State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: SEPTEMBER 24, 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF ELECTRIC AND GAS (BROWN, MAKIN, LOWERY, BULECZA-BANKS)
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (REVELL)
DIVISION OF LEGAL SERVICES (JAYE)

RE: DOCKET NO. 980895-GU - PETITION BY FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION FOR AUTHORITY TO IMPLEMENT PROPOSED FLEXIBLE GAS SERVICE TARIFF AND TO REVISE CERTAIN TARIFF SHEETS.

AGENDA: 10/6/98 - REGULAR AGENDA - TARIFF FILING - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: COMPANY WAIVES 60-DAY SUSPENSION DATE OF 9/14/98

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\EAG\WP\980895.RCM

CASE BACKGROUND

On July 15 1998, Chesapeake Utilities Corporation (Chesapeake) filed a petition for approval to implement a proposed Flexible Gas Service tariff and revise certain tariff sheets. On September 21, 1998, Chesapeake Utilities Corporation filed a revision to its petition. By this petition, Chesapeake seeks authority to implement a new Flexible Gas Service tariff. The tariff is designed to meet Chesapeake's need to compete for potential customers who have viable energy options in a way that assures existing customers will not be required to subsidize contracts entered into pursuant to the Flexible Gas Service Tariff. Chesapeake's proposed Flexible Gas Service tariff will apply to customers who demonstrate to Chesapeake that viable alternatives to natural gas exist. Only after receipt and investigation of a documented statement detailing a customer's option would Chesapeake offer Flexible Gas Service. A similar flexible gas tariff was approved by the Commission for City Gas Company of Florida in Docket No. 960920-GU, Order No. PSC-96-1218-FOR-GU, issued September 24, 1996.

Chesapeake also seeks to make changes in its tariff to expand payment alternatives to customers. Chesapeake proposes to expand its payment options to include payment by credit card or debit card. In addition, Chesapeake seeks authority to bill customer deposits to residential customers who are unable to physically come to the payment center. Billing the required deposit will facilitate the application process for new customers.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission approve Chesapeake's petition to implement a Flexible Gas Service Tariff?

RECOMMENDATION: Yes. The Commission should approve Chesapeake's petition to implement a Flexible Gas Service Tariff. (Brown, Makin, Lowery, Bulecza-Banks)

STAFF ANALYSIS: The purpose of the flexible gas tariff is to enable Chesapeake to compete for new customers, and maintain existing ones. The tariff is designed to attract new customers by having the flexibility to offer rates that can compete with other sources of energy such as propane, fuel oil, and electricity.

The tariff also serves to assist Chesapeake in maintaining existing customers who may choose to bypass Chesapeake's distribution system and connect directly to the pipeline or decide to move their establishment within the territory of a more economically friendly local distribution company.

As proposed, Chesapeake will only offer Flexible Gas Service after receipt and review of a documented statement detailing a customer's alternatives. The documented statement of alternatives, along with the executed contract, will be submitted to the Commission within 30 days of execution of the contract. The information will include the name of the customer, the contract rate, the alternative energy sources available, and a copy of the contract entered into between the customer and the Company. Because each contract will be separately negotiated, Chesapeake regards the confidentiality provision as an essential component of the tariff. Without the approval of confidentiality, Chesapeake could not offer the program.

The proposed tariff incorporates several protective measures designed to ensure that the general body of ratepayers will not be adversely affected by the adoption of the Flexible Gas Service tariff.

Chesapeake will not attempt to recover from other customers the difference between the otherwise applicable tariff rate and the Flexible Gas Service tariff, either through cost recovery clauses or directly or indirectly in future base rate cases.

For new customers served off Chesapeake's existing distribution system, the Flexible Gas Service tariff will have a floor price equivalent to the incremental cost of providing service to that customer.

To further clarify Chesapeake's objective for the tariff, to the extent that the company enters into flexible gas service agreements with customers, Chesapeake is at risk for the capital investment necessary to serve the flexible gas service customers, not the general body of ratepayers. With the exception of pipeline safety requirements, all elements of the agreement between Chesapeake and the flexible gas service tariff customers, including rates, terms, and conditions of service, are not subject to regulation by the Florida Public Service Commission.

