweighs the under-recovery discovered above. In regard to the cost recovery of rate case expense, it is, as a practical matter, unlikely that the amortization of rate case expense allowed for rate-making purposes will provide for exact cost recovery. Delta could recover more or less than its actual cost, depending on the interval between rate cases. Therefore, the Commission denies rehearing on this issue, based on its use of the conservative amortization period and the inherent fluctuations in rate case expense recovery.

Second, Delta stated that the test-period reported rate case expense of $65,223 reasonably reflects the cost of this case plus the previously allowed second-year amortization of the prior rate case expense. Nowhere in the evidence of record, as submitted on November 15, 1985, is there any documentation of the actual rate case expenses for this case. KRS 278.400 states that upon rehearing any party may offer additional evidence that could not, with reasonable diligence, have been offered at the formal hearing. The Commission does not believe this to be the case on this issue. Therefore, rehearing on this issue should be denied.

Depreciation Expense

Delta requested rehearing on the issue of depreciation expense on the grounds that the Commission's disallowance of $84,017 in depreciation expense was not based on the evidence of record. Although Delta did not specifically state in what manner the decision was not based on the evidence of record, Delta stated in a following paragraph that a depreciation study was not used as the basis for the Commission decision on depreciation expense, thus implying a lack of evidence.

The choice of a 40-year useful life for coated steel and plastic pipe was not capricious. The Commission is of the opinion that a 40-year useful life for these items is a conservative estimate of the depreciable life of coated steel and plastic pipe.

As an alternative to the Commission's reconsideration of depreciation expense, Delta states that the Commission should increase net investment rate base for the amount of depreciation expense disallowed for rate-making purposes. The Commission's treatment of depreciation expense in this case was not on a prospective basis in regard to Delta's cost of service, but on a constant basis in regard to the matching of net investment rate base and capital structure. If the Commission were to treat cost of service, rate base and capital structure all on a prospective basis, the Commission could reduce net investment rate base by an additional $1,047,282 and project capital structure to the end of that prospective period. Obviously, this would be a highly complicated and highly speculative process and would result in virtually endless rate proceedings. Instead, the Commission relies on a historical test period adjusted for known and measurable changes found reasonable, and net investment and capitalization at a designated date. The test period in this case was the 12-month period ended March 31, 1985, which was the date used to establish the net investment rate base and capital structure. Therefore, rehearing on the amount of depreciation expense and its affect on net investment rate base should be denied.

Excess Tax Deferrals

The issue of excess tax deferrals is currently being appealed by Delta in the Franklin Circuit Court. Delta, however, requested reconsideration of this issue in its petition for rehearing. The Commission reaffirms its decision on the rate-making treatment given excess tax deferrals in Case Nos. 8528, 9059 and 9331. The Commission also reminds Delta that the Commission will abide by the decision of the Franklin Circuit Court. As the issue of excess tax deferrals is currently before the Circuit Court, the Commission denies rehearing on this issue.

Normalization and Transportation Revenues

On December 6, 1985, Delta applied for rehearing of normalized revenues and transportation revenues. Delta stated that it had lost two customers that accounted for 16,100 Mcf of its general service volumes, and that it had lost three transportation customers. In its supporting memo, Delta requested that the Commission exclude the revenues of these customers from their respective categories.

Delta had initially proposed the use of actual test-year sales and is only now proposing an adjustment for loss in general service sales. It has proposed no adjustment for the growth it has experienced in residential and commercial sales. It is not the Commission's practice to adjust for lost sales except in extraordinary cases. The 16,100 Mcf loss is not likely to result in future sales lower than test-year sales for a growing company such as Delta. Therefore, rehearing should not be granted on this issue.

Delta should be granted rehearing on their request to exclude off-system transportation revenues from two customers, Johnson County Gas Company and Sipple Brick Company. Delta should be prepared to show how such an adjustment to total revenues is appropriate, given its sustained growth in recent years, including the test year.

Rehearing should be denied on the loss of on-system volumes from Corbin Brick. The loss of this customer occurred after the hearing and after the issuance of the Order in this case; it is a new proposed adjustment.

FINDINGS AND ORDERS

The Commission, after examining the evidence of record and being advised, is of the opinion and finds that:

1. A rehearing should not be granted on the issue of right-of-way clearing expense.

2. A rehearing should not be granted on the issue of rate case expense.

3. A rehearing should not be granted on the issue of depreciation expense.

4. A rehearing should not be granted on the issue of excess tax deferrals.

5. A rehearing on the issue of excluding lost general service volumes should be denied.

6. A rehearing on the issue of excluding lost off-system transportation revenues should be granted.

7. A rehearing on the issue of excluding lost on-system transportation revenues should be denied.

IT IS THEREFORE ORDERED that:

1. Rehearing on the issue of right-of-way clearing expense be and is hereby denied.

2. Rehearing on the issue of rate case expense be and is hereby denied.

3. Rehearing on the issue of depreciation expense be and is hereby denied.

4. Rehearing on the issue of excess tax deferrals be and is hereby denied.

5. Rehearing on the issue of excluding lost general service volumes be and is hereby denied.

6. Rehearing on the issue of excluding lost off-system transportation revenues be and is hereby granted.

7. Rehearing on the issue of excluding lost on-system transportation revenues be and is hereby denied.

Done at Frankfort, Kentucky, this 30th day of December, 1985.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner Williams did not participate in this case.

Commissioner

ATTEST:

Secretary