DELTA NATURAL GAS COMPANY, INC.
CASE NO. 2022-00341

COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION
DATED JANUARY 10, 2023

1. Refer to the Direct Testimony of Jonathan Morphew (Morphew Direct Testimony), page 4, lines 13-17, and Schedule IV 2022-Summary. Explain why Delta is proposing to include in its Pipeline Replacement Program (PRP) 2022 spend in excess of amounts recovered in base rates.

Response:

Delta is proposing to recover "PRP-related plant in service not included in base gas rates minus the associated PRP-related accumulated depreciation and accumulated deferred income taxes," in accordance with Sheet No. 43 of its tariff. If Delta was recovering all of its PRP-related plant in service expenses from 2022 in base rates, Delta would not have proposed recovering a portion of its 2022 PRP spend in this case. As the record in Case No. 2021-00285 clearly reflects, Delta did not receive complete recovery of its 2022 PRP spend because the requirements for a forecasted test year mandate use of a 13-month average rate base.

The Commission's January 3, 2022 Order in Case No. 2021-00185 stated, "The Commission denies Delta's request to file a true-up adjustment for any over- or under-recoveries realized in **2021**, as such revenues and expenses are now included in rate base; therefore, a true-up filing would be inappropriate."[1] It is undisputed that the "revenues and expenses" from **2022** are not fully "included in rate base." It was Delta's understanding based upon this Order that the recovery of unincluded 2022 expense would be permitted in this filing, following the Commission's examination of the expenditures for prudency.

Delta's PRP approved in Case No. 2010-00116 gave Delta the opportunity to earn a return on qualifying historic pipeline expenditures. Delta submitted all eligible pipeline expenditures to the Commission each year for review, and the PRP rate was ordered by the Commission based on the historic pipeline expenditures deemed by the Commission to be eligible under the program. Delta's use of the PRP allowed Delta to defer a base rate case for more than a decade, which greatly benefited customers. Consistent utilization of the PRP allows for a timely return on these safety investments, while smoothing out rate increases to customers. Moreover, Delta's unaccounted for gas and the number of leaks have materially declined, which demonstrates that the PRP is allowing the company to operate more safely.

In Case No. 2021-00185, Delta proposed revisions to its PRP tariff. The Commission granted Delta's proposal to utilize a forecasted PRP with a true-up period. Delta's main goals in this transition filing from a historic mechanism to a forward-looking mechanism are three-fold:

First, to include in the PRP rate an estimate of PRP work to be performed in the current year, to reduce regulatory lag by currently earning a return on current expenditures. Second, to provide to the Commission the same level of detail of historical spending as in the past, giving the

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[1] Case No. 2021-00185, Order at 21(Ky. PSC Jan. 3, 2022).

Commission the same opportunity to analyze each cost included by Delta in the calculation, with the Commission making the final determination of which actual expenditures ultimately are included in PRP rate base, and third, to ensure that the PRP rate base calculation going forward properly excludes any rate base earning a return from Case No. 2021-00185, but properly rolls forward into the 2023 PRP calculation the appropriate beginning balances. Delta is not attempting to recover 2022 under-recoveries. There needs to be proper recognition of the fact, though, that the 1/1/2023 beginning balance of PRP rate base used in calculating the 2023 rate includes the net book value of the PRP expenditures made in 2022 that were not included in base rates from Case No. 2021-00185.

The third goal above relates to why Delta is proposing to include in its PRP its 2022 eligible expenditures in excess of amounts recovered in base rates.

