**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

| | | |
|---|---|---|
| **ELECTRONIC APPLICATION OF DELTA** | **)** | |
| **NATURAL GAS COMPANY, INC. FOR AN** | **)** | **CASE NO. 2024-00346** |
| **ADJUSTMENT OF GAS RATES** | **)** | |

**REBUTTAL TESTIMONY OF**
**JOHN B. BROWN**
**PRESIDENT**
**DELTA NATURAL GAS COMPANY, INC.**

**Filed: March 21, 2025**

**Q. Please state your name and business address.**

A. My name is John B. Brown. My business address is 3617 Lexington Road, Winchester, Kentucky 40391.

**Q. By whom are you employed and in what capacity?**

A. I am employed by Delta Natural Gas Company, Inc. (“Delta” or “Company”) as its President. I am the chief officer in charge of Delta’s operations.

**Q. What is the purpose of your testimony?**

A. I will first describe the rebuttal testimony Delta is providing in response to the testimonies of David Dittemore and Richard Baudino that were submitted on behalf of the Office of the Attorney General (“AG”). Next, I will respond to Mr. Dittemore’s proposed adjustment to reduce Delta’s labor costs by imputing “overhead lobbying costs,” as well his recommendation that all expense associated with American Gas Association (“AGA”) dues be removed from the revenue requirement. I then respond to Mr. Dittemore’s gross revenue conversion factor. I will also identify the adjustments proposed by Mr. Dittemore that Delta is not contesting.

**Q. Please describe the rebuttal testimony Delta is submitting in this proceeding.**

A. In addition to myself, William Packer, Paul Moul, and Jeffrey Wernert are submitting rebuttal testimony. Mr. Packer’s testimony addresses Mr. Dittemore’s proposed adjustments to incentive compensation expense. Mr. Moul’s rebuttal testimony responds to Mr. Baudino’s recommended return on equity and the hypothetical capital structure he suggests imposing on Delta. Finally, Mr. Wernert responds to Mr. Dittemore’s various adjustments to Delta’s cash working capital calculation.

**Q. Please explain how Delta has treated lobbying expenses in this case.**

A. Consistent with Commission precedent, Delta removed lobbying expenses from its test year revenue requirement in this case. Those costs include the services of Capital Link Consultants performed by Greg Coker, as well as the portion of dues to the American Gas Association and other organizations that are attributable to lobbying. During discovery, Delta determined that it needed to remove an additional $7,871 from its test year revenue requirement to fully remove lobbying expenses.

**Q. Has Mr. Dittemore recommended imputing "overhead lobbying costs" to further reduce Delta's labor costs?**

A. Yes. Mr. Dittemore has proposed an adjustment "to recognize that internal resources (labor) will be involved in the supervision and interaction with external lobbyists hired by the Company."[1] Mr. Dittemore admits that Delta has "excluded the estimated $23,100 attributed to lobbying services from the base period," but claims that "Delta internal resources that communicate with Capital Link and oversee its work … should be quantified and translated to a cost designated as lobbying and charged as a non-operating expense."[2]

**Q. What amount of expense has Mr. Dittemore attributed to "indirect lobbying expense?"**

A. Mr. Dittemore concedes "[t]here was no objective way to quantify this level of indirect Delta labor that should be designated as associated with the lobbying effort."[3] He then states he "assumed that the level of effort and time spent on developing a strategy and interacting with external lobbying resources would be equal in cost to the direct external lobbying costs associated with Capital Link." He then "removed $23,330 in costs as a

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[1] Direct Testimony of David N. Dittemore on behalf of the Kentucky Attorney General of February 18, 2025 in Case No. 2024-00346.
[2] *Id.* at 20-21.
[3] *Id.* at 22.

proxy for the indirect labor costs incurred by Delta in its lobbying effort."[4] The amount is equal to the projected Capital Link Consultants expense plus a 1% inflation factor.[5]

**Q. Do you agree with Mr. Dittemore's imputation of $23,330 in "overhead lobbying costs?"**

A. No, I do not. Delta explained in response to Item No. 71 of the Attorney General's First Request for Information that the "time Delta employees spend engaging with Capital Link Consultants on lobbying matters is limited, immaterial, and is not tracked." As President, I am the Delta employee that Mr. Coker reports to. It would be inefficient if it took as much of my time to oversee Mr. Coker as it does for Mr. Coker to perform his services. A contractor that requires such extensive supervision would not be retained. Moreover, the proposed imputation of $23,330 is approximately 10% of my base salary. I certainly do not spend 10% of my time overseeing Mr. Coker's work. While I do not track the exact amount, I expect it is likely more like 1% of my time.

**Q. Has the Commission approved an adjustment to impute "overhead lobbying costs" in prior Delta rate cases?**

A. No, it has not. I am unaware of the Commission approving such an adjustment in any rate case involving any utility. If the Commission determines that Delta should track the time it spends overseeing and interacting with Capital Link Consultants, Delta suggests the reasonable approach would be to order Delta to do so on a prospective basis, as compared to reducing its labor costs by $23,330 in this proceeding, which significantly exceeds the amount of time Delta employees engage in such interactions.

**Q. Please describe Mr. Dittemore's proposed adjustment to AGA expense.**

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[4] *Id.* at 22.
[5] *Id.* at Exhibit DND-8.

A. Mr. Dittemore recommends removing all of the $24,075 in AGA dues that is included in Delta's operating expenses, even though only $1,493—or 6%—are for lobbying activities.[6] Mr. Dittemore alleges that Delta did not "provide[] sufficient support justifying the inclusion of AGA dues within the revenue requirement."[7]

**Q. Do you agree with Mr. Dittemore's removal of all AGA dues from operating expenses?**

A. No, I do not. The AGA reports to Delta the percentage of its dues that are attributable to lobbying. I have confirmed with AGA representatives that the lobbying percentage on the dues invoice includes all non-deductible lobbying that is defined under Internal Revenue Code Section 162(e). That includes federal and state legislative lobbying, and executive branches and grassroots lobbying, which the IRS defines broadly.

**Q. Are you confident that Delta and its customers benefit from its membership in the AGA?**

A. Yes. For example, the AGA offers programs that highlight practices that enhance public safety and gas system integrity. This includes the whitepapers and technical notes that AGA publishes for member use alone that provide timely and detailed data and analysis on discrete operational issues. AGA also has created a variety of safety bulletins that specifically address threats to gas distribution and gas transmission pipeline systems, based on practices used by operators to mitigate risk. These bulletins also provide observations based on reportable incidents to the Department of Transportation by operators.

**Q. Can you please describe the reasonableness of the expense given how Delta has utilized its AGA membership to enhance the safety and reliability of its system?**

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[6] *Id.* at 22-23, Exhibit DND-9.
[7] *Id.* at 23.

A. Certainly. Delta is requesting that less than $23,000 annually be included in rates for Delta's membership in the AGA, which is the preeminent industry organization for natural gas. Delta has judiciously monitored its AGA expense and has reduced its expense by ***nearly a third*** over the last fifteen years. For example, in Case No. 2010-00116, Delta was permitted to include net AGA expense of $32,156 in its revenue requirement. At that time, Delta was paying $33,496 in annual AGA dues, with a 4% reduction in rates for the portion of the dues attributable to lobbying. Now, fifteen years later, Delta is requesting to recover $9,200 less than in 2010 (29%), after deducting 6.2% for lobbying, to continue to receive the benefits that we have passed on to our customers for decades due to the good work of the AGA.

It would cost Delta much more than $23,000 to independently obtain the information and expertise that Delta receives from AGA. For example, Delta receives manuals and standards published by the AGA, such as the Natural Fuel Gas Code. Delta would have to purchase these manuals at a cost if it was not an AGA member. Likewise, Delta has become better informed regarding the risks associated with Aldyl-A vintage pipe and how those risks should be factored into the Company's Pipeline Replacement Plan through studies and presentations by the AGA. While Delta has thankfully not had to utilize the services, AGA's Mutual Assistance Program is an extremely valuable resource available to assist our customers in time of emergency or disaster. It would be irresponsible to operate in our industry without this sort of partnership with our peers. As another example, AGA was invaluable in assisting the industry, including Delta, with regard to operating safely during the COVID-19 pandemic, including with respect to customer premise visits that had to be performed during that time.

**Q. Please respond to Mr. Dittemore's imputation of a Gross Revenue Conversion Factor.**

A. Mr. Dittemore applies a Gross Revenue Conversion Factor, which he describes as the "ratio applied to revenue expense adjustment to convert the nominal revenue or expense adjustment amount to a revenue requirement amount."[8] Delta agrees that a Gross Revenue Conversion Factor is appropriate. However, Delta's rate model inadvertently excludes the application of this factor to its O&M, Depreciation and Taxes, Other expense adjustments. Based upon Delta's expense adjustments, the Gross Revenue Conversion Factor increases Delta's revenue requirement by $30,603. My Rebuttal Exhibit JB-1 supports this calculation. To the extent the Commission adjusts these noted expense categories, the associated gross revenue conversion factor can then be properly adjusted as well. If the $30,603 is not added into the revenue requirement, then logically any increases or decreases to the Company's proposed O&M, Depreciation and Taxes, Other adjustments should be exclusive of the gross up component as well.

**Q. Please explain which of Mr. Dittemore's adjustments Delta is not contesting.**

A. Two of Mr. Dittemore's adjustments reflect corrections that Delta made in the course of the proceeding. The first is the correction to the forecasted expense for employee medical benefits, which is explained in response to Item No. 66 of the AG's First Request for Information. The second adjustment pertains to two corrections to direct lobbying expense: (1) Delta understated its projected test period lobbying costs by $3,664, as explained in its response to Item No. 13 of Commission Staff's First Request for Information and (2) the need to remove $4,207 associated with allocated labor costs for lobbying indicated that it

[8] *Id.* at 7.

failed to remove allocated labor costs, as explained in response to Item No. 70 of the AG's First Request for Information.

**Q. What is your recommendation to the Commission?**

A. My recommendation is that the Commission deny Mr. Dittemore's adjustments to (1) impute overhead lobbying expense and (2) remove all AGA dues from operating expenses. Further, I recommend the Commission allow Delta's addition of $30,603 for gross revenue conversion factor amounts inadvertently excluded in its filing which understated its revenue requirement by said amount.

**Q. Does this conclude your testimony?**

A. Yes, it does. Thank you.

## VERIFICATION

**COMMONWEALTH OF KENTUCKY )**
**) SS:**
**COUNTY OF CLARK )**

The undersigned, **John B. Brown**, being duly sworn, deposes and says he is President and Chief Officer of Kentucky Operations of Delta Natural Gas Company, Inc., that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge, and belief.

John B. Brown

**JOHN B. BROWN**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 18th day of March, 2025.

Jennifer Page Bingham (SEAL)
Notary Public

My Commission Expires:

June 19, 2027

JENNIFER PAGE BINGHAM
NOTARY PUBLIC
STATE AT LARGE KENTUCKY
COMM. # KYNP74158
MY COMMISSION EXPIRES JUNE 19, 2027

**Delta Natural Gas Company Inc.**
**Revenue Conversion Factor Correction**
**Case No. 2024-00346**
**For the Forecasted Period Ended June 30, 2026**

**Rebuttal Exhibit JB-1**

| Line No. | Expense Adjustment | Per Filing Expenses | Revenue Conversion Factor Missed (1) | Revenue Conversion Factor Correction |
|---|---|---|---|---|
| 1 | **Operations & Maintenance Adjustments** | | | |
| 2 | Adjustment to current GCR rate | $ 835,352 | 0.0061314 | $ 5,122 |
| 3 | Other O&M Adjustments | $ 2,072,446 | 0.0061314 | $ 12,707 |
| 4 | **Total Operations & Maintenance Adjustments** | $ 2,907,798 | 0.0061314 | $ 17,829 |
| 5 | **Depreciation Expense Adjustment** | $ 2,382,979 | 0.0061314 | $ 14,611 |
| 6 | **Other Taxes** | | | |
| 7 | Payroll and Property tax adjustment | $ (299,625) | 0.0061314 | $ (1,837) |
| 8 | TOTAL EXPENSE ADJUSTMENTS | $ 4,991,152 | | **$ 30,603** |

(1) 1.0061314 as shown on AG Exhibit DND-2 less 1.00

**COMMONWEALTH OF KENTUCKY**
**BEFORE THE PUBLIC SERVICE COMMISSION**

| | | |
|---|---|---|
| **APPLICATION OF DELTA NATURAL GAS** | **)** | |
| **COMPANY, INC. FOR AN ADJUSTMENT** | **)** | **CASE NO. 2024-00346** |
| **OF RATES** | **)** | |

**REBUTTAL TESTIMONY OF**

**PAUL R. MOUL**

**March 21, 2025**

## PREPARED REBUTTAL TESTIMONY OF PAUL R. MOUL

**Q. Please state your name, occupation and business address.**

A. My name is Paul R. Moul. My business address is 251 Hopkins Road, Haddonfield, New Jersey 08033-3062. I am Managing Consultant at the firm P. Moul & Associates, an independent financial and regulatory consulting firm.

