BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into the application of the flexible pricing provision of Industrial Interruptible Service rate schedule of Florida Division of Chesapeake Utilities Corporation (former Central Florida Gas Company division).	)	DOCKET NO. 910701-GU
	)	ORDER NO. 25236
	)	ISSUED: 10/21/91

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
SUSAN F. CLARK
J. TERRY DEASON
MICHAEL McK. WILSON

ORDER APPROVING FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION'S APPLICATION OF THE FLEXIBLE PRICING PROVISION OF ITS INDUSTRIAL INTERRUPTIBLE SERVICE RATE SCHEDULE

BY THE COMMISSION:

This proceeding was initiated by our staff to have us review the manner in which Chesapeake Utilities Corporation (Chesapeake), formerly Central Florida Gas Company, applies the flexible pricing provisions of its Industrial Interruptible Service Rate Tariff. We have conducted such a review, and have decided that Chesapeake has applied its tariff in a manner consistent both with the terms of the tariff itself and with our intent in approving the tariff.

In September of 1985 (Order No. 14965), the Commission approved modifications to the interruptible rate schedules of three natural gas utilities; Peoples Gas, West Florida Natural Gas, and Central Florida Gas Company (now the Florida Division of Chesapeake Utilities). We recognized that the utilities were in danger of losing a significant portion of their interruptible load to lower priced alternate fuel sources, a circumstance that did not bode well for the economic viability of the utilities.

> . . .[L]oss of significant interruptible load by a utility could result in a request for relief that would seek to have the remaining investment (after reductions for that plant not used and useful) and costs borne by the remaining customers through higher rates.

We permitted the utilities to offer competitive discounts to their interruptible customers in the form of flexible rate tariffs. The new rates provided the utilities the opportunity to compete with alternate fuels and to address potential bypass by their interruptible customers. The rates benefitted both the utilities and their firm ratepayers by retaining interruptible load on the utility system, but the utilities were required to absorb all losses of revenue associated with the rate reductions under the new flexible rates.

In 1988, three years after the flexible rate tariffs were first approved, Peoples Gas System, Inc. petitioned for modification of its tariff to provide relief from the revenue losses the company had experienced in the implementation of flex rates. In December of that year (Order No. 20529), we approved the tariff modifications that Peoples suggested. Specifically we approved a "Competitive Rate Adjustment Clause" that permitted the company to recover from its other ratepayers the revenue shortfalls resulting from the application of its flexible rate tariff. The competitive rate adjustment clause also permitted the company to refund to other ratepayers any revenue surplus the company collected from the application of the tariff in times when the market for alternate fuels permitted the utility to raise its flexible rates above the usual tariffed rate. The tariff modification would, the Commission said:

> . . . permit PGS to recover revenues lost due to rate reductions to contract customers. The utility's proposal also presents the opportunity for non-contract customers to realize a reduction in rates through refunding of surpluses if natural gas again achieves a competitive advantage over alternate fuels used by the utility's contract customers. . .

Our decision in Order No. 20529 set the standard for other utilities to follow, and thereafter West Florida and Chesapeake received Commission approval for modifications to their flexible rate tariffs. The tariffs were similar to Peoples' tariff, with one significant difference. Peoples' tariff recovers all revenue shortfalls from its other ratepayers, and refunds all revenue surpluses to them. The company is held harmless from the results of the application of its flexible rates. West Florida's tariff and Chesapeake's tariff both provide, however, that the company and the company's firm ratepayers will share the burden of recovering the revenue shortfalls that occur when the company is forced to

lower its flex rates below the usual tariffed rate. Concomitantly, both the company and the company's firm ratepayers will share the benefit of recovering the surplus when the market for alternate fuels permits the company to raise its flexible rates above the usual tariffed rate.

When we approved Peoples' flexible rate tariff modifications in 1988, we did so because Peoples had been forced to lower its rates to retain its interruptible customers, and it had experienced significant revenue losses as a result. From the initiation of flexible rates, and in fact until September of last year, our whole experience with the application and effect of flexible rates had been in the context of lowering rates to interruptible customers to compete with alternate fuels.

The market has changed significantly since flexible rates were first developed. At present at least, natural gas competes effectively with alternate fuels on its own, and Chesapeake for one has never been forced to flex its interruptible rate downward to be competitive with its customers' alternate fuels. Thus it has never experienced any revenue losses associated with the application of its flexible rate tariff.

In September of 1990, the company flexed its interruptible rate upward, and collected surplus revenue from all of its interruptible customers, which it intends to split with its other ratepayers in conformance with the terms of its flexible rate tariff. The company contends that the tariff permits it to raise its rates to its interruptible customers even though it has never experienced any revenue losses. Otherwise, the company argues, there would be no reason or incentive to share the risks of loss on the down side.

The primary issue before us in this proceeding is whether Chesapeake's application of its flexible interruptible tariff provisions is consistent with our interpretation of the purpose and effect of those tariff provisions. In other words, may Chesapeake, solely upon its own evaluation of competitive conditions, flex its rate above the base non-energy fuel charge, whether or not it has previously suffered revenue loss from flexing its rate below that level?