Accordingly, Staff recommends the Commission approve Chesapeake's proposed Flexible Gas Service tariff.

ISSUE 2: What is the appropriate accounting treatment?

RECOMMENDATION: If Issue 1 is approved, the accounting treatment proposed by Chesapeake in Attachment 1 should be approved. However, Staff further recommends that the Commission review the results of th proposed accounting methodology to ensure that the remaining ratepayers are adequately compensated. (REVELL)

STAFF ANALYSIS: The Company indicates in its Petition that there will be protective measures in place to insure that existing customers will not be adversely affected by the adoption of this tariff. One such measure the Company proposes is for all capital costs, expenses and revenues associated with this tariff to be placed below-the-line for earnings surveillance report purposes. The tariff states that with the exception of pipeline safety requirements, any customers under this tariff are not subject to Florida Public Service Commission regulation. This economically deregulates any customers under this tariff.

If the Company's petition to establish this tariff is approved, the rate making treatment indicated in Attachment 1 is proposed by the Company. The Company proposes to make specific adjustments to its earnings surveillance report removing all capital costs, including a portion of common plant, Operation and Maintenance (O&M) expenses, and revenues from the per books amounts. The attachment states that the Company will use the methodology in the Company's most recently approved cost of service study to allocate common plant and embedded O&M expenses. Staff believes the Commission should reserve the right to audit and review all contracts and financial data associated with the tariff for the reasonableness of the results. Additionally, the Commission should reserve the right to change the methodology if necessary to achieve reasonable results.

This proposed tariff is somewhat similar to the tariff approved for City Gas Company in Order No. PSC-96-1218-FOR-GU, dated September 24, 1996, in that in both the City Gas tariff and the proposed tariff for Chesapeake, customers under this class will individually negotiate contract prices, and must demonstrate that the customer has access to an alternate fuel supply. City Gas presently has no customers under its tariff. Within 30 days of the signing of any contract, however, City Gas will submit detailed information about the contract to the Commission. The information to be submitted includes the name of the customer, the contract rate, the alternative energy sources available, and a copy of the contract.

Both tariffs are designed to eliminate any impact of negotiated rates under this tariff on the general body of ratepayers. The Chesapeake tariff, however, does not include the proposed accounting treatment in the body of the tariff itself as does the City Gas tariff. The accounting treatment proposed by Chesapeake is similar, but not identical, to that approved for City Gas.

The proposed accounting treatment also differs from the negotiated tariffs in effect for the largest investor-owned electric utilities. The tariffs for the electrics vary somewhat, but in all instances, all capital and O&M costs, and revenues received are included above-the-line.

It is probable that any customer under this tariff would be very large with other available energy sources, and would not need any regulatory protection. The intent is to remove customers from regulatory authority, with the remaining ratepayers isolated from the effects resulting from reduced revenues which could occur when companies have a contract under this tariff. According to Chesapeake's latest cost of service study, the cost to serve residential customers per dollar of revenue is higher than the costs required to serve large industrial customers. Under Chesapeake's present rate structure, residential customers are currently being subsidized by special contracts customers. Therefore, residential customers may be affected with the removal of the industrial revenues.

Whenever the rates for a customer class are above parity, the effect is that other customer classes below parity are being subsidized to some degree. According to Chesapeake's latest cost of service study, the rate of return on customers under the "Special Contracts" tariff, a tariff with individually negotiated rates, is above parity. The same analysis indicates that the rate of return for residential customers is below parity. The rate of return for special contracts customers subsidizes residential rates. These subsidies would be lost if these amounts were placed below the line, since present Special Contracts customers are the potential customers for the Flexible Gas Service tariff.

The remaining ratepayers may not be fully compensated through the use of fully allocated costs. Fully allocated embedded costs are usually less than current replacement costs. The Company is in a position to serve larger customers, in part, due to its current embedded distribution plant. The Company will be using the embedded distribution system paid for by the general body of ratepayers. By being in the natural gas business, the company will have certain advantages. It has an available experienced workforce to use on an as-needed basis for maintenance, administrative support and other customer services. Existing customers should be able to share in the benefits received from larger customer contributions to revenue.

If Issue 1 is approved, the accounting treatment proposed by Chesapeake in Attachment 1 should be approved. However, Staff further recommends that the Commission review the results of the proposed accounting methodology to ensure that the remaining ratepayers are adequately compensated.

