COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

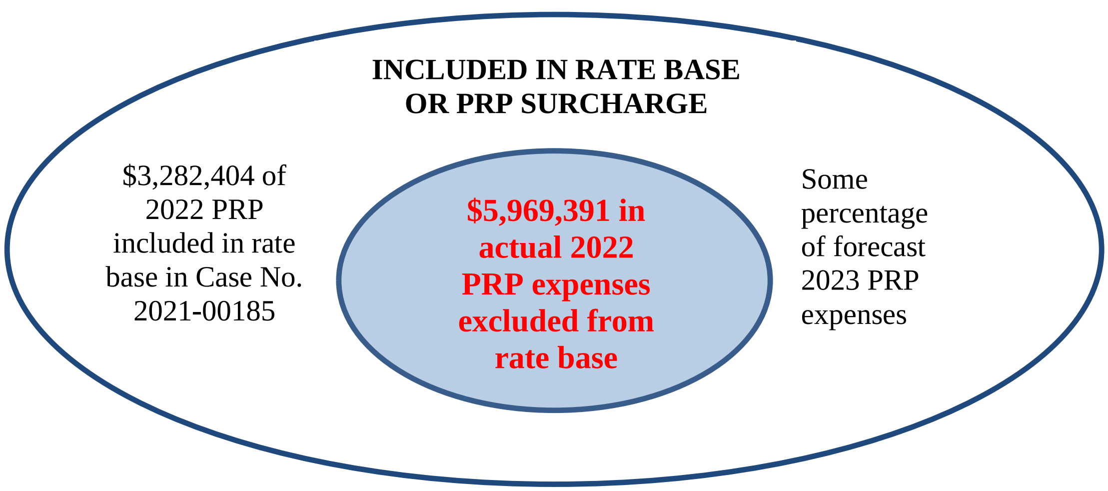
ELECTRONIC APPLICATION OF DELTA NATURAL GAS COMPANY, INC. FOR ITS PIPE REPLACEMENT FILING	)))	**CASE NO. 2022-00341**

DELTA NATURAL GAS COMPANY, INC.'S BRIEF

In accordance with the Commission's July 12, 2023 Order, Delta Natural Gas Company, Inc. ("Delta") submits its Brief regarding the issues in this proceeding.

Introduction

The question for the Commission to resolve is simple: may Delta include in rate base the plant it has **already placed in service** pursuant to the Pipe Replacement Program ("PRP")? To answer this question, the Commission need only look to the straightforward language of KRS 278.509 and Delta's tariff in setting the PRP rate in this proceeding. If the Commission utilizes a 13-month average for rate base in setting the PRP rate, the result is a punitive donut hole that materially impairs Delta's ability to earn its allowed rate of return:



Delta's total PRP expenses in 2022 were $9,251,795. Of that total, only $3,282,404 were included in rate base in Case No. 2021-00185. This leaves **65%** of the already-incurred 2022 PRP expenses excluded from Delta's rate base until Delta files another rate case if the 13-month average is used in this case, instead of the terminal amount that has been applied since inception of the PRP in 2010. Use of the 13-month average for the forecast 2023 expenses will further exacerbate the issue, as only half of the projected $8,074,114 will be included in rate base. As shown in the chart below, if the Commission departs from its long-standing precedent in Delta PRP cases, $10,006,448 will be excluded from rate base:

Category	**Included in Rate Base**	**Excluded from Rate Base**
2022 Plant in Service	$3,282,404	$5,969,391
2033 Forecast Expenses	$4,037,057	$4,037,057
TOTAL EXCLUDED		**$10,006,448**

Background

Delta's PRP efforts have been an unqualified success. The number of leaks on Delta's system has decreased year-over-year since 2018,[1] along with the percentage of unaccounted gas.[2] In just the last four years, leaks have decreased by **36%** and the percentage of unaccounted for gas has decreased by **65%**. These reductions are quantifiable evidence that Delta's pipeline replacement investments are yielding operational and safety benefits to its customers and the communities in which it serves.

There have been three milestones since the inception of Delta's PRP, the first of which occurred in 2010 when the Commission approved the program for recovery of the cost of replacing Delta's bare steel pipe and replacement of service lines, curb valves, meter loops, and mandated

[1] Delta's Response to Commission Staff's First Request for Information, Item No. 5.
[2] Delta's Response to Commission Staff's First Request for Information, Item No. 6.

pipe relocations.[3] The second milestone was in 2018 when the Commission permitted Delta to expand the program to include the replacement of pre-1983 vintage plastic pipe, known as Aldyl-A, with all work under the PRP to be completed by 2033.[4] The third occurred in 2021, when Delta was permitted to transition to a forecasted PRP with a true-up period to align with Delta's recent practice of utilizing a future test year in rate cases.[5]

In Case No. 2021-00185, which was Delta's last rate case, Delta requested that the PRP rate be reset to zero, with PRP expenses rolled-into rate base. Because the regulatory requirement for forecast test year rate cases mandate use of a 13-month rate base average, the amount of forecast PRP included in rate base in the rate case did not include all of the PRP incurred in 2022. Instead, only $3,282,404 was included in rate base.