**Q. Did you file Direct Prepared Testimony in this proceeding?**

A. Yes, I did. On November 25, 2024, I filed direct testimony concerning the rate of return for Delta Natural Gas Company, Inc. ("Delta" or the "Company").

**Q. What is the purpose of your Rebuttal Testimony in this proceeding?**

A. My testimony responds to the direct testimony submitted by Richard A. Baudino, a witness appearing on behalf of the Office of the Attorney General ("OAG"). If I fail to address each and every issue in the testimony of Mr. Baudino, it does not imply agreement with those issues.

**Q. What are the key rate of return issues that the Commission should consider when deciding this case?**

A. Mr. Baudino has challenged the Company's forecast capital structure ratios and has proposed an alternative hypothetical capital structure. Mr. Baudino has also disputed the Company's rate of return on common equity and has proposed an even lower return on equity for the Company's Pipe Replacement Program ("PRP"). Aside from technical issues that I will discuss later in my rebuttal testimony, the Commission should take into consideration the following:

1) A rate of return that will be reflective of prospective capital cost rates in the context of the relatively high level of interest rates.

2) A rate of return that will reflect and be supportive of the Company's financial and risk profile.

As I explain below, the recommendation of Mr. Baudino fails to adequately consider these two points and thereby understates the cost of common equity in this proceeding for Delta.

**Q. Based on your analysis of Mr. Baudino's testimony, have you revised your cost of equity proposal in this case?**

A. No. In conjunction with my analysis of Mr. Baudino's direct testimony, I have concluded that my originally proposed 10.95% cost of equity for Delta continues to be an appropriate recommendation. If anything, later market data could support an upward revision in my proposal, because interest rates continue to be higher than what I reflected in my direct testimony. But I am not advocating an upward revision here.

**Q. What explains the substantial disparity between Mr. Baudino recommendation and your proposed 10.95% equity return?**

A. Mr. Baudino has understated the cost of equity for Delta, which if adopted by the Commission, would be of serious concern to investors in the financial community. The difference between Delta's cost of equity and the proposal by Mr. Baudino is attributable to a number of factors, including: (i) an erroneous deletion of Southwest Gas from the proxy group, (ii) the determination of a reasonable Discounted Cash Flow (DCF) return; (iii) whether a leverage adjustment to the DCF is warranted; and (iv) the extent to which other methods of determining the cost of equity provide a reasonable measure of the appropriate cost of common equity

**Q. Should the Commission consider the future trend in capital cost rates when**

**deciding the return on equity issue in this case?**

A. Yes. Unlike Mr. Baudino's approach that takes a backward view of interest rates, i.e. six months covering August 2024 through January 2025. A forward-looking assessment of the capital markets is especially relevant here because the Company's rates will be based on a fully forecasted test year. High inflation expectations are a contributing factor that points to high interest rates. The trend of inflation rates has been 2.4% (09/24), 2.6% (10/24), 2.7% (11/24), 2.9% (12/24), 3.0% (01/25), and 2.8% (02/25). With this situation, it seems unlikely that Federal Open Market Committee ("FOMC") might further cut the Fed Funds rate in the near term, unless the employment situation weakens materially. There also is the possibility that the Fed Funds rate could be increased at some point in the future. To add perspective, there was considerable discussion early in 2024 that the FOMC might cut the Fed Funds rate six times in 2024. We now know that the Fed Funds rate was cut only three times in 2024. It seems apparent that only a few, or no further rate cuts may develop in 2025. A variety of factors influence the FOMC, such as the condition of the economy, the health of the labor markets, and other factors. With no definitive plan in place, it would be speculative to infer that the Fed Funds rate will decline in the near-term future. High interest rates clearly point to high capital costs prospectively. I will describe the forecasts of interest rates below.

**Q. What are the forecasts of interest rates?**

A. To gain a consensus view of future interest rates, I tabulated the forecasts of yields on 10-year Treasury notes published by a variety of well recognized and investor-influencing sources. I chose the 10-year Treasury note because it is available on a uniform basis that is consistent across each source. The comparisons are:

| | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|---|---|---|---|---|---|---|
| Blue Chip | 4.2% | 4.1% | 4.0% | 4.0% | 4.0% | 3.9% |
| CBO | 4.15% | 3.95% | 3.92% | 3.90% | 3.88% | 3.85% |

The Blue Chip (December 1, 2024) and CBO (January 2025) forecasts reflect the general consensus is that interest rates will remain at elevated levels and may decline only slightly in the future. Moreover, these forecasts do not fully reveal the recent upward trend in interest rates that developed since September 2024. The relatively high levels of interest rates represent one key factor that adds to the risk of common equity. And for comparison purposes, the yield on public utility bonds always exceeds Treasury yields. The recent trend in the yield on Baa-rated public utility bonds has been 5.41% (09/24), 5.61% (10/24), 5.75% (11/24), 5.77% (12/24), 6.05% (01/25), and 5.90% (02/25). The Commission should take into account the expected level of interest rates when it sets the cost of equity for Delta.

**Q. How would investors react to a decision by the Commission if it were to adopt the recommendation of Mr. Baudino?**

A. The investment community would be concerned if the Commission were to adopt Mr. Baudino's proposal. The return on equity used by the Commission to set rates embodies in a single numerical value a clear signal of regulatory support for the financial strength of the utilities that it regulates. Although cost allocations, rate design issues, and regulatory policies relative to the cost of service are important considerations, the opportunity to achieve a reasonable return on equity represents a direct signal to the investment community of regulatory support for the utility's financial strength (or lack thereof). In a single figure, the return on equity utilized to set rates provides a common and widely understood benchmark that can be compared from one company to another and is the basis by which returns on all financial assets (stocks – both utility and non-regulated, bonds, money market instruments, and so forth) can be measured. So, while varying degrees of sophistication are required to interpret the meaning of specific Commission policies on technical matters, the return on equity figure is universally understood and communicates to investors the types of returns that they can reasonably expect from an investment in utilities operating in Kentucky.

**Q. Why should the Commission care what investors think?**

A. For a utility to obtain new capital and retain existing capital at reasonable cost and on reasonable terms, the authorized rate of return on common equity must be high enough to satisfy investors with returns that are commensurate with the risk of their investments. The cost of equity proposed by Mr. Baudino, if adopted by the Commission, would provide a signal to the investment community of unsupportive regulation. That is to say, if the Commission were to adopt the proposal by Mr. Baudino, it would discourage commitments by investors to Delta because more attractive risk-adjusted returns are available in other states. Investors are aware of the actions by regulators and those regulatory actions can have an impact on assessments by the credit rating agencies.

**Q. In his analysis, Mr. Baudino considers the Volatility Index (i.e., "VIX"). Please elaborate.**

A. I agree with Mr. Baudino that the VIX is a valid measure of expected stock market volatility and one which I follow routinely. This index is provided by the CBOE Global Markets (formerly Chicago Board Options Exchange) and is a gauge of volatility in the equity market and, hence, provides a measure of risk. It is well-established that greater volatility indicates higher risk, which, all else equal, translates into a higher cost of equity. It is widely accepted that high readings for the VIX are often accompanied by bearish sentiment and a low VIX is associated with bullish sentiment. The trading pattern of the VIX is typically inverse to the level of stock prices. That is to say, the VIX increases when stock prices are falling and the VIX declines when stock prices rise. This situation is sometimes associated with increases in the cost of equity when the VIX increases and vis-a-versa. While volatility in the stock market has subsided since the beginning of the pandemic in 2020, it continues to exceed pre-Pandemic levels (i.e., 16.33 in 2019). The current level as of early March 2025 is revealed by the CBOE VIX of 23.51 (03/04/2025). This warrants a higher equity return at this time because the higher stock market volatility.

**Q. How is the remainder of your testimony organized?**

A. I will cover the issues of (i) capital structure, (ii) the composition of the proxy group, (iii) the weight to be given to the DCF method, (iv) the DCF growth rate, (v) the leverage adjustment to the DCF and CAPM methods, (vi) the CAPM method, (vii) the Risk Premium analysis, (viii) Comparable Earnings, and (ix) the equity return component of the PRP.

## CAPITAL STRUCTURE

**Q. Mr. Baudino has essentially proposed a hypothetical capital structure rather than**

**the Company's actual forecast capital structure. Is his proposal reasonable for Delta?**

A. No. The Company's forecast structure ratios in this case consist of 47.24% debt and 52.76% common equity. These ratios are entirely consistent with the capital structure ratios for the natural gas industry. There is nothing unusual about the Company's forecast structure that would require any adjustments to it. Indeed, his proposal for Delta that contains 50% debt and 50% equity is incompatible with his testimony in the Columbia of Kentucky rate case where he accepted the Company's capital structure ratios consisting of 47.36% debt and 52.64% common equity. There is no discernable difference between the Columbia capital structure and Delta's. Hence, the Company's proposed capital structure is entirely appropriate in this case based on Mr. Baudino's position in the Columbia case.

**Q. Is the Company's proposed capital structure reasonable by reference to the Gas Group?**

A. The Company's forecast structure ratios are within the ratios that investors expect for a natural gas distribution company. I have verified the reasonableness of the Company's common equity ratio by considering the capital structure ratios based on investor expectations as presented below. That analysis has revealed that the Company's actual common equity ratio is verified by the Gas Group based upon forecast data widely available to investors from Value Line. Those ratios are:

| Company | 2027-2029 |
|---|---|
| Atmos Energy Corp. | 60.0% |
| Chesapeake Utilities Corp. | 52.0% |
| New Jersey Resources Corp. | 45.0% |
| NiSource Inc. | 45.0% |
| Northwest Natural Holding Company | 45.0% |
| ONE Gas, Inc. | 55.0% |
| Southwest Gas Holdings, Inc. | 44.0% |
| Spire, Inc. | 45.0% |
| Range: | |
| High | 60.0% |
| Low | 44.0% |

Source: The Value Line Investment Survey, February 21, 2025

From the data shown above, Delta has a common equity ratio for the test year that is within the range for the proxy group (i.e., 44.0% to 60.0%) and that its actual forecast capital structure has adequate support. There is no justification for imposing a hypothetical capital structure on Delta when its actual capital structure is reasonable.

**Q. Would there be consequences for the Company if a hypothetical 50% common equity ratio were imposed on it in this case?**

A. Yes. With a 50% hypothetical common equity ratio, the Company would be denied an equity return on $4.985 million of its actual common equity. So with Mr. Baudino's proposed 9.55% equity return proposal, the Company could only hope to experience an 9.05% equity return on its actual equity. All investors, both debt and equity, would react unfavorably to such an outcome. Rather, the Commission should support the Company's financial integrity by endorsing its actual forecast structure.

**Q. Is there another issue that should be considered regarding Mr. Baudino's hypothetical capital structure?**

A. Yes. Another problem with Mr. Baudino's approach is that when proposing a hypothetical debt ratio, he creates a mismatch between the cost of long-term debt that he accepts and the hypothetical debt ratio that he advocates. This mismatch arises because the hypothetical long-term debt ratio of 50% contains more debt (i.e., $4,984,584) than the amount of long-term debt that is actually outstanding for Delta, which carries a 4.51% cost rate that relates to the actual 47.24% debt ratio. That is to say, with more debt in the hypothetical capital structure, a higher cost of debt would be related to the higher hypothetical debt ratio. Mr. Baudino never addresses this inconsistency in his proposal, and hence, it should be rejected.