The chart attached at Exhibit 1 illustrates the interaction between 2022 and 2023 PRP expenses. The only amount from 2022 that influences the 2023 PRP calculation is in determining the correct beginning balance for the 2023 PRP calculation. Based on the application of the 13-month convention for the rate case, $3,282,404 is and will continue to be earned through Case No. 2021-00185 base rates and should not be included in the beginning balance of the 2023 calculation. That leaves $3,282,404 of expenditures to be included in the beginning balance for 2023. In addition, Delta anticipated spending $2,551,061 in excess of the projection in the rate case and thus received no recovery of that amount in 2022. Including the $2,551,061 in the beginning balance of the 2023 PRP calculation acknowledges that while Delta received $0 recovery during 2022 on these eligible expenses and does not propose to receive any recovery during 2022, these amounts should be included in the beginning balance in order to begin recovery on these expenditures in 2023. All of these expenditures will be subject to Commission review in connection with the filing in March 2023 of actual expenditures.

Not including either reconciling item, the $3,282,404 of the original estimate not in base rates, or the $2,551,061 spent in addition to the original estimate, in the beginning balance of 2023 PRP would deny Delta the opportunity to earn its allowed return of 9.175% on eligible PRP expenditures currently and going forward.

Note that the $2,551,061 is an estimate. Delta will file detail of PRP additions with the Commission for future approval and adjustment of the rate to reflect any adjustments due to the Commission's review or differences in projections to actual expenditures.

The use of a forecasted test year in the recent rate case, which is permitted under Kentucky law, should not prohibit Delta from recovering its prudently incurred PRP-related expenses, especially given the lack of standard filing requirements for PRP mechanisms. To do so is inconsistent with Delta's tariff, the purposes of KRS 278.509, which are to encourage the accelerated replacement of gas infrastructure and would result in disallowing or deferring recovery in 2023 PRP rates on over $5 million of prudent capital expenditures, which is anticipated to have a revenue impact of approximately $1.1 million. This amount is material to Delta's operations, as this equates to **20%**

of Delta's rate increase ordered in Case No. 2021-00185. Given the timing of Delta's rate proceeding—its first in over a decade—Delta has already experienced regulatory lag associated with the unrecovered 2022 expenses and Delta has not proposed (and has no plans to propose) any recovery that will cure the regulatory lag experienced in 2022. But the financial impact to Delta if such expenses are not included for recovery in this proceeding in determining the 2023 rates is material to 2023 and in every year after 2023 until the next general rate case. Absent a finding that the PRP-related expenses were imprudently incurred, Delta is being deprived timely recovery simply as a result of the timing of its rate proceeding. This delay in recovery will erode Delta's projected ROE to the point of requiring Delta to accelerate plans for the next rate case filing.

Witness: John B. Brown

EXHIBIT 1 IS ATTACHED IN EXCEL FORMAT

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DATED JANUARY 10, 2023

2. Refer to the Morphew Direct Testimony, page 4, lines 19-20. Explain why Delta is proposing to true-up PRP amounts recovered in base rates.

Response:

As explained in more detail in the response to Question No. 1 above, the true-up adjustment referred to in the Morphew testimony is to true-up the $2,551,061 estimate of 2022 PRP expenditures in excess of the PRP expenditures included in base rates ($3,282,404). This amount included in base rates of $3,282,404 is fixed and not subject to adjustment. The unknown amount is the amount of eligible PRP expenditures during 2022 that earned zero recovery during 2022 but should be included in the beginning balance of PRP rate base when calculating 2023 PRP rates so that Delta would begin to recover on those expenditures.

Witness: John B. Brown

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3. Refer to Schedule I and Schedule II 2023. Explain why Delta did not use a 13-month average rate base to calculate it's forecasted PRP rates.

Response:

Delta did not use a 13-month average rate base to calculate its forecasted PRP rates because it utilized the historical PRP model it has used in the past which utilizes the terminal value. The terminal value can be used as the base for the current year PRP as well as the following years, allowing for earning a return on all PRP expenditures between general rate cases. Utilizing the terminal value for the calculation is consistent with previously issued Commission Orders related to forecasted PRP mechanisms. Delta is attaching an updated model (Exhibit 2) which includes the calculation of 13-month average rate base consistent with its forecasted rate base calculation in Case No. 2021-00085. Making this change reduces the 2023 PRP adjustment from $1,482,509 as originally filed to $1,039,062, but in order for the mechanism to have integrity and not create a donut hole of expenditures not earning a return, the terminal value, not the average value, must be used as the beginning balance of the following year's calculation. Likewise, the terminal value of PRP expenditures not earning a return in 2022 must be considered in the beginning balance for the 2023 PRP rate calculation.