We hold that, yes, under the provisions of its approved tariff, Chesapeake may flex its rate above the non-energy fuel charge based upon its own evaluation of the competitive conditions between natural gas and alternate fuels, whether or not it has

previously suffered revenue loss from flexing its rate below the non-energy fuel charge.

Chesapeake's Industrial Interruptible Sales tariff, which was effective July 9, 1990 provides;

> The non-fuel charge for service hereunder shall be subject to the flexible pricing mechanism described in the Rates section of this Rate schedule. It is the intention of Company that this charge shall be determined based upon competition with Customer's alternative fuel. . . . The non-fuel charge to Customer shall be determined by Company based upon Company's evaluation of competitive conditions. . . . Company may from time to time increase or reduce the non-fuel charge as it deems necessary or appropriate to compete with alternate fuel, but shall have no obligation to do so. . . .

Under the terms of the tariff, the company may recover from its firm ratepayers the revenue shortfalls that result from discounted interruptible rates. The difference between the discounted rates and the base non-energy fuel charge established in the company's last rate case based on the cost of service study is multiplied by the volumes billed each year ending September 30. One half of that amount is then recovered from all firm ratepayers during the following year, while the company bears the burden of the other half of the shortfall. The company may, at its option, defer all or a portion of the recovery to a subsequent period.

When the market for alternate fuels permits, Chesapeake may adjust its interruptible rates above the base non-fuel charge, and thus collect revenues from its interruptible customers that exceed the utility's cost to serve those customers. When Chesapeake collects a surplus, Chesapeake will reduce rates to its firm customers the following year by one half the amount of the surplus.

Rates that are based on cost of service are the means by which revenue deficiencies are allocated between rate classes based on cost causality. Those who create the cost pay the cost. This is not to say that every rate class always pays an equal rate of return or every rate class is always at parity based on the cost to serve. Consideration must be given in some cases to certain rate design constraints. Nevertheless, the cost of service principle in

ratemaking strives to achieve parity between rate classes wherever possible.

Flex rate pricing, however, is based upon value of service, not cost of service. Customers with alternate fuels are interested in cost of service only when it serves as a cap on gas rates and results in service at a price lower than competitive conditions warrant. If competing fuel prices drop, the customer has shown a willingness to abandon the cost of service philosophy and pressure the utility to lower rates to the value of service level. Strict adherence to cost of service principals should not obscure the objective of regulation to serve as a surrogate for competition where no competition exists. Regulation provides protection to the customer who needs protection when faced with a natural monopoly. By definition, a customer with a readily available alternate fuel does not face a monopoly with regard to fuel choice.

If Chesapeake should bill an interruptible customer at a rate that exceeds its alternate fuel cost, Chesapeake's tariff permits the customer to control its gas cost by providing an affidavit to Chesapeake showing the delivered cost of competitive fuels. After verification of the data, Chesapeake will reduce its billed rate to that customer. Thus, at any time, an interruptible customer can control its gas cost so it will be paying less for gas than for the next cheapest alternative.

Under all pricing conditions within the 0.00 cents to 90 percent of the applicable firm rate, the customer benefits by buying gas cheaper than the next lowest priced substitute. Firm customers benefit by having their rate reduced by the competitive rate adjustment in the following period. Finally, the utility shareholders benefit by having their earnings increase. It is hard to see who is harmed by letting competitive pricing forces operate in markets where customers have readily available substitute fuels.

Nonetheless, we retain control over the company's earnings, because the utility's increase in earnings is all treated above the line. If the increase causes the utility to earn above its authorized rate of return, the Commission can order a refund of the excess earnings.

We see no reason to restrict Chesapeake's application of its flexible rate tariff to require the company and its firm customers to experience a loss in revenue from competition with alternate fuels before they are entitled to benefit from an increase in revenue from that competition. While natural gas is competitively priced at present, it may not be so in the foreseeable future. The

operation of the market itself theoretically will ensure that over time the company, its firm customers, and its interruptible customers will bear equally the costs and the benefits of competition with alternate fuels. It is therefore

ORDERED that for the reasons discussed above, Chesapeake Utilities Corporation has applied its Industrial Interruptible Service Rate Schedule in a manner consistent with the policy and intent of the Commission. It is further

ORDERED that this docket should be closed.

By ORDER of the Florida Public Service Commission, this 21st day of OCTOBER, 1991.

STEVE TRIBBLE, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida

Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.

MEMORANDUM

October 18, 1991

TO : **DIVISION OF RECORDS AND REPORTING**

FROM: **DIVISION OF LEGAL SERVICES (BROWN)** MCB

RE : **DOCKET NO. 910701-GU**

25236

The attached order is ready to be issued: ORDER APPROVING FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION'S APPLICATION OF THE FLEXIBLE PRICING PROVISION OF ITS INDUSTRIAL INTERRUPTIBLE SERVICE RATE SCHEDULE

MCB
Attachment
cc: Division of Electric & Gas