## PROXY GROUP

**Q. Are there differences in the proxy groups utilized in this case?**

A. Yes. Mr. Baudino makes an erroneous deletion to my proxy group. Mr. Baudino drops Southwest Gas from the proxy group without adequate justification. He says that Southwest underwent a corporate restructuring that causes him to exclude it from the proxy group. However that is a backward looking analysis and investors look to the future when analyzing the business structure of Southwest. Indeed, as revealed by the table provided below, the segment assets of Southwest Gas are predominantly rate-regulated.

| Company | Percent Regulated Assets |
|---|---|
| Atmos Energy Corp. | 97% |
| Chesapeake Utilities Corp. | 85% |
| New Jersey Resources Corp. | 69% |
| NiSource, Inc. | 100% |
| Northwest Natural Gas | 93% |
| One Gas, Inc. | 100% |
| Southwest Gas Corp. | 79% |
| Spire, Inc. | 81% |
| Average | 88% |

As such, Southwest Gas is predominantly a regulated gas distribution utility, just like the other members of the Gas Group, and it should be included in the proxy group.

## COST OF EQUITY - DCF

**Q. Are there limitations to the application of the DCF that indicates that it should not be used alone to establish the equity return?**

A. My point is that all models have their strengths and weaknesses, and it is important to rely on more than one model in determining the cost of common equity. There are many assumptions associated with the specification of the DCF. These are:

- The form of the model. A choice must be made whether to employ the continuous or discrete form of the model.
- Whether a finite or infinite form of the model realistically represents investor's horizon.
- Whether compounding of the quarterly dividend should be employed.
- The timing of the dividend payments regarding the interval from the ex-dividend date and the stock measurement date needs to be addressed.

- A choice is necessary relative to a representative price that would reasonably represent the rate effective period, e.g., 12-month average, 6-month average, 13-week average, spot, etc.
- Assumptions concerning the structure of returns which under the DCF assumes that the price-earnings multiple, dividend payout ratio, and earned return will be constant.
- Whether single or multiple growth rates better reflect investor expectations.
- Choices concerning the use of historical or forecast growth rates.
- From a historical perspective, whether 10-years, 5-years, or some other historical period is representative of investor expectations.
- Choice among variables to measure growth, e.g., earnings per share, dividends per share, book value per share, cash flow per share, retention growth, price growth, etc.
- Choice of investor influencing growth rates that are available from I/B/E/S First Call, Zacks, and Value Line.
- Whether the growth rate if measured by the formula "b x r" should be modified for external growth, i.e., "sv."
- The potential misspecification of the rate of return applicable to book value when taken directly from DCF if the market price diverges from book value.

Many of the assumptions, especially the constant price-earnings multiple, constant payout rate, and constant earned return, are particularly unrealistic.

**Q. As to the DCF growth component, what financial variables should be given greatest weight when assessing investor expectations?**

A. As noted above, to properly reflect investor expectations within the limitations of the DCF model, earnings per share growth, which is the basis for the capital gains yield and the source of dividend payments, must be given greatest weight. The reason that earnings per share growth is the primary determinant of investor expectations rests with the fact that the capital gains yield (i.e., price appreciation) will track earnings growth with a constant price earnings multiple (a key assumption of the DCF model). It is also important to recognize that analysts' forecasts significantly influence investor growth expectations. Moreover, it is instructive to note that Professor Myron Gordon, the foremost proponent of the DCF model in public utility rate cases, has established that the best measure of growth for use in the DCF model are forecasts of earnings per share growth.[1]

**Q. Among the variables that Mr. Baudino considered in his growth rate analysis for DCF purposes was the dividends per share forecast by Value Line. Is that a valid measure for DCF purposes?**

A. No. As I describe in my prefiled direct testimony and above, forecast earnings growth is the only valid measure of expected growth for DCF purposes. The theory of DCF indicates that the value of a firm's equity (i.e., share price) will grow at the same rate as earnings per share and dividend growth will equal earnings growth with a constant payout ratio. Therefore, to reflect investor expectations within the limitations of the DCF model, earnings per share growth, which is the basis for the capital gains yield and the source of dividend payments, must be given primary emphasis. We can clearly

[1] "Choice Among Methods of Estimating Share Yield," The Journal of Portfolio Management, Spring 1989 by Gordon, Gordon & Gould.

see from page 1 of Exhibit RAB-3 that the dividend growth rate is an outlier. There are no other measures of growth or DCF returns shown on that exhibit that are near the dividend variable. Indeed, the average of the DCF returns for the remaining growth rates using earnings forecasts is 10.06% (10.15% + 10.48% + 9.54% = 30.17% ÷ 3). The other DCF return using dividend growth proposed by Mr. Baudino is invalid.

**Q. Mr. Baudino claims that your earnings growth forecasts are unsustainable based on GDP growth. Is that valid?**

A. No. By attempting to incorporate GDP growth in the DCF analysis introduces a growth rate that is generic and would apply to any, or all, companies. However, each company has a unique company-specific growth rate. His approach is simply incompatible with the basic concept of the DCF, where future cash flows for each company are systematically related to one another by a constant growth rate that represents a basic tenant of the constant DCF. It is also incompatible with the use of the growth rates of a comparable barometer group of companies to meet the requirement that a utility is to be permitted to earn a return equal to comparable companies. The DCF equation is P = D / (k-g). Mr. Baudino's proposed growth rate does not fit within this equation. Earnings growth occurs through revenue growth, net of: O&M, depreciation, taxes, and interest. None of these factors are addressed with the nominal or real GDP growth. Moreover, Mr. Baudino is essentially developing a generic growth rate that would apply to any, or all, companies, whether they are regulated or non-regulated companies. However, each company has a unique company-specific growth rate. His approach is simply incompatible with the basic concept of the DCF. He artificially lowers his DCF return of 10.06% to 9.54% or

9.57% (see page 33 of his testimony), which introduces a downward bias to his final recommendation.

## COST OF EQUITY - CAPM

**Q. Mr. Baudino also used the CAPM as part of his analysis of the cost of equity. Are there deficiencies in his analysis?**

A. Yes. Although I agree with his use of the yields of 30-year Treasury bonds, Mr. Baudino makes CAPM calculations that produce eight (8) results in the range of 8.32% to 10.71%. Of these, there are five (5) that range from 8.32% to 9.21%. By any reasonable standard, such low returns are simply not credible, especially when the yield on Baa-rated public utility bonds is 5.90%. The only CAPM results provided by Mr. Baudino that contain valid returns are 9.73%, 9.84%, and 10.71% (see Exhibit RAB-4, page 2).

In his CAPM, Mr. Baudino uses betas that are published by S&P IQ and Value Line. In each instance, the S&P IQ betas are "raw betas" and are consistently less than the Value Line betas. This is apparently attributed to the lack of an adjustment procedure for the S&P IQ betas. To address this issue, Mr. Baudino made a "Blume Adjustment" which was not adequate to reduce the gap between the betas. Indeed, the S&P IQ betas are only 0.76 when the Value Line beta is 0.90.

Next, Mr. Baudino used an inappropriate approach to establish the market premium (Rm-Rf). While his approach is similar to the expectational and historical market premiums that I employed his inputs are suspect. Unfortunately, his market premium came up short. This is revealed by CAPM calculations that produce a result as low as 8.32%. Using a more conventional approach, his CAPM would be 9.73% to

10.71%. The principal departure from the normal input in developing the market risk premium ("MRP"), he reviewed "Expert Surveys" and his own calculations. His "Expert Surveys" are not conclusive because Mr. Baudino has not shown that current investors consider or use this method. He then uses the 2024 survey conducted by IESE Business School, indicating that it provides the highest MRP that produces a 9.21% CAPM result. There is no evidence that investors use this source of the MRP in their CAPM calculations. I have also considered both historical data and investor expected future returns when measuring the equity risk premium. Mr. Baudino used these inputs also. Furthermore, the implied total market return using Mr. Baudino's final inputs is just 10.78% (4.66% + 6.12%) to a low of 9.08% (4.66% + 4.42%), which is clearly incompatible with actual stock market returns of 26.29% in 2023, 25.02% in 2024, a five-year annualized return of 16.07%, and 12.0% on average for the past 97 years (1926-2023). The 8.86% to 10.16% total market return is significantly below the returns that investors actually realized. Moreover, an update of Exhibit RAB-4, page 1 with later Value Line data from March 14, 2024 provides a total market return of 13.78% (2.20% + 11.58%). With this total market return, the CAPM result would be 12.23% (4.66% + (.83 × (13.78% - 4.66%))).

## RESPONSE TO MR. BAUDINO'S CRITIQUE

**Q. Mr. Baudino provides a critique of your direct testimony and highlights various areas where he believes that you have overstated the Company's cost of equity. Mr. Baudino questions the propriety of your leverage adjustment. Please respond.**

A. Mr. Baudino has not properly recognized that my leverage adjustment is not a market-to-book ratio adjustment. In response to his specific criticisms, my adjustment does not alter the use of book values of common equity and long-term debt in calculating the weighted average cost of capital. My adjustment does not address any of the factors that Mr. Baudino identifies would cause market prices to deviate from book value. And, my adjustment is not an attempt to "prop up high market-to-book ratios" (see page 42 of his testimony) because it does not provide a return that supports any particular M/B ratio, high or low. Further, my leverage adjustment does not address any distinction between investors' expected returns and their required returns, which might be associated with market prices above book value. Mr. Baudino makes this assertion (see page 42 of his direct testimony) that when a company has a market-to-book ratio above 1, it is expected to earn more than its required return. But such a claim is unwarranted given the evidence of the history of market-to-book ratios. If that assertion were correct then it leads to the inevitable conclusion that if investors expected to earn their required return, then stock prices would revert to their book value. Rather, the long history of market-to-book ("M/B") ratios for utilities since 1945 shows that M/B ratios equal to 1.0 are unusual and that ratios of greater than 1.0 are quite common. Indeed, in only about 11% of the years studied did utility stock prices approximate book value. In 74% of the years, utilities stock prices exceeded book value and sometimes by a substantial amount. The average market-to-book ratio over the past 72 years is 143%. These data show that it is unusual for market prices to gravitate to book value.

My adjustment deals only with risk differences attributed to changes in financial risk. As to the rating agencies, they are concerned primarily with a company's cash flow and the ability to adequately cover debt service. While the rating agencies have specific benchmarks for the proportion of debt to capitalization, they do not calculate market based measures of the cost of equity and link those results to a company's book value capital structure. Hence, they would not need to address this issue.

**Q. Mr. Baudino asserts that your proposed DCF growth rate is near the high end of the range of your analysis. Please respond.**

A. My DCF growth rate is entirely within investor growth expectations for the gas utilities and is fully supported by my data. Focusing on my Attachment PRM-9 shows the analysts' forecasts of average earnings growth for the gas utilities were 5.83% by First Call/IBES, 6.00% by Zacks, and 6.56% by Value Line. The 6.25% growth rate that I used in my DCF analysis is entirely within this range.

**Q. Mr. Baudino seems to believe that using historical data for the Risk Premium approach creates a problem with using historical premiums that reflect current investor expectations. Please respond.**

A. I share Mr. Baudino's concern in this regard. There are two ways to deal with this issue. First, an analyst can use all reliable data to establish the risk premium, thus avoiding a bias in selecting a particular period. This represents one of the approaches that Mr. Baudino employed to arrive at his market premium component of the CAPM. Second, an analyst can develop a risk premium from historical data that seeks to emulate investors' current expectations. I followed the latter approach. The value of this approach is that it allows the risk premium to vary over time -- which is what my risk premium does.

**Q. Mr. Baudino suggests that your CAPM results are overstated. Please respond.**

A. I used sources and methodologies similar to those employed by Mr. Baudino. For example, I used the Value Line source provided by Mr. Baudino. Finally, I tempered this forecast with historical data. Using the updated Value Line data, the market risk premium is now 9.12% (13.78% - 4.66%). Combined with the historical market risk premium shown on Exhibit RAB-4, page 2 of 7.31%, the updated market risk premium is now 8.22% (9.12% + 7.31% - 16.43% ÷ 2). Using Value Line betas and ignoring the size adjustment, the CAPM result is shown below.

| | *Rf* | + | *ß* | x ( | *Rm-Rf* | ) = | *k* |
|---|---|---|---|---|---|---|---|
| Gas Group | 4.66% | + | 0.90 | x ( | 8.22% | ) = | 12.06% |

As to my use of unlevered and levered betas, I employed the Hamada formula, which is merely an extension of the Modigliani & Miller formula that I used in the DCF. As a consequence, the explanation that I provided above for the leverage adjustment also applies to the relevered betas. It is only because the regulatory process uses book values to calculate the weighted average cost of capital that we need to address this issue here.