ISSUE 3: Should the Commission approve Chesapeake's request to expand its payment options?

RECOMMENDATION: Yes. The Commission should approve Chesapeake's request to expand its payment options. (Brown, Makin, Lowery, Bulecza-Banks)

STAFF ANALYSIS: By allowing Chesapeake to expand its payment options to include payments by credit card or debit card, customers can benefit from the convenience of other alternatives of payment. The application process for new customers will therefore be expedited by these other alternatives.

ISSUE 4: What is the appropriate effective date for the Flexible Gas Service tariff and revise certain tariff sheets?

RECOMMENDATION: The effective date for the Flexible Gas Service tariff and revise certain tariff sheets should be the effective date of the Commission's vote. (Brown, Makin, Lowery, Bulecza-Banks)

STAFF ANALYSIS: Staff believes the effective date for the Flexible Gas Service tariff should be the effective date of the Commission's vote.

ISSUE 5: Should this docket be closed?

RECOMMENDATION: Yes. If no substantially affected person files a protest within 21 days of the issuance of the order, the docket should be closed. If a protest is filed within 21 days from the issuance of the order, the tariff should remain in effect with any increase held subject to refund, pending resolution of the protest. (Jaye)

STAFF ANALYSIS: If no substantially affected person files a protest within 21 days of the issuance of the order, the docket should be closed. If a protest is filed within 21 days from the issuance of the order, the tariff should remain in effect with any increase held subject to refund, pending resolution of the protest.

CHESAPEAKE UTILITIES CORPORATION
FLORIDA DIVISION
FLEXIBLE GAS SERVICE TARIFF
DOCKET NO. 980895-GU

Per Staff's request, Chesapeake Utilities Corporation ("the Company") offers the following additional information with respect to its Petition for Authority to Implement Proposed Flexible Gas Service Tariff.

Rate-making Treatment:

To the extent that the Company enters into flexible gas service agreements with customers, the Company is at risk for the capital investment necessary to serve the flexible gas service tariff customers, not the general body of ratepayers.

Rate Base:

In the case of providing service to a new customer under this tariff, the Company will identify the incremental capital costs, including construction work-in-progress, required to provide service to the customer. In this instance, the Company will separately account for all such costs, excluding them from rate base.

Where the customer is served from the Company's existing distribution system, a portion of the net book value of common distribution facilities, including mains and measuring and regulating stations, reflecting the customer's distance from the nearest point on an interstate Gas Pipeline and the size of pipe required to serve that customer's peak demand for gas shall be removed from rate base.

In the case of transferring an existing customer to this tariff, in addition to excluding all incremental capital costs and common distribution facilities from rate base, the net book value of the main, service line, and metering equipment that were specifically installed to serve the particular customer shall be removed from rate base.

Furthermore, in all cases, the Company will utilize the methodology approved in its most recent cost of service study to allocate common general plant and working capital to the flexible gas service customer, which shall also be removed from rate base.

Operating, Maintenance and Administrative Expenses:

As part of the cost of service analysis performed by the Company in determining the Customer's rate, the Company will specifically identify all incremental costs, if any, associated with the flexible gas service tariff Customer. These expenses will primarily be related to the incremental capital required to serve the customer. In addition, the Company will utilize its most recently approved cost of service study to allocate embedded costs including general distribution and maintenance, meter reading, customer billing and accounting, sales, and general and administrative expenses.

In future rate cases and earnings surveillance reports, the Company will exclude all operating, maintenance, and administrative costs related to this tariff as determined by this methodology.

Depreciation and Amortization Expenses:

The Company will exclude all depreciation and amortization expenses related to this tariff in future rate cases and in its earnings surveillance report. Depreciation and amortization expenses may be incremental and/or allocated and will be determined based on the rate base allocated to each customer under this tariff as defined above.

Revenues and Related Taxes:

Revenues related to this tariff will be excluded from regulated revenues. In filing quarterly earnings surveillance reports, the Company will remove actual revenues related to this tariff, as well as revenue related taxes and income taxes from its calculation of FPSC adjusted rate of return.

All cost allocations related to this tariff shall remain subject to FPSC audit.