Since its inception in 2010, Delta has hewed closely to the purposes and intent of pipeline replacement programs. The PRP has permitted Delta to accelerate the replacement of aging infrastructure without increasing base rates for over a decade. This has benefited Delta's customers both operationally and financially. From an operational perspective, Delta's number of leaks and unaccounted-for gas are declining. These metrics demonstrate that Delta's use of the PRP is allowing Delta to operate more safely. Financially, Delta has filed rate increases less frequently than its peers. If the Commission utilizes a 13-month average, Delta will be forced to consider accelerating rate relief, which is contrary to the purposes of pipeline replacement programs.

Witness: John B. Brown

EXHIBIT 2 IS ATTACHED IN EXCEL FORMAT

4. Provide a 2023 PRP rate calculation that uses a rate base which excludes 2022 spend, includes a 13-month average of 2023 spend, and uses the pro rata method to determine accumulated deferred income taxes.

Response:

See the attached Exhibit 3. Delta emphasizes that in order for a portion of 2022 PRP expenditures to ever earn a return through the PRP, those expenses need to be included in the beginning balance for recovery as modeled in the response to Question No. 3 (Exhibit 2). The model attached to this response, Exhibit 3, excludes $5,833,465 of prudently incurred PRP expenses from current and future recovery.

Exhibit 3 also contains an "ROE Comparison" tab, which compares the as-filed position to the modeling scenarios in Exhibits 2 and 3 and the 2021 "As Approved" and 2022 "Experienced" positions. Delta experienced an effective ROE on the PRP in 2022 of 3.216%. As the chart illustrates, only the proposal as filed gives Delta the opportunity to earn a return approaching the 9.175% authorized return. As shown in the requested Exhibit 3, the rate of return falls to only 2.528%, which is a steep drop from the rate authorized by the Commission only last year.

Witness: John B. Brown

EXHIBIT 3 IS ATTACHED IN EXCEL FORMAT

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5. Provide the number of leaks per year on Delta's system from 2018 through the most recently available leak survey.

Response:

Provided below are the number of leaks per year on Delta's system from 2018, through 2022.

2018 – 330
2019 – 228
2020 – 257
2021 – 250
2022 - 210

Witness: Jonathan Morphew

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6. Provide the lost and unaccounted for gas percentage on Delta's system from 2018 through the most recently available information.

Response:

The percent of unaccounted for gas as defined on annual DOT reporting from 2018 through 2021 is as follows:

2018 – 3.4%
2019 – 2.9%
2020 – 2.0%
2021 – 1.16%

Witness: Jonathan Morphew

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7. Provide all Requests for Proposals (RFPs) or invitations to bid that Delta has sent to construction companies related to this pipe replacement program since January 1, 2019.

Response:

Please find the attached Invitations to Bid from 2019 through 2023. Please note the absence of a 2022 Invitation to Bid. [redacted] The bid sheet for 2022 pricing is provided on the responses to Question 8. [redacted]

Witness: Jonathan Morphew

ATTACHMENTS TO QUESTION NO. 7 FILED UNDER SEAL PURSUANT TO THE PETITION FOR CONFIDENTIAL PROTECTION FILED ON JANUARY 19, 2023

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8. Provide all responses or bids that Delta received to any RFPs or invitations to bid sent to construction companies related to this pipe replacement program since January 1, 2019. Identify the winning bids and the method used to select the winning bids.

Response:

The following contracts were awarded by lowest bid on the project. They were awarded as follows:

[redacted]

Witness: Jonathan Morphew

ATTACHMENTS TO QUESTION NO. 8 FILED UNDER SEAL PURSUANT TO THE PETITION FOR CONFIDENTIAL PROTECTION FILED ON JANUARY 19, 2023