Regarding Mr. Baudino's observations about the size adjustment, the SBBI Yearbook clearly shows that the size premiums were developed from all types of companies, including public utilities.

**Q. Mr. Baudino opposes any recognition of flotation costs in the cost of equity determination in this case. Please respond.**

A. There are two points that require clarification regarding my discussion of flotation costs in this case. First, while I did submit data concerning flotation costs applicable to the natural gas industry, there is no increment in my final recommendation for flotation costs. Hence, this is not an issue in this case for Delta. Second, Mr. Baudino makes the claim that flotation costs are likely already accounted for in the stock prices that are used in the DCF. Mr. Baudino provides no evidence of his assertion, and my Attachment PRM-11 demonstrates that flotation costs are distinct from stock prices which refutes Mr. Baudino's assertion.

**Q. Mr. Baudino also finds fault with your Comparable Earnings. Please respond.**

A. As noted previously, I did not factor the results of the Comparable Earnings method directly into my recommended cost of equity for Delta. Rather, the results of the Comparable Earnings approach were used to confirm the results of the market based models (i.e., DCF, Risk Premium, and CAPM) that I did use to arrive at my recommended cost of equity.

## PRP EQUITY RETURN COMPONENT

**Q. Mr. Baudino proposes a reduction of 10 basis points in the equity component on the Company's investments included in the PRP. Is this penalty in the return warranted?**

A. No. First, Mr. Baudino bases his reduction on the one previously implemented for electric utilities in their Environmental Cost Recover ("ECR") rider. There is insufficient support to make a similar reduction for Delta. Second, nearly all of the natural gas distribution companies that comprise the Gas Group that is used to measure the cost of equity for Delta already have some form of infrastructure rehabilitation mechanism. Hence, whatever the benefit of such a rider is already reflected a market-determined the cost of equity and no further recognition is necessary here. In fact, Mr. Baudino's proposal essentially double-counts the benefit of the PRP rider, because it is already reflected in his DCF return and for him to adjust for it again results in double-counting. Third, there is no reason to lower the equity return in the PRP because it would defeat the purpose of the PRP, i.e., provide rate recovery between rate cases. To lower the PRP equity return would discourage natural gas utilities from making those investments until they could be included in base rates. This would encourage more frequent base rate cases, because natural gas utilities would delay PRP investments until a return could be realized without Mr. Baudino's proposed penalty. Finally, changing the framework to the PRP midstream would be unfair to the natural gas utilities who have the expectation of a full return on those investments through the program term until 2033.

**Q. Does this complete your Prepared Rebuttal Testimony?**

A. Yes, it does.

## VERIFICATION

**STATE OF NEW JERSEY** )
) **SS:**
**COUNTY OF CAMDEN** )

The undersigned, **Paul Moul**, being duly sworn, deposes and says he is Managing Consultant at P. Moul & Associates, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge, and belief.

Paul R. Moul

**PAUL MOUL**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 17th day of March, 2025.

Jennifer Page Bingham (SEAL)
Notary Public

My Commission Expires:

June 19, 2027

**JENNIFER PAGE BINGHAM**
NOTARY PUBLIC
STATE AT LARGE KENTUCKY
COMM. # KYNP74158
MY COMMISSION EXPIRES JUNE 19, 2027

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

| | | |
|---|---|---|
| **ELECTRONIC APPLICATION OF DELTA NATURAL GAS COMPANY, INC. FOR AN ADJUSTMENT OF GAS RATES** | **)<br>)<br>)** | **CASE NO. 2024-00346** |

**REBUTTAL TESTIMONY OF**
**WILLIAM C. PACKER**
**VICE PRESIDENT, REGULATORY ACCOUNTING AND REGIONAL CONTROLLER**
**ESSENTIAL UTILITIES, INC.**

**Filed: March 21, 2025**

**Q. Please state your name and business address.**

A. My name is William C. Packer. My business address is 762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania 19010.

**Q. By whom are you employed and in what capacity?**

A. I am employed by Essential Utilities, Inc. ("Essential"), which is the ultimate parent company of Delta Natural Gas Company, Inc. ("Delta" or "Company"), as Vice President Regulatory Accounting and Regional Controller.

**Q. What is the purpose of your testimony?**

A. I will respond to the proposed adjustments to incentive compensation expense in the testimony of David Dittemore submitted on behalf of the Office of the Attorney General ("AG").

**Q. Please explain why Delta seeks to recover incentive compensation in this case.**

A. Delta has demonstrated that the total compensation an employee can earn—including incentive compensation—is reasonable based on the market. Having a component of an employee's total compensation at-risk is an important aspect of setting compensation. As I described in my direct testimony, we benchmark the reasonableness of employee pay to market based on an all-in, total compensation basis. Incentive compensation is designed to drive efficiency and performance, both of which are consistent with our core values and mission. It gives the employees a true stake in the process, such that their ability to perform at the highest level could yield this component of their compensation.

**Q. Please explain the incentive pay Delta proposes to recover.**

A. Delta included both short-term and long-term incentive-based pay in the forecasted test period. This includes the short-term and long-term incentive pay Delta expects to directly pay its employees and the costs for short-term and long-term incentive pay allocated to Delta from its parent company, PNG Companies LLC ("PNG"), and its ultimate parent company, Essential.

**Q. Has Mr. Dittemore recommended removing certain portions of incentive compensation to further reduce Delta's labor costs?**

A. Yes. Mr. Dittemore has proposed adjustments to both short-term and long-term incentive pay. First, for short-term incentive pay, Mr. Dittemore proposes to remove 50 percent of PNG allocated costs and 100 percent of Essential allocated costs. He does not recommend removing any portion of Delta's short-term incentive costs. Second, Mr. Dittemore recommends removing all long-term incentive pay.

**Q. Do you agree with Mr. Dittemore that any portion of incentive pay tied to financial metrics should be disallowed?**

A. No. While I understand the Kentucky Public Service Commission ("Commission") has disallowed incentive compensation costs for funding and performance metrics tied to financial objectives, the Commission acknowledged that such items should be disallowed "absent a clear showing of benefit to ratepayers."[1] I continue to believe the incentive pay included in Delta's revenue requirement is an important portion of our total compensation package, which is reasonable and ultimately beneficial to Delta's customers. By using a combination of base pay and incentive compensation, Delta and its parent companies are able to offer a competitive market-based total compensation for employees while

[1] *Electronic Application of Kentucky Power Company for (1) A General Adjustment of Its Rates for Electric Service; (2) Approval of Tariffs and Riders; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; (4) Approval of a Certificate of Public Convenience and Necessity; and (5) All Other Required Approvals and Relief,* Case No. 2020-00174, Order at 14 (Ky. PSC Jan. 13, 2021).

continuing to motivate employees to achieve goals that will improve performance and efficiency for the benefit of Delta's customers.

**Q. Is it appropriate for Mr. Dittemore to remove all short-term incentive pay for the Essential allocated costs?**

A. No. Mr. Dittemore states: "The short-term incentive metrics associated with Essential Utilities were not clearly identified in response to OAG 1-35" and therefore proposes to eliminate 100 percent of the Essential allocated costs, resulting in a revenue requirement reduction of $158,051.[2] Delta provided the Delta and Peoples KY short-term incentive plan details in response to OAG 1-35 and provided the PNG short-term incentive plan details in response to OAG 2-13. The Attorney General did not request the details of the Essential short-term incentive plan.

Mr. Dittemore recommends a 50 percent disallowance of the PNG short-term incentive plan.[3] The Essential short-term incentive plan uses the same metrics as the PNG short-term incentive plan: Financial (50%), Safety (20%), Customer Satisfaction (10%), Environmental (10%), and Individual (10%).[4] Thus, 50% of the metrics are non-financial metrics. Accordingly, under Mr. Dittemore's own rationale, 50 percent of the Essential allocated costs for short-term incentive pay should be recovered as the Essential short-term incentive plan is identical to the PNG short-term incentive plan.

**Q. Is Mr. Dittemore's recommended disallowance of all long-term incentive compensation consistent with the Commission's Order in Delta's last rate case?**

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[2] Dittemore Testimony at 17.
[3] *Id.*
[4] The Essential plan documents are attached to my testimony as Rebuttal Exhibit WCP-1.

A. No. In Delta's last rate case, Case No. 2021-00185, the Commission allowed 20 percent of long-term incentive plan costs to be recovered, noting that "controlling operations and maintenance expenses based on reasonable targets is beneficial to ratepayers."[5] The Commission further directed: "Delta should be prepared in its next rate case to demonstrate that this portion of its long-term incentive plan targets and payouts benefit ratepayers. If Delta maintains its expense levels between rate cases only to increase them during a rate case, customers do not benefit from this portion of the long-term incentive plan."[6]

Mr. Dittemore argues that Delta failed to meet the standard in the Commission's prior order without providing any detail of the type of information that he believes would meet this standard. Delta has provided many examples of maintaining O&M expenses throughout this case. Most notably, Delta has forecasted a significant decrease in headcount from its last rate case.[7] This decrease in headcount is strong evidence that Delta's employees are continuing to provide safe and reliable service even with less personnel resources. This efficiency benefits our customers. Fifteen percent of Delta's long-term incentive plan is based on the controlling of O&M expenses and should be recovered.[8]

**Q. Do you agree with Mr. Dittemore's treatment of the restricted stock unit ("RSU") component of its long-term incentive compensation?**

[5] *Electronic Application of Delta Natural Gas Company, Inc. for an Adjustment of Its Rates and a Certificate of Public Convenience and Necessity*, Case No. 2021-00185, Order at 9 (Ky. PSC Jan. 3, 2022).
[6] *Id.* at 9-10.
[7] In Case No. 2021-00185, Delta forecasted 162 full-time employees for the years 2021 through 2024. In the present case, Delta is projecting 149 full-time employees for 2025 through 2027.
[8] The 2025 Long-Term Incentive Compensation presentation is attached to my testimony as Rebuttal Exhibit WCP-2.

A. No, I do not. Mr. Dittemore recommends the exclusion of all long-term incentive compensation, including the 50 percent associated with RSUs.[9] He argues that because there are no performance metrics associated with the RSUs and they fluctuate with the stock value, there are no customer benefits associated with them. I disagree completely.

The only prerequisite to the award of RSUs is tenure with the Company. RSUs vest upon achievement of a restriction based upon the continued service of an employee. Put simply, RSUs are a time-based measure, not a financial measure. RSUs thus directly promote retention and provide employees an investment interest in the business that promotes efforts to provide safe, adequate, and reliable utility service. Further, such retention benefits Delta by avoiding the costs associated with replacing experienced employees, including recruitment, interviews, background checks, and training – costs otherwise borne by our customers.

**Q. What is your recommendation to the Commission?**

A. My recommendation is that the Commission deny Mr. Dittemore's adjustments to both short-term and long-term incentive compensation. At the very least, Delta has met the Commission's burden to recover 65 percent of long-term incentive compensation and 50 percent of the Essential allocated short-term incentive compensation.

**Q. Does this conclude your testimony?**

A. Yes, it does.

[9] *Id.*

**VERIFICATION**

**STATE OF PENNSYLVANIA** )
) **SS:**
**COUNTY OF MONTGOMERY** )

The undersigned, **William Packer**, being duly sworn, deposes and says he is Vice President, Regulatory Accounting & Regional Controller for Essential Utilities, Inc., that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge, and belief.

William C. Packer
**WILLIAM PACKER**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 18th day of March, 2025.