When Delta submitted its annual PRP filing in October 2022 that initiated this proceeding, it requested to include in rate base: (1) the portion of 2022 PRP plant in service that was not included in rate base in Case No. 2021-00185 and (2) forecast 2023 PRP expenses. Delta calculated rate base utilizing terminal values because (1) it has done so since 2010 when the PRP was established; (2) there were no revisions to Delta's PRP tariff that would affect the use of terminal values; and (3) it is undisputed that *not* utilizing terminal values excludes over $10 million from rate base.

Delta was not provided notice that the Commission may depart from its long-standing practice of applying terminal values until Commission Staff issued data requests in this proceeding raising this issue. Because of the material impact to Delta's operations if the Commission were to

---

[3] *In the Matter of: Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates* (Case No. 2010-00116) (Ky. PSC Oct. 21, 2010).
[4] *In the Matter of: Electronic Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.* (Case No. 2018-00086) (Ky. PSC Aug. 21, 2018).
[5] *In the Matter of: Electronic Application of Delta Natural Gas Company, Inc. for an Adjustment of Its Rates and a Certificate of Public Convenience and Necessity* (Case No. 20121-00185) (Ky. PSC Jan. 3, 2022).

exclude $5,969,391 of 2022 plant in service and $4,037,057 in 2023 investments from rate base in this proceeding, Delta requested a hearing. The Commission's July 12, 2023 Order directed Delta to submit a brief addressing the legal issues in the matter.

Argument

I. The Purposes and Successes of Delta's PRP

By statute, the Commission may allow "recovery of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a regulated utility."[6] Now that most LDCs have replacement programs, the commonplace nature of the programs could belie the critical role of the programs in operating *safely*. For example, in 2018, the Commission permitted Delta to expand its PRP to include the replacement of Aldyl-A pipes. Delta had explained that PHMSA bulletins were alerting utilities to "the susceptibility of older plastic pipe to premature cracking,"[7] while the Attorney General asserted that the replacement of vintage plastic pipe was "premature and unwarranted."[8]

Unfortunately, there are tragic reminders confirming the necessity of proactive replacement. Just this month the National Transportation Safety Board ("NTSB") released an investigative update regarding the March 2023 natural gas explosion in West Reading, Pennsylvania that killed seven people and injured eleven others. The NTSB confirmed that the explosion was caused by the failure of an Aldyl-A service tee that cracked.[9] This incident is a

---

[6] KRS 278.509.

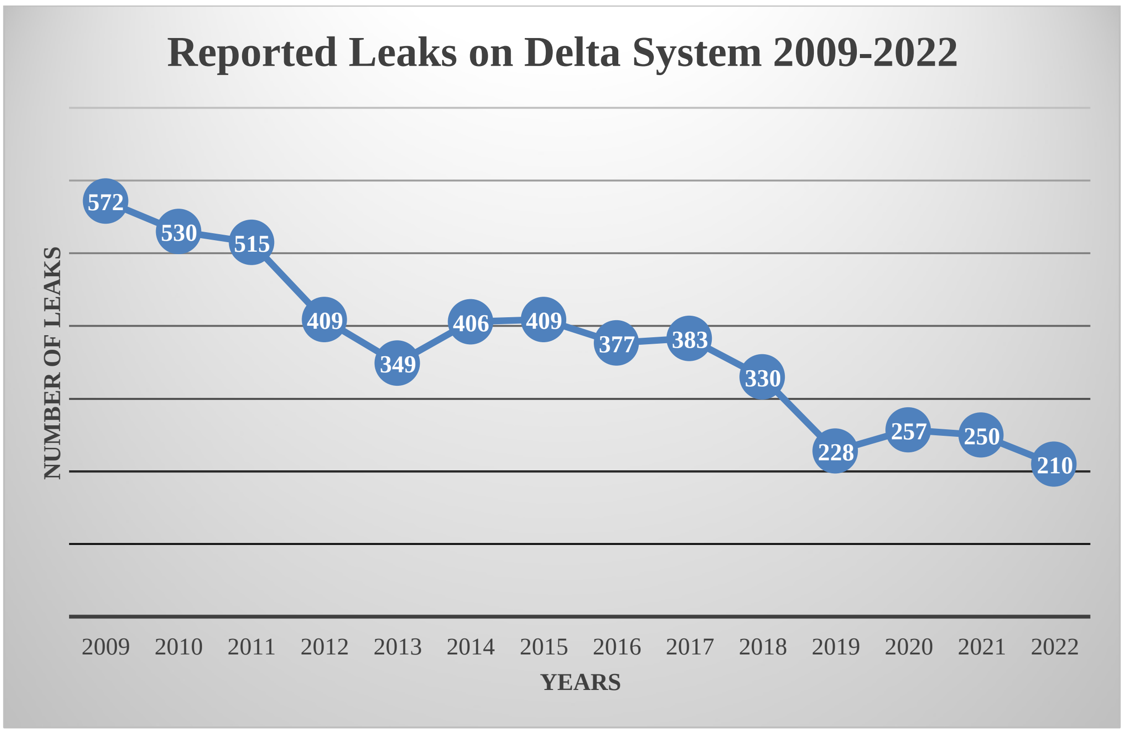
[7] *In the Matter of: Electronic Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.* (Case No. 2018-00086), Delta Natural Gas Company, Inc.'s Response to Attorney General Final Comments (July 10, 2018).