Jennifer Page Bingham (SEAL)
Notary Public

My Commission Expires:
June 19, 2027

JENNIFER PAGE BINGHAM
NOTARY PUBLIC
STATE AT LARGE KENTUCKY
COMM. # KYNP74158
MY COMMISSION EXPIRES JUNE 19, 2027

## 2024 Short Term Incentive Plan
## Metric: Essential

Dear Participants:

I am pleased to introduce to you our updated Short-Term Incentive Plan ("Plan"). The purpose of the Plan is to reward and align all our efforts to operate efficiently while sustaining our mission of reliability and safely delivering gas, water and wastewater treatment services to our customers in the many communities we service.

The Plan is designed to focus our collective efforts on business metrics that are core to our mission and reward our performance when achieving these metrics. The five areas that will be measured in the Plan are Financial, Safety, Customer Satisfaction, Environmental Stewardship and Individual Goals – all measured with our customers in mind.

The Company succeeds when everyone works together as a team to achieve our short and long-term business goals. Thank you for all your continuing efforts and hard work on behalf of our Company, and for your focus on making Essential Utilities, Inc. successful.

Chris Franklin
President and Chief Executive Officer

## Plan Goals

Essential provides a short-term incentive plan (STI) to reward and align efforts to operate efficiently, while sustaining our mission of reliably and safely delivering gas, water and wastewater treatment services to our customers. This incentive is a bonus payment and is measured and paid by March 15 following the end of the Plan year.

The short-term incentive plan is designed to focus the company's collective efforts on metrics that are core to our mission and reward our performance in achieving these metrics. The five metrics in this plan are financial, safety, customer satisfaction, environmental stewardship and diversity - all measured with our customers in mind. These metrics may change, and levels or targets will be updated at least every year. If achievement of the goals falls below a defined threshold outlined in the company's annual proxy statement, participants will not receive a bonus payment.

Although one-time events can impact the company's business, any modifications or adjustments to the short-term incentive plan must be approved by the Essential Utilities Board of Directors' Executive Compensation Committee. The tables below detail the Short-Term Incentive Plan goals:

**Essential**

| Metric | Metric Component | Weight | Threshold 50% | Target 100% | Maximum 150% |
|---|---|---|---|---|---|
| Financial (50%) | Essential Earning Per Share (EPS) | 35.00% | $1.93 | $ 1.98 | $ 2.03 |
| | Essential ROE | 15.00% | 8.04% | 9.54% | 11.04% |
| Safety (20%) | Essential Lost Time/Restricted Time | 5.00% | 1.70 | 1.20 | 0.85 |
| | Essential Responsible Vehicle Accident Rate | 5.00% | 3.00 | 2.50 | 2.00 |
| | Gas Damage Prevention | 10.00% | 3.33 | 3.22 | 3.11 |
| Customer Satisfaction (10%) | Essential Service Level | 10.00% | 82.90% | 83.90% | 84.90% |
| Environmental Stewardship (10%) | Aqua Water Compliance | 2.50% | 99.65% | 99.75% | 100.00% |
| | Aqua Wastewater Compliance | 2.50% | 94.00% | 96.50% | 99.50% |
| | Peoples Gas Leaks | 2.50% | 180 | 165 | 150 |
| | Peoples Gas LTIIP | 2.50% | 97.50% | 100.00% | 102.50% |
| Individual Goals (10%) | Individual Goals #1 | 5.00% | | | |
| | Individual Goals #2 | 5.00% | | | |

## Plan Design

The Plan design assigns a weight and a payout range for each metric.  They are as follows:

| Metric | Weight | Payout Range |
|---|---|---|
| Financial | 50% | 0% - 150% |
| Safety | 20% | 0% - 150% |
| Customer Satisfaction | 10% | 0% - 150% |
| Environmental Stewardship | 10% | 0% - 150% |
| Individual Goals | 10% | 0% - 150% |

Metric target goals were established utilizing recent historical statistics, industry standards, and desired performance.

## Plan Definitions

### ***Financial Metrics (50%)***

**Earnings Per Share (EPS)** - The financial metric is based on the Company's final earnings per share (EPS).  The annualized amount is forecasted for each quarter until final at year-end. Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock.  Earnings per share serves as an indicator of a company's profitability.  The final determination may be non-GAAP and may include certain management adjustments.

**Return on Equity (ROE)** - Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.  The financial metric compares Actual ROE vs. Approved Average ROE (including certain management adjustments).

### ***Safety Metrics (20%)***

**Lost Time Incidents/Restricted Time Incidents (LTI/RTI)** - An OSHA recordable incident in which an employee is not able to return to work on the day or shift following the incident.

**Responsible Vehicle Accidents (RVA)** - Number of Responsible Vehicle Accidents (RVA) or the number of Moving Vehicle Accidents during which the driver failed to do everything reasonable to avoid the accident per million miles driven. The determination of the preventability is based on criteria similar to that found in the National Safety Council's Guide to Determine Motor Vehicle Accident Preventability Report.

**Gas Safety** – Based on Inspections completed within Department of Transportation (DOT) compliance dates. Includes the following items weighted at 25% each: Regulating Station inspections, Leak Surveys, Critical Valve Inspections and Corrosion Test Station reads.

### ***Customer Satisfaction Metric (10%)***

**Service Level** - Service level (as a performance measure) is denoted simply as the percentage of calls that were answered by the call center in the predetermined time threshold as well as those calls that were serviced through interactive voice response (IVR) automation.

### ***Environmental Stewardship Metrics (10%)***

**Water Stewardship: Water Compliance Rate (WCR)** - A Water event causing the operating system to be out of compliance for at least 1 day. The compliance rate is the number of days all water systems are in compliance versus all available days (365 days per system) in 2023. Systems purchased within 1 year of the reporting period that are out of compliance are excluded. Includes Action Level Exceedance (ALE) for lead.

**Wastewater Stewardship: Wastewater Compliance Rate (WWCR)** - A Wastewater event causing the operating system to be out of compliance for at least 1 day. The compliance rate is the amount of days all wastewater systems are in compliance versus all available days (365 days per system) in 2023. Systems purchased within 1 year of the reporting period that are out of compliance are excluded.
**Gas Environmental Stewardship: Reduction – Leaks Outstanding** – The number of leaks outstanding at year end 2023 as reported in the Department of Transportation (DOT) reports. Reduction is measured as a three-year average 2020 – 2023 (estimated).

**Gas Environmental Stewardship: LTIIP Mileage Replacement** – LTIIP mileage replacement is planned mileage as included in the LTIIP for Mains. It measures the percent complete of the Approved LTIIP.

### ***Individual Goals (10%)***

**Individual Performance Factor:** Annually, participants will have a minimum of two Individual Short Term Incentive Goals that align with the broader Company goals. The goals will be mutually determined by the participant and their management team. Communication relative to performance against these goals will be discussed throughout the year. At the end of the performance period, the participant will be given a score between 0 and 15 to indicate how they performed relative to achieving the goals.

## Plan Payment, Eligibility & General Information

**Incentive Pay**
Incentive pay under this Short-Term Incentive Plan ("Plan") is the portion of an employee's total compensation that is based on achievement of financial, safety, customer satisfaction, environmental stewardship and individual goals. If all or a portion of the established goals are achieved, eligible employees of Essential Utilities, Inc. (the "Company") may receive a full or partial bonus payment under the Plan. If the goals are not achieved, participants will not receive a bonus payment.

**Plan Eligibility**
*Full Payout Eligibility*
To be a participant in the Plan eligible for a full incentive payout, an employee must:

- Be a full or part time employee of the Company in a position eligible for participation in the program.
- Be continuously employed by the Company for the entire Plan year and at the time of the incentive payout.

*Prorated Payout Eligibility*
If an employee is otherwise eligible for a full incentive payout but is not employed by the Company for the entire Plan year, the employee will be eligible for a prorated payout based on the percentage of time worked in each eligible position during the Plan year in the following situations:

- An employee hired on or before September 30 of the Plan Year.
  - An employee hired into an eligible position on and after October 1, will be eligible to participate in the following Plan year.
- An employee who has transferred to or between eligible positions during the Plan year.

*Retirement*
Retirement means an employee's termination of employment on or after the date the employee first satisfies the conditions for early retirement or normal retirement benefits under the company policy.

If an eligible employee officially retires, they will receive a prorated payment on the scheduled payment date.

- If retirement is within the first ten months of the Plan year, the employee will receive 100% on the Individual Performance Factor portion of their metric.
- If retirement is in November or December of the Plan year, the employee's manager assigns the Individual Performance Factor percent to their metric.

Payment will be made at the same time as payment is made to active employees, but no later than March 15 of the following year.

*Death*
If an eligible employee dies prior to the incentive payout date, the Company will pay the deceased employee's estate the portion of the incentive bonus the deceased employee would otherwise have been entitled to receive assuming a 100% combined Company and Individual Factor, but prorated for the number of days of employment the employee completed in the Plan year before his/her death. Payment will be made at the same time as payment is made to active employees, but no later than March 15 of the following year.

*Ineligibility*

Employees will not be eligible for incentive payouts under the Plan, if they:

- Voluntarily terminate employment prior to the incentive payout date.
- Are terminated by the Company with or without cause at any time prior to the incentive payout date.

**Target Incentive Payout**

Eligible employees will be assigned a "Target Bonus Percentage" depending on duties and responsibilities. The Board of Directors will approve the Target Bonus Percentage for the CEO and the Senior Officers recommended by the Compensation Committee each year. The Executive Compensation Committee must review and approve final bonus payouts for the Company before payments are made.

The Target Bonus Percentage is a percentage of an employee's annual base rate of pay in effect on the close of the Plan year (December 31st).

**Plan Year**

The Plan year begins on January 1st and ends on December 31st.

**Incentive Payouts**

If the performance goals are achieved during the Plan year, eligible participants will receive incentive payouts as described above in March of the following year, and no later than March 15. If a participant is eligible to participate in a deferral Plan of the Company and the employee makes a deferral election with respect to an incentive payout, the incentive payout will be paid in accordance with the terms of the deferral Plan.

Achievement of the performance goals will be reviewed by the Internal Audit Department of the Company before any payment under the Plan is made.

**Plan Administration**

The Plan will be administered by the Administrator in its sole discretion. The Administrator is (1) for employees who are designated by the Company as "Section 16 officers," the Executive Compensation Committee of the Board of Directors (the "Compensation Committee") and (2) for all other eligible employees, the Senior Vice President, Chief Human Resources Officer of the Company, in consultation with the President & CEO of the Company.

The Administrator has full power and discretionary authority to interpret and administer the Plan, to make all decisions under the Plan, and to take all actions as the Administrator deems necessary or advisable to carry out the Plan. Any action required of the Administrator under the Plan shall be made in the Administrator's sole discretion and not in a fiduciary capacity. All decisions of the Administrator shall be final and binding on the Company, the participants, and any other persons claiming an interest under the Plan. All incentive payouts will be awarded conditional upon the participant's acknowledgement, by continuing in employment with the Company, that all decisions of the Administrator shall be final and binding on the participant and any other person claiming an interest in the Plan. The Administrator may delegate such administrative duties as it deems advisable.

**Tax Matters**

All payments under the Plan will be made subject to applicable federal, state, and local tax withholding requirements. The Plan is intended to comply with the short-term deferral rule set forth in the regulations under Section 409A of the Internal Revenue Code ("Section 409A"). If and to the extent that any payment under the Plan is deemed to be deferred compensation subject to the requirements of Section 409A, the Plan shall be administered so that such payments are made in accordance with the requirements of Section 409A, including the six-month delay for specified employees, if applicable. An employee may not designate the calendar year of payment except in accordance with Section 409A. If any payout is subject to Section 409A, (i) the timing of the employee's execution of a release shall not, directly or indirectly, result in the employee designating the calendar year of payment, and if a payment that is subject to execution of a release could be made in more than one taxable year, based on timing of the execution of the release, payment shall be made in the later taxable year, and (ii) any payout upon termination of employment (other than death) shall be made at the same time as incentive payouts are made to other participants under the Plan, and not at the date of termination of employment.

**Incentive Award Recoupment Policy**
In the event of a significant restatement of our financial results caused by fraud or willful misconduct, the Company reserves the right to review the incentive compensation received by the eligible employee(s) with respect to the period to which the restatement relates, recalculate the Company's results for the period to which the restatement relates and seek reimbursement of the portion of the incentive compensation that was based on the misstated financial results from the eligible employee whose fraud or willful misconduct was the cause of the restatement.

Further, any Incentive Award Recoupment Policy that may be adopted from time to time by the Company's Board of Directors will apply to the incentive compensation awarded under this Plan to any of the employees covered by such Policy.

**Goal Establishment and Achievement**
The Compensation Committee will establish all performance goals under the Plan which relate to Company performance. Each year, the Plan will be reviewed in accordance with the Compensation Committee's Charter.

**Applicable Law**
The Plan will be construed and governed in accordance with the laws of the Commonwealth of Pennsylvania.

**Amendment and Termination**
The Executive Compensation Committee may amend or terminate the Plan at any time.

**Additional Information**
Payments under this Plan may not be transferred, assigned, pledged or encumbered by a participant. The Plan is an unfunded incentive compensation arrangement. Each participant's right to receive a payment under the Plan shall be no greater than the right of an unsecured general creditor of the Company. Nothing in the Plan, and no action taken under the Plan shall confer upon a participant the right to continue in the employ of the Company, or affect the right of the Company's right to terminate a participant's employment at any time for any reason. Unless otherwise specifically provided in an employee benefit plan of the Company, payments under the Plan shall not constitute compensation for purposes of any employee benefit plan.

**Final STI Calculations**
Calculations for STI are finalized once the Company goals have been completed and all metric calculations are reviewed and approved by management and the Executive Compensation Committee. Proration and other multipliers used in the final STI calculation may be based on an individual's entry into the respective STI Plans and other factors.

Any questions regarding the STI plan may be directed to your Human Resources representative as well as your manager.

NYSE: **WTRG**

# 2025 Long Term Incentive Compensation at Essential

Essential
Providing natural resources for life.

March 18, 2025

# Agenda

- Long Term Incentive (LTI) Overview
- Breaking Down LTI: RSUs and PSUs
- 2025 PSU Metrics
- Setting Up Your Account on Merrill Lynch
- Questions

NYSE: **WTRG**

# 2025 Long Term Incentive Overview

Essential™
Providing natural resources for life.

# Long Term Incentive (LTI) Overview

- Intended to motivate recipients to achieve our longer term business objectives by tying incentives to the performance of our common stock over the long-term; and to reinforce the link between the interests and goals of management, employees and shareholders.
- LTI plan revisited annually by the Compensation Committee
- Managed by the HR department and is hosted on Merrill Lynch’s Benefits Online platform
- Recipients receive awards provided that 1) Essential meets goals and 2) Recipient remains employed at Essential
- LTI eligibility is determined at a position level – based on the market prevalence of this type of reward element for that role

# Some Important Facts about Essential's LTI Program

| | |
| --- | --- |
| Highly performance-driven with different goals than the STI program | Focused on driving company value |
| Components including measures, weightings, thresholds, targets and maximums | Aligned with utility industry norms and the company's strategic plan. Targets updated annually |
| Equity components and percentages are subject to change annually | Equity and vesting schedule focused on retention of key employees |

# Overview of 2025 LTI

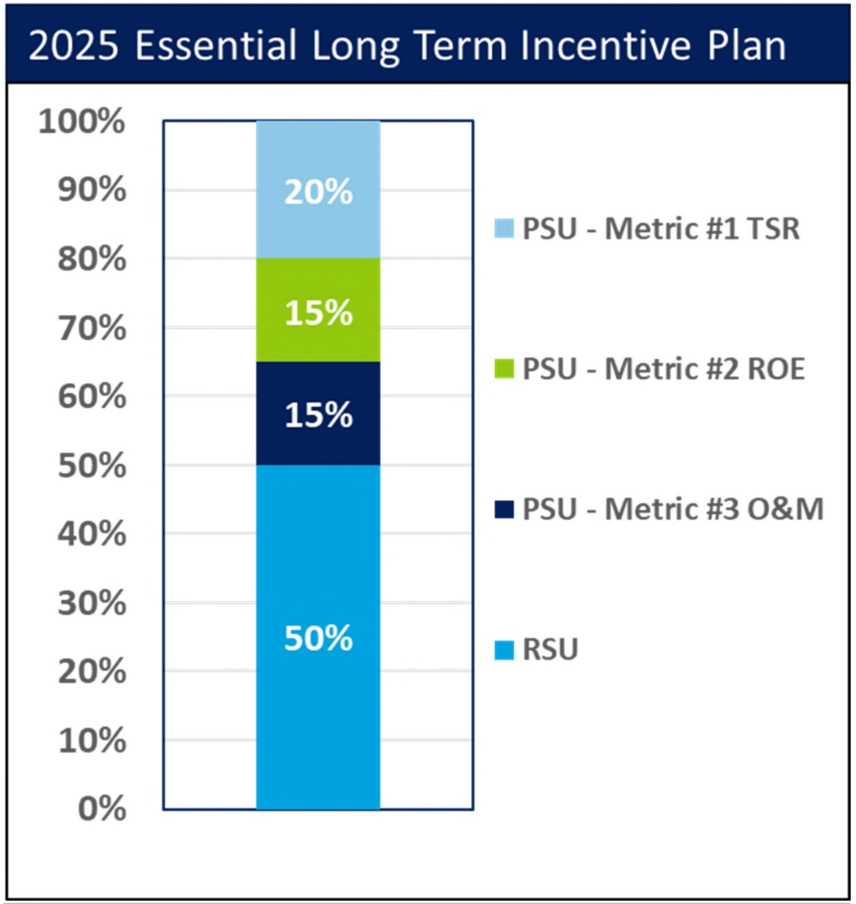
- Award period: January 1, 2025 – December 31, 2027
- Peer group is based on Essential's revenue and market cap scope as well as business mix. The number of peer group companies is 16 and encompasses a mix of similar sized utilities
- Long term incentives focus on driving Company value
- Compared peer company benchmarks in LTI program designs including components, measures, weightings and thresholds to ensure we offered competitive long-term incentives
- Using performance stock units (PSUs) in the long-term incentive program aligns with utility industry norms and the company's strategic plan
- Drives Essential's focus on retention of key employees by continuing to issue restricted stock units (RSUs)
- Annually conducted shareholder meetings with the top 25 shareholders including Vanguard, State Street, BNY Mellon, etc., to solicit feedback and input on the peer group and incentive plan designs

*Enhancements for 2025:*

1. Increase in RSUs to 50% of the LTI mix
2. RSUs now vest one-third each year

# 2025 Essential Long Term Incentive Plan Components

- 2025 LTI Award comprised of:
  - 50% Restricted Share Units
  - 50% Performance Share Units
- Emphasis on performance-based incentives
- One 16 company utility peer group comparison
- Focus on growth with Return On Equity measures
- Three-year O&M targets to ensure efficiency realized of acquisitions




**Vesting:**
PSUs - 3-year cliff
**RSUs – 1/3 vest per year**

# LTI Components: Restricted Share Units & Performance Share Units

- Restricted Share Units (RSUs) – 50% of LTI
  - One-third of the RSUs vest each year – meaning you earn WTRG shares faster than before
  - Recipients receive full number of allotted shares in their Merrill Individual Accounts
  - Dividend equivalents are paid on vesting date through Payroll
  - Unvested RSUs do not have voting rights
- Performance Share Units (PSUs) – 50% of LTI
  - Vest three years after the grant date based on performance of Company on three metrics
  - Payout is based on a percentage of target amount (0 – 200%)
  - At time of vesting shares are issued to your Merrill Lynch brokerage account
  - Recipients receive dividend equivalent payment at the end of the three-year performance period

# PSU Scoring

- You have been awarded a target number of PSU shares – based on 50% of your target LTI $s (which is based on your LTI target % multiplied by your annual salary)
- Essential's performance over a three-year period on three metrics determines the percentage of target that will be paid out:
  - Essential performance ranking compared to peer group companies
  - Achieving or exceeding budgeted Return on Earnings
  - Achieving or exceeding three year Operations & Maintenance (O&M) Expense budget
- Scoring updates sent out twice a year

# 2025 Total Shareholder Return: Our Compensation Peer Group

| Company | Total Revenues (last 12 months) ($M) | Net Revenues (last 12 months) ($M) | 7/29/24 Market Cap ($M) | ISS Peer | Primary Industry |
|---|---|---|---|---|---|
| Alliant Energy Corporation | $3,962 | $2,973 | $14,326 | | Electric Utilities |
| American States Water Company | $567 | $567 | $3,030 | | Water Utilities |
| American Water Works Company, Inc. | $4,359 | $4,359 | $27,540 | ✓ | Water Utilities |
| Atmos Energy Corporation | $4,095 | $2,685 | $19,167 | | Gas Utilities |
| Avista Corporation | $1,908 | $1,106 | $3,045 | ✓ | Multi-Utilities |
| Black Hills Corporation | $2,128 | $1,355 | $4,020 | ✓ | Multi-Utilities |
| California Water Service Group | $985 | $985 | $3,033 | | Water Utilities |
| Evergy, Inc. | $5,636 | $4,119 | $13,154 | | Electric Utilities |
| New Jersey Resources Corporation | $1,732 | $1,006 | $4,606 | ✓ | Gas Utilities |
| NiSource Inc. | $5,240 | $4,047 | $14,045 | | Multi-Utilities |
| NorthWestern Energy Group, Inc. | $1,472 | $1,043 | $3,240 | | Multi-Utilities |
| OGE Energy Corp. | $2,772 | $1,820 | $7,687 | ✓ | Electric Utilities |
| ONE Gas, Inc. | $2,054 | $1,202 | $3,964 | ✓ | Gas Utilities |
| Portland General Electric Company | $3,214 | $1,868 | $4,822 | ✓ | Electric Utilities |
| Southwest Gas Holdings, Inc. | $5,300 | $3,924 | $5,196 | ✓ | Gas Utilities |
| Spire Inc. | $2,610 | $1,395 | $3,885 | ✓ | Gas Utilities |
| | | | | | |
| **Summary Statistics** | | | | | |
| 25th Percentile | $1,864 | $1,090 | $3,724 | | |
| 50th Percentile | $2,691 | $1,607 | $4,714 | | |
| 75th Percentile | $4,161 | $3,211 | $13,377 | | |
| | | | | | |
| **Essential Utilities, Inc.** | **$1,937** | **$1,711** | **$11,061** | | **Water Utilities** |
| Percentrank | 28% | 52% | 71% | | |
| Average Percentile Rank | **50%** | | | | |

# 2025 Total Shareholder Return Performance



Essential

- 16-company most prevalent long-term incentive metric in the peer group. Performance is based on relative TSR rank in the three-year grant period against our 16- company peer group, with percentile ranking determining the overall payout level (0 – 200%)
- For the 2025 grant, we improved the payout target in the TSR metric from the 30th percentile to the 25th percentile

| 2025 TSR Ranking Payout Schedule | | |
|---|---|---|
| 16 Peers + Essential (N=17, in total) | | |
| Rank (including Essential) | Percentile Ranking | Payout as % of Target |
| 1 | 100.0% | 200.0% |
| 2 | 93.7% | 200.0% |
| 3 | 87.5% | 193.8% |
| 4 | 81.2% | 178.0% |
| 5 | 75.0% | 162.5% |
| 6 | 68.7% | 146.8% |
| 7 | 62.5% | 131.3% |
| 8 | 56.2% | 115.5% |
| 9 | 50.0% | 100.0% |
| 10 | 43.7% | 84.3% |
| 11 | 37.5% | 68.8% |
| 12 | 31.2% | 53.0% |
| 13 | 25.0% | 35.0% |
| 14 | 18.7% | 0.0% |
| 15 | 12.5% | 0.0% |
| 16 | 6.2% | 0.0% |
| 17 | 0.0% | 0.0% |

# 2025 LTI – Essential 3 Year ROE and O&M Target

| Average 3 Year ROE Budgeted Target | Attainment |
|---|---|
| 8.50% | 50% |
| 8.73% | 60% |
| 8.97% | 70% |
| 9.21% | 80% |
| 9.45% | 90% |
| 9.69% | 100% |
| 9.75% | 120% |
| 9.81% | 140% |
| 9.87% | 160% |
| 9.93% | 180% |
| 10.00% | 200% |

&

| O&M 3 Year Budget Target $000s | Attainment |
|---|---|
| $ 1,984,000 | 50% |
| $ 1,974,000 | 60% |
| $ 1,964,000 | 70% |
| $ 1,954,000 | 80% |
| $ 1,944,000 | 90% |
| $ 1,934,000 | 100% |
| $ 1,929,000 | 110% |
| $ 1,924,000 | 120% |
| $ 1,919,000 | 130% |
| $ 1,914,000 | 140% |
| $ 1,909,000 | 150% |
| $ 1,904,000 | 160% |
| $ 1,899,000 | 170% |
| $ 1,894,000 | 180% |
| $ 1,889,000 | 190% |
| $ 1,884,000 | 200% |

*As reference, 2025 O&M budget increased 8% over 2024 forecast*

- To ensure cost effectiveness, operations and maintenance targets include the budget plus the first two years in the plan.