[8] *In the Matter of: Electronic Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.* (Case No. 2018-00086) Attorney General's Recommendation to Submit Case on Record, and Final Comments (July 9, 2018).

[9] https://www.ntsb.gov/investigations/Pages/PLD23LR002.aspx.

catastrophic example of the harms the PRP is designed to prevent by allowing utilities to recover costs for these prudent investments outside of a rate case.

Delta's PRP program has been critically important to reducing the number of leaks on its system. Since 2009—the year immediately before the inception of the PRP—to 2022, reported leaks have been reduced by **56%**:[10]



In Case No. 2021-00185, the Commission asked Delta to "[p]rovide the percentage of Delta's system that will be replaced through Delta's PRP at the conclusion of the PRP under the current plan," which is 2033.[11] Delta stated that based on current information, approximately 14.4% of the system will have been replaced upon completion of the PRP program.[12] The fact that Delta has been able to reduce its leaks by over half by replacing a small fraction of its system

[10] For 2009 to 2017 data, see Case No. 2018-00086, Delta's Responses to Commission Staff's First Request for Information, Item No. 4 (May 7, 2018). For 2018 to 2022 data, see Commission Staff's First Request for Information, Item No. 5 in this action.
[11] Case No. 2021-00185, Delta's Responses to Commission Staff's Post-Hearing Requests for Information, Item No. 10 (Dec. 3, 2021).
[12] *Id.*

demonstrates that Delta has prudently determined which assets to replace to optimize operational benefits. There are multiple, quantifiable measures demonstrating that Delta's PRP program is accomplishing exactly what was proposed: accelerating main replacements that are a higher risk to fail so that the system can operate more safely.

II. Excluding $5.9 Million in 2022 PRP Expenses Contravenes the Purpose of the Program

When the Commission approved Delta's PRP in 2010, it stated: "Delta believes that, absent such a mechanism, it would be necessary to file rate cases more frequently, its level of incremental capital investment would be reduced, and the time required to replace" the pipelines would be increased.[13] This remains true today.

Delta's PRP tariff allows it 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."[14] It is beyond dispute that Delta could not capture all of its 2022 PRP rate base in Case No. 2021-00185 because the mandated use of a 13-month average rate base renders it a mathematical impossibility. To be clear, if Delta was recovering all of its PRP-related plant in service from 2022 in base rates, Delta would not have proposed recovering a portion of its 2022 PRP spend in this case.

Delta's PRP rate calculation in this case properly excludes all rate base earning a return from Case No. 2021-00185, but likewise properly rolls forward into the 2023 PRP calculation the appropriate beginning balances. Delta is not attempting to recover 2022 under-recoveries but there must be proper recognition that the January 1, 2023 beginning balance for PRP rate base includes

---

[13] *In the Matter of: Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates* (Case No. 2010-00116) (Ky. PSC Oct. 21, 2010).

[14] P.S.C. No. 13, Original Sheet No. 43.

the net book value of the PRP expenditures made in 2022 that were not included in base rates from Case No. 2021-00185.

Delta provided a chart in response to Item No. 1 of the Commission Staff's First Request for Information that delineates the relationship between 2022 and 2023 PRP expenses. The chart demonstrates that 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. But as shown in Delta's June 30, 2023 updated filing, Delta added $9,251,795 in 2022 PRP plant in service, which means that $5,969,391 in prudently incurred assets will be excluded from the beginning rate base balance if the Commission departs from its long-standing practice of utilizing terminal values in Delta PRP filings. The result would be to exclude 65% of the prudently incurred PRP rate base in the same year that Delta realized its lowest reported leaks since the inception of the program.