# How your 2025 grant was determined

| 4/1/2025 Salary | × | Target % | = | LTI Award Value as of grant date 2/5/2025 |
|---|---|---|---|---|
| $150,000 | | 10% | | $15,000 |

- Your LTI target percentage is as of the award date
- Grant date: 2/5/2025
- Performance years 2025 - 2027
- Grant vesting date: 2/5/2028

# Determining Number of Award Units

Essential

**Grant**

$15,000 Value

→ **50% Restricted Stock Units (RSUs)**

$15,000 x 50% / $34.93 = 215 units

→ **50% Performance Stock Units (PSUs)**

$15,000 x 50%/$34.93 = 215 units

- Closing price of $ for WTRG used for the grant
- Units are rounded to nearest whole value

# Upside Potential of the LTI Program

- Dividends: WTRG stock pays dividends. Those dividends are calculated and accrued by the finance team throughout the vesting period. The participant does not have the ability to reinvest those dividends into stock during the vesting period. On the vesting dates, the participant will receive a cash payment of those dividends through payroll.
- Stock Price: If the stock price increases during the vesting period, the grant vests at the stock price on the vesting date so the value is higher than the initial grant value. The stock is valued every day on the Merrill website.
- PSUs and the performance multiplier:
  - Each participant receives a number of PSUs on the award date. At the end of the vesting period, the performance factor is announced. The original number of PSU shares are multiplied by the factor to determine the number of shares that will vest.

# Definition of Retirement for 2025 grant

- If you leave Essential employment, for reasons other than retirement, death or disability, you forfeit all unvested awards (see plan documents)
- Retirement is defined in the plans as: Age 55 + 5 Years of Service with at least 6 months written advanced retirement notice to your manager and HR.
- You will receive the RSUs (not pro-rated) within 60 days of retirement
- You will receive the PSUs (not pro-rated) on the normal vest date once the Performance factor is known.

New definition for Retirement treatment with 2025 grant

NYSE: **WTRG**

# Setting Up a Merrill Account

Essential™
Providing natural resources for life.

# About Merrill’s Brokerage Services

## Disclaimer

Merrill, its affiliates, and financial advisors do not provide legal, tax or accounting advice. You should consult your own legal and/or tax advisors before making any financial decisions.

# Merrill Online: Understanding Equity Awards

- Equity Awards are a tool to attract, retain and motivate employees
- Your financial success is linked to Essential Utilities Inc.'s overall success
- Encourages you to think like an owner of Essential Utilities Inc.

Investment products:

| Are Not FDIC Insured | Are Not Bank Guaranteed | May Lose Value |
|---|---|---|

# Merrill Online: Purpose of Brokerage Account

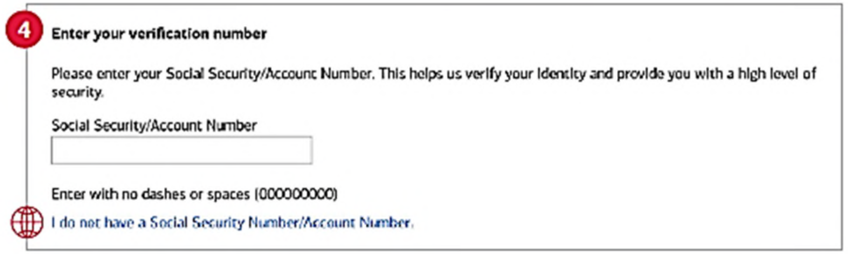
- A Merrill Brokerage Account is needed to:
  - ➢ Accept grant awards
  - ➢ Manage any transactions associated with your account
  - ➢ Exercise options
  - ➢ Sell shares
- Shares will be deposited into this account when they vest/exercise
- This is completely separate from any other account you have with Merrill

# About Merrill Online Accounts

# Merrill Online:  Opening your Account

## Log in to Benefits OnLine

Visit benefits.ml.com and log in or download the app to view your equity awards.


**1 Enter your User ID and password**

Do you already have a User ID and password for another plan at Merrill? If so, you don't need to create new ones. Just enter your existing User ID and password and select **Log in**.

**2 Forgot your User ID or password?**

If you've forgotten your User ID or password, select these links and the site will walk you through the steps to recover them.

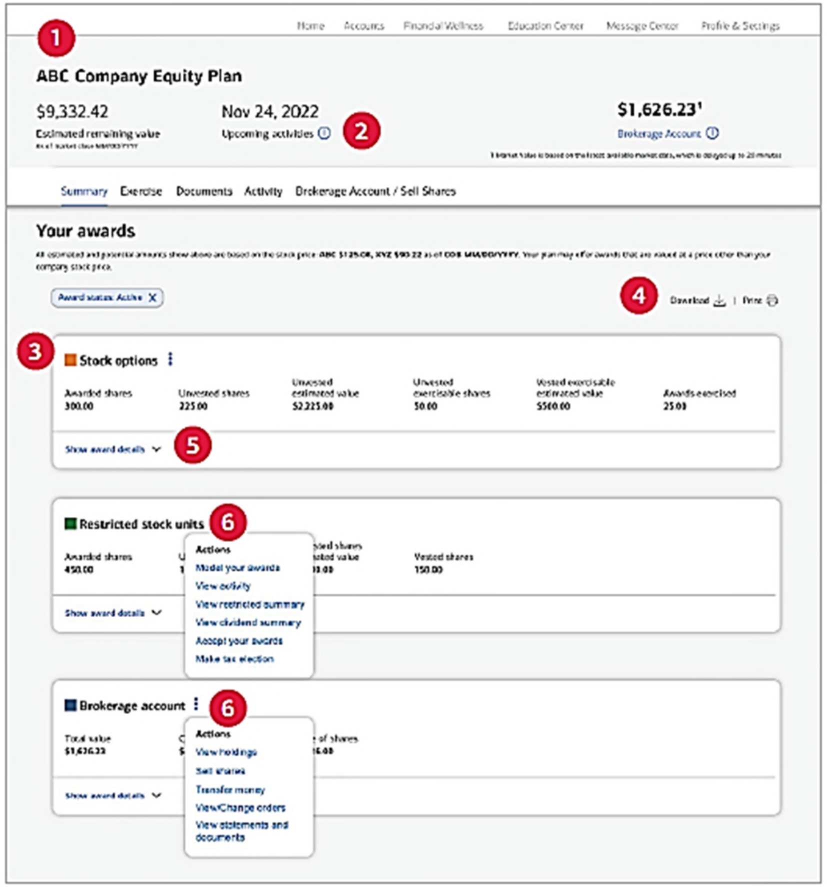
**3 Create your User ID now**

If you're new to Benefits OnLine and don't have a User ID or password, select this link, then follow the prompts to get started.

**4 Enter your verification number**

You'll be asked to enter your Social Security number or account number. If you receive a prompt for a PIN, enter the PIN mailed to you from Merrill. If you don't have a PIN, select **Forgot Your PIN** and follow the prompts.

# Merrill Online:  Review and Accept Your Awards




**1 Your awards at a glance**

A ribbon at the top of the page displays the estimated value of your awards and brokerage account balance.

**2 13-month vesting timeline**

Select the "i" icon to reveal a 13-month activity timeline that includes upcoming vesting dates and estimated income from your awards.

**3 Consolidated award and brokerage account tiles**

See a high-level overview of each award type you've received from your employer and the balance of shares and/or cash in the brokerage account used for your awards.

**4 Download and print award information**

You can download .csv files for use in Excel or print a PDF.

**5 Show award details**

Select to expand and view specifics about each award (see page 6 for details).

**6 Quick action menus**

Select the three dots to see quick links to common actions, such as modeling or accepting awards, selling shares and transferring cash.

When you log into your ML account, you will see an action item for each of your 2025 awards:

1. Read the RSU plan document and Click Accept/Agree to receive the Grant
2. Read the PSU plan document and Click Accept/Agree to receive the Grant

# Merrill Lynch Contacts

- **Merrill Lynch Contact Information**
- Toll Free Number: 877.767.2404

Download the free Benefits OnLine app to stay on top of your equity awards.*
Be sure to turn on app notifications to receive important updates.

- **Benefits OnLine**
- Online account access: www.benefits.ml.com

- **Mailing address of Merrill Lynch Service Center**

  Merrill Lynch Wealth Management

  Retirement & Benefit Plan Services

  1400 Merrill Lynch Drive

  MSC NJ2-140-03-50

  Pennington, NJ 08534

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

| | | |
|---|---|---|
| **ELECTRONIC APPLICATION OF DELTA NATURAL GAS COMPANY, INC. FOR AN ADJUSTMENT OF GAS RATES** | **)<br>)<br>)** | **CASE NO. 2024-00346** |

**REBUTTAL TESTIMONY OF**
**JEFFREY W. WERNERT, JR**
**PRINCIPAL**
**THE PRIME GROUP, LLC**

**Filed: March 21, 2025**

## Exhibits

Exhibit JWW-1 – Lead-Lag Study CWC Calculations

**Q. Please state your name and business address**.

A. My name is Jeffrey W. Wernert, Jr. My business address is 2604 Sunningdale Place East, La Grange, Kentucky 40031.

**Q. By whom and in what capacity are you employed?**

A. I am a principal with The Prime Group, LLC, a firm located in La Grange, Kentucky, providing consulting and educational services in the areas of utility regulatory analysis, revenue requirement support, cost of service, rate design and economic analysis.

**Q. On whose behalf are you testifying in these proceedings?**

A. I am testifying on behalf of Delta Natural Gas Company ("Delta"), which provides natural gas transportation and sales service in central and southeastern Kentucky.

**Q. Did you submit direct testimony in this proceeding?**

A. Yes.

**Q. What is the purpose of your rebuttal testimony?**

A. The purpose of my rebuttal testimony is to address Kentucky Office of the Attorney General's ("AG's") witness David N. Dittemore's recommendation to set Delta's cash working capital ("CWC") to negative ($883,180), which lowers the overall CWC included in Rate Base by $2,283,013.

**Q. When determining CWC, are there multiple methodologies that could be considered reasonable?**

A. Yes. There is more than one way to determine CWC which could be considered reasonable including the 1/8$^{th}$ methodology, the methodology proposed by Delta in this proceeding which gives weights to both the revenue lag days and the expense lead days, and the methodology proposed by Mr. Dittemore which "nets" the revenue lag days from the expense lead days which is then applied to the expense amounts to determine CWC. Historically, Delta's CWC was calculated on the 1/8$^{th}$ methodology. Recently, the Commission has indicated a preference for a lead-lag study to be performed when determining CWC and during Delta's last rate proceeding, Mr. William Seelye provided a lead-lag study at the request of Commission Staff[1] that utilized the same methodology as the study I have sponsored in this proceeding. Other utilities in Kentucky have used the methodology where no weight is given to the revenue lag days and they are netted from the expense lead days, with the resulting net lead-lag days applied to the average daily expense amounts for the determination of CWC.

**Q. Please describe Mr. Dittemore's proposal regarding CWC.**

A. Mr. Dittemore submitted an alternative lead-lag study based on Delta's proposed revenue lag and expense lead days which included adjustments to various components of Delta's expenses. This results in an overall reduction in the revenue requirement proposed by Delta of $197,943.

**Q. Do you agree with Mr. Dittemore's recommendation?**

A. No. While Mr. Dittemore's alternative lead-lag study methodology is reasonable, his recommendation fails to recognize that Delta prospectively reduced the collection lag

---

1 See Delta's Response to Item No. 29 in Commission Staff's Third Request for Information in Case No. 2021-00185.

component of the revenue lag days utilized in calculating Delta's proposed CWC to the benefit of customers.  Delta's historical period for evaluating revenue lag was based on revenue data from calendar year 2023 and resulted in a collection lag time of 31.33 days.[2] As discussed in Mr. John Brown's testimony, Delta believed this revenue lag time was atypically high due to long payback periods resulting from the pandemic and transition to the use of a shared customer contact center with Peoples.[3] A more recent twelve-month period was evaluated utilizing data from the twelve months ended August 2024 which resulted in a revenue lag time of 25.74 days, a roughly 18% reduction but still higher than pre-pandemic levels. Delta believes that a 15-day collection lag, a more than 50% reduction since 2023, is feasible given their internal efforts to improve the collection processes and ultimately used that collection lag component in their calculation of CWC.

**Q. Do utilities typically reduce the revenue lag time in a lead-lag study below the level indicated by the historical data?**

A. No. Most utilities do not make prospective changes to reduce the revenue lag time as Delta did in this proceeding.

**Q. Does Mr. Dittemore acknowledge that Delta's prospective reduction in collection lag time to 15 days results in a lower CWC requirement?**

A. Yes. In the AG's response to Delta's Data Request number 21, Mr. Dittemore states that "the use of a lower collection lag reduces the revenue lag, which translates to a

2 Wernert Direct Testimony, p 6, lines 15 – 16
3 Brown Direct Testimony, p 15, lines 4 – 12

reduction in overall Cash Working Capital and therefore a lower Rate Base and revenue requirement."[4]

**Q. If Delta had proposed the collection lag based on historical data, would the CWC adjustment result in an increase in Rate Base in Mr. Dittemore's alternative lead-lag study?**

A. Yes. Utilizing Mr. Dittemore's alternative lead-lag study, if Delta had not proposed the much lower prospective 15-day collection lag, the calendar year 2023 collection lag time of 31.33 days would result in a CWC of $1,169,642. The twelve months ended August 2024 collection lag time of 25.74 days would result in a CWC of $466,925. These values are much closer to Delta's original proposed CWC of $1,399,833 and result in a much lower reduction in the overall revenue requirement compared to Mr. Dittemore's recommendation. The detailed calculations for each of these respective amounts is shown in Exhibit JWW-1.

**Q. Are there other problems with setting a negative CWC in this proceeding?**

A. Yes. Setting CWC at a negative value creates a financial disincentive for any utility to improve its cash management practices. With a negative CWC, the utility's efforts to reduce its collection times or reduce its Accounts Receivables balances through internal improvements would effectively penalize itself. As mentioned in Mr. Brown's testimony, Delta has made a concerted effort to improve its collection processes over

4 See the Attorney General's Response to Item No. 21 of Delta's First Request for Information.

the past two years and setting CWC at Mr. Dittemore's recommendation would be detrimental to these efforts.

**Q. Does this conclude your testimony?**

A. Yes, it does.

## VERIFICATION

**COMMONWEALTH OF KENTUCKY )**
**) SS:**
**COUNTY OF OLDHAM )**

The undersigned, **Jeff Wernert**, being duly sworn, deposes and says he is a Consultant for The Prime Group, LLC, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge, and belief.

Jeff Wernert

**JEFF WERNERT**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 17th day of March, 2025.

Jennifer Page Bingham (SEAL)
Notary Public

My Commission Expires:
June 19, 2027

**JENNIFER PAGE BINGHAM**
NOTARY PUBLIC
STATE AT LARGE KENTUCKY
COMM. # KYNP74158
MY COMMISSION EXPIRES JUNE 19, 2027

**Delta Natural Gas Company Inc.**
**Cash Working Capital Calculation**
**Case No. 2024-00346**
**For the Forecasted Period Ended June 30, 2026**
**($ Millions)**



| Line No. | Item | Amount: Delta - Pro Forma Amounts | Adjustments: Incentive Comp. | Emp. Benefits | Lobbying | AGA Dues | To Remove Non-Cash Taxes | Interest Synchronization | Adjusted O&M | (Lead)/Lag Days | Dollar Days |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | **O&M Expense** | | | | | | | | | | |
| 2 | Purchased Gas ......................................................... | $ 16,227,683 | | | | | | | $ 16,227,683 | (41.76) | (677,695,611) |
| 3 | Payroll Expense......................................................... | $ 12,054,195 | | | $ 23,330 | | | | $ 12,077,525 | (11.01) | (132,956,760) |
| 4 | Pension Expense......................................................... | $ 143,115 | | | | | | | $ 143,115 | (11.01) | (1,575,497) |
| 5 | Incentive Compensation............................................ | $ 712,104 | $ (458,371) | | | | | | $ 253,733 | (256.70) | (65,134,381) |
| 6 | 401k Match Expense................................................ | $ 616,109 | | | | | | | $ 616,109 | (11.01) | (6,782,504) |
| 7 | Uncollectible Expense.............................................. | $ 614,533 | | | | | | | $ 614,533 | (6.62) | (4,070,056) |
| 8 | Charges from Affiliates............................................. | $ 3,186,443 | | | | | | | $ 3,186,443 | (36.75) | (117,102,555) |
| 9 | Other O&M................................................................ | $ 2,809,671 | | $ (1,152,293) | $ 7,871 | $ (22,582) | | | $ 1,642,667 | (16.57) | (27,213,838) |
| 10 | Total O&M Expenses | $ 36,363,853 | | | | | | | $ 34,761,808 | | $ (1,032,531,202) |
| 11 | **Income Tax Expense** | | | | | | | | | | |
| 12 | Current: Federal and State....................................... | $ 3,233,710 | | | | | $ (3,233,710) | | $ - | - | - |
| 13 | Deferred: Federal and State (EDIT Amort.)............ | $ (752,652) | | | | | $ 752,652 | | $ - | - | - |
| 14 | Total Income Tax Expense | $ 2,481,058 | | | | | | | | | $ - |
| 15 | **Taxes Other Than Income** | | | | | | | | | | |
| 16 | Property Tax Expense............................................... | $ 2,491,300 | | | | | | | $ 2,491,300 | (297.14) | (740,269,359) |
| 17 | Payroll Tax Expense................................................. | $ 853,479 | | | | | | | $ 853,479 | (11.01) | (9,395,622) |
| 18 | Other Taxes............................................................. | $ - | | | | | | | $ - | | - |
| 19 | **Interest Expense..........................................................** | $ 3,845,087 | | | | | | $ 174,628 | $ 4,019,715 | (27.99) | (112,511,823) |
| 20 | **Sales Taxes.................................................................** | $ 1,347,718 | | | | | | | $ 1,347,718 | (50.30) | (67,786,515) |
| 21 | **School Taxes...............................................................** | $ 1,695,608 | | | | | | | $ 1,695,608 | (34.58) | (58,627,750) |
| 22 | **Franchise Fees............................................................** | $ 714,418 | | | | | | | $ 714,418 | (76.25) | (54,474,274) |

| | | |
|---|---|---|
| **Expenses Subject to Lead Lag Results** | $ 45,884,046 | $ (2,075,596,545) |
| **Weighted Days - Lead Days for Operating Expenses** | -45.24 | |
| **Average Daily Expense Subject to Lag** | $ 125,710 | |

| Line No. | Item | Amount |
|---|---|---|
| 23 | Recap: | |
| 24 | Expense Lead Days | -45.24 |
| 25 | Revenue Lag Days, Calendar Year 2023 | 54.54 |
| 26 | Net Lead Days | 9.30 |
| 27 | Average Daily Operating Expenses | $ 125,710 |
| 28 | Cash Working Capital Provided | $ 1,169,642 |
| 29 | Less: Delta Cash Working Capital Requested | $ 1,399,833 |
| 30 | Adjustment to Reduce Cash Working Capital | $ (230,191) |
| 31 | OAG Sponsored Pre-Tax Return | 8.62% |
| 32 | Nominal Revenue Requirement Adjustment - before GRCF | $ (19,837) |

**Delta Natural Gas Company Inc.**
**Cash Working Capital Calculation**
**Case No. 2024-00346**
**For the Forecasted Period Ended June 30, 2026**
**($ Millions)**

**Exhibit JWW-1**


| Line No. | Item | Amount | Adjustments | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Delta - Pro Forma Amounts | Incentive Comp. | Emp. Benefits | Lobbying | AGA Dues | To Remove Non-Cash Taxes | Interest Synchronization | Adjusted O&M | (Lead)/Lag Days | Dollar Days |
| 1 | **O&M Expense** | | | | | | | | | | |
| 2 | Purchased Gas | $ 16,227,683 | | | | | | | $ 16,227,683 | (41.76) | (677,695,611) |
| 3 | Payroll Expense | $ 12,054,195 | | | $ 23,330 | | | | $ 12,077,525 | (11.01) | (132,956,760) |
| 4 | Pension Expense | $ 143,115 | | | | | | | $ 143,115 | (11.01) | (1,575,497) |
| 5 | Incentive Compensation | $ 712,104 | $ (458,371) | | | | | | $ 253,733 | (256.70) | (65,134,381) |
| 6 | 401k Match Expense | $ 616,109 | | | | | | | $ 616,109 | (11.01) | (6,782,504) |
| 7 | Uncollectible Expense | $ 614,533 | | | | | | | $ 614,533 | (6.62) | (4,070,056) |
| 8 | Charges from Affiliates | $ 3,186,443 | | | | | | | $ 3,186,443 | (36.75) | (117,102,555) |
| 9 | Other O&M | $ 2,809,671 | | $ (1,152,293) | $ 7,871 | $ (22,582) | | | $ 1,642,667 | (16.57) | (27,213,838) |
| 10 | Total O&M Expenses | $ 36,363,853 | | | | | | | $ 34,761,808 | | $ (1,032,531,202) |
| 11 | **Income Tax Expense** | | | | | | | | | | |
| 12 | Current: Federal and State | $ 3,233,710 | | | | | $ (3,233,710) | | $ - | - | - |
| 13 | Deferred: Federal and State (EDIT Amort.) | $ (752,652) | | | | | $ 752,652 | | $ - | - | - |
| 14 | Total Income Tax Expense | $ 2,481,058 | | | | | | | | | $ - |
| 15 | **Taxes Other Than Income** | | | | | | | | | | |
| 16 | Property Tax Expense | $ 2,491,300 | | | | | | | $ 2,491,300 | (297.14) | (740,269,359) |
| 17 | Payroll Tax Expense | $ 853,479 | | | | | | | $ 853,479 | (11.01) | (9,395,622) |
| 18 | Other Taxes | $ - | | | | | | | $ - | | - |
| 19 | **Interest Expense** | $ 3,845,087 | | | | | | $ 174,628 | $ 4,019,715 | (27.99) | (112,511,823) |
| 20 | **Sales Taxes** | $ 1,347,718 | | | | | | | $ 1,347,718 | (50.30) | (67,786,515) |
| 21 | **School Taxes** | $ 1,695,608 | | | | | | | $ 1,695,608 | (34.58) | (58,627,750) |
| 22 | **Franchise Fees** | $ 714,418 | | | | | | | $ 714,418 | (76.25) | (54,474,274) |

| | | |
|---|---|---|
| **Expenses Subject to Lead Lag Results** | $ 45,884,046 | $ (2,075,596,545) |
| **Weighted Days - Lead Days for Operating Expenses** | -45.24 | |
| **Average Daily Expense Subject to Lag** | $ 125,710 | |

| Line No. | Item | Amount |
|---|---|---|
| 23 | Recap: | |
| 24 | Expense Lead Days | -45.24 |
| 25 | Revenue Lag Days, 12ME August 2024 | 48.95 |
| 26 | Net Lead Days | 3.71 |
| 27 | Average Daily Operating Expenses | $ 125,710 |
| 28 | Cash Working Capital Provided | $ 466,925 |
| 29 | Less: Delta Cash Working Capital Requested | $ 1,399,833 |
| 30 | Adjustment to Reduce Cash Working Capital | $ (932,908) |
| 31 | OAG Sponsored Pre-Tax Return | 8.62% |
| 32 | Nominal Revenue Requirement Adjustment - before GRCF | $ (80,393) |