When Delta obtained approval to establish a PRP in 2010, it explained that absent a mechanism, it may have to file rate cases more frequently. In part because of the PRP, Delta was able to defray seeking a rate increase for over a decade. Should the Commission exclude the $5,969,391 from rate base in 2022 alone, the annual revenue impact to Delta will be $1.1 million. By order of magnitude, this equates to **20%** of Delta's rate increase ordered in Case No. 2021-00185. 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—the rate case that it managed to delay for over a decade. 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. Respectfully, that result

(1) conflicts with the purpose of KRS 278.509; (2) disincentivizes investments in replacing at-risk pipe; and (3) unwinds the successes of this program, which have allowed for substantial operational performance through moderated PRP rates.

III. Abandoning Use of Terminal Values Without Notice is Unreasonable

Since inception of Delta's PRP, the beginning rate base balances have been based on terminal values. When Delta proposed revisions to its PRP in Case No. 2021-00185, it reviewed the Commission's orders regarding rate base calculations for pipe replacement programs following rate cases in which a future test year was utilized. Specifically, Delta reviewed the orders pertaining to Columbia Gas of Kentucky, in which the Commission repeatedly permitted Columbia to subsequently update the mechanism to include unrecovered investments from the rate case forecasted test year.[15] Delta's decision to enter into a settlement agreement in its most recent rate case, and accept the modifications the Commission made to that settlement agreement, was informed by the assumption that the Commission would follow its precedent with respect to the treatment of PRP plant in service. Again, the impact of the Commission departing from its precedent with respect to the 2022 plant in service amounts to **20%** of the rate increase Delta received in Case No. 2021-00185. For 2023 expenses, use of the 13-month average excludes an additional $4,037,057 from rate base, for a total of $ 10,006,448 in just two years.

Delta is aware that the Commission departed from its longstanding precedent on this issue in Columbia's recent gas replacement mechanism filing in Case No. 2022-00342, in which it stated "the Commission finds no reason to continue with an erroneous methodology."[16] For the reasons explained above, use of the terminal values is not erroneous; indeed, it is the only means by which

[15] *In the Matter of Columbia Gas of Kentucky, Inc. 2017 Accelerated Main Replacement Program Filing,* Case No. 2017-00413, Order (Ky. PSC Dec. 22, 2017).
[16] *In the Matter of: Electronic Application of Columbia Gas of Kentucky, Inc. for Annual Adjustments to the Safety Modification and Replacement Program*, Case No. 2022-00342, Order (Ky. PSC Feb. 6, 2023).

Delta may "recover[] of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a regulated utility," as envisioned by KRS 278.509.

The Commission's Order denying rehearing in the Columbia proceeding states that because KRS 278.509 is permissive, the "only mandates in the statute are limitations on the permissive authority granted to the Commission that prohibit the Commission from allowing a utility to recover costs through a rider unless the costs are fair, just and reasonable, as well as not recovered in existing rates."[17] Delta respectfully submits this explanation misses the mark of Delta's concerns. While the Commission may indeed have the discretion it claims, the discretion should be guided by: (1) the outcome the Commission hopes to bring about and (2) whether a change in position should first be explained to a utility before the utility bears the financial brunt of it. Here, there is no question the PRP is working. Delta is doing exactly what it said it would: improving safe operations and defraying rate cases. At bottom, if the Commission utilizes a 13-month average in this case, Delta will be forced to accelerate its next rate case. Delta respectfully submits this is an adverse result for all parties—including customers and the Commission. Moreover, Delta further submits that the reasonable approach would be to put utilities on notice when it plans to change its methodology on an industry-wide issue so that affected utilities are not caught unaware that a settled rate increase amount would be sharply eroded one year later.

Conclusion

Delta respectfully requests that the Commission approve the PRP rate as proposed in its filing.

---

[17] *Id.*

Dated: July 26, 2023

Respectfully submitted,

Monica H. Braun

Monica H. Braun
Mary Ellen Wimberly
monica.braun@skofirm.com
maryellen.wimberly@skofirm.com
Stoll Keenon Ogden PLLC
300 West Vine Street
Suite 2100
Lexington, KY 40507
Telephone: (859) 231-3000
Facsimile: (859) 259-3503
Counsel for Delta Natural Gas Company, Inc.

CERTIFICATE OF COMPLIANCE

In accordance with 807 KAR 5:001, Section 8(7), this is to certify that Delta's July 26, 2023 electronic filing is a true and accurate copy of the documents being filed in paper medium; that the electronic filing has been transmitted to the Commission on January 26 2023; and that there are currently no parties that the Commission has excused from participation by electronic means.

Monica H. Braun