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-

RECEIVED-FPSC 02 AUG -7 PM 2:40 COMMISSION CLERK

DATE: AUGUST 8, 2002

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF COMPETITIVE MARKETS & ENFORCEMENT (MAKIN, BULECZA-BANKS)
OFFICE OF THE GENERAL COUNSEL (STERN)

RE: DOCKET NO. 020277-GU - PETITION OF FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION FOR AUTHORITY TO CONVERT ALL REMAINING SALES CUSTOMERS TO TRANSPORTATION SERVICE AND TO EXIT MERCHANT FUNCTION.

AGENDA: 08/20/02 - REGULAR AGENDA - TARIFF FILING - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 60-DAY SUSPENSION DATE: 06/20/02 - COMPANY WAIVES THE 60-DAY SUSPENSION DATE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\CMP\WP\020277.RCM

CASE BACKGROUND

In April 2000, the Commission adopted Rule 25-7.0335, Florida Administrative Code, which requires each local distribution company (LDC) to offer the transportation of natural gas to all non-residential customers. The rule further provides that each LDC may offer the transportation of natural gas to residential customers when it is cost effective to do so.

At the time of the Commission's adoption of Rule 25-7.0335, the Florida Division of Chesapeake Utilities Corporation (Chesapeake or the Company) offered transportation service to non-residential customers that comprised approximately 70% of the Company's total system throughput.

At the end of December 2001, transportation volumes had increased to more than 96% of the total system throughput. The remaining sales customers on the Company's system included 663 non-residential customers, all of whom are in the low usage rate classifications, and cumulatively represent about 2.5% of total system throughput. The 9,587 residential customers account for the remaining 1.5% of system throughput.

Given the reduced level of its system throughput associated with sales service, and the continuing migration of its non-residential customers to transportation service, the Company believes that if it were to remain in the merchant function, it would find it increasingly difficult to deliver gas to its customers at competitive prices. Accordingly, on March 28, 2002, the Company filed its petition for authority to convert all remaining sales customers to transportation service and to exit the merchant function. Based on the Company's experience, the number of producers and/or marketers interested in providing gas supply for such a diminished level of usage on a stand-alone basis is limited.

Chesapeake has concluded that the only cost effective approach available to it is to completely exit the merchant function, and require all remaining sales customers convert to transportation service. This recommendation addresses Chesapeake's petition.

Jurisdiction over this matter is vested in the Commission by several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission approve the Florida division of Chesapeake Utilities Corporation's petition for authority to convert all remaining sales customers to transportation service and to exit the merchant function?

RECOMMENDATION: Yes. The Commission should approve Chesapeake's petition, effective August 20, 2002, the date of the Commission vote in this matter. (MAKIN, BULECZA-BANKS)

STAFF ANALYSIS: Under Chesapeake's proposal, a Transitional Transportation Service (TTS) would be established to facilitate the conversion of the remaining sales service customers to aggregated customer pools. Qualified gas marketers would be retained to administer the pools. These Pool Managers would have the capability of combining the gas supply requirements of customers in the TTS pool(s) with other customers served by the Pool Manager, both on and off the Company's distribution system.

Chesapeake believes its customers' gas supply needs are best served by a gas marketer with the ability to "rebundle" the Company's small volume gas users into a diversified, state-wide customer group consisting of industrial and commercial customers with different levels of weather sensitivity and peak usage. The increased market power of a larger overall customer group with greater gas volume requirements, would result in a higher probability of obtaining lower gas costs than would be achievable by the decreasing sales service volumes on the Company's system alone.

Chesapeake's approach will allow all stakeholders adequate time to develop the knowledge and experience needed for a successful transition to a fully competitive open market. Chesapeake would maintain a contractual relationship with the Pool Manager(s) throughout the transition period, which is designed to provide reliable service at reasonable prices, while gradually introducing more options and choices to a better informed customer group.

The TTS tariff includes a phased in transition period to be completed over several years. In addition, to avoid any conflict of interest or appearance of impropriety, the Company will exclude its own marketing affiliate from participating in all phases.

The implementation of Phase One would be for a two-year period where all remaining residential and non-residential sales customers would receive gas supply service through one qualified Pool Manager, selected by the Company through a Request for Proposals (RFP) process. The TTS agreement between the Company and the selected Pool Manager would be structured to provide customers the opportunity to select between two pricing options: a monthly indexed price, similar to the current PGA pricing mechanism, or a fixed price option that enables customers to mitigate the potential price volatility of the monthly indexed price.

Near the end of the initial two-year period, the Company would evaluate customer acceptance of the program, assess its own capabilities to expand program options, and make a determination of the feasibility and timing for initiating Phase Two. Chesapeake would also report to the Commission on the results of Phase One, and the customer education and implementation plan for Phase Two.

Staff recommends that the report should be submitted no later than 90 days from the conclusion of Phase One. If the tariff becomes effective on August 20, 2002, the report would be due no later than 90 days after August 20, 2004.

Phase Two would expand the choices available. The Company would retain, through an RFP process similar to that used in Phase One, a minimum of two Pool Managers. The Company would require each Pool Manager to offer a range of gas pricing terms and conditions. Customers would have the ability to choose between the two Pool Managers, and select the pricing option that best matched their individual circumstances. At the end of Phase Two, the Company would report to the Commission on the results of Phase Two, and the Phase Three customer education and implementation plan. The duration of Phase Two is left open, but is expected to be at least one year. Staff recommends that the Company be required to submit a letter when Phase Two ends, notifying the Commission that it has ended. As in Phase One, the Company should be required to file its report within 90 days of the end of Phase Two.

Phase Three would completely transition customers to a fully competitive marketplace. With its customers being better informed and having several years of experience with gas marketers and various pricing options, the Company would replace the TTS tariff with its Aggregated Transportation Service Program. Customers would be free to choose any Pool Manager authorized to deliver gas on the Company's distribution system, and negotiate price and other terms with no constraints imposed by the Company. Pool Managers would be authorized to directly solicit any and all customers for gas supply services.

The Company's proposal is carefully designed to avoid exposure of its customers to the risk of service disruption. The TTS Agreement provides for severe financial penalties and potential termination of the agreement in the event that the TTS Pool Manager fails to deliver gas. The Company is prepared to act as the supplier of last resort in the case of longer term problems.

The TTS Agreement would specifically define the Pool Managers' actions or omissions constituting a default, including: failure to observe the terms and conditions of the TTS Agreement; failure in performance of essential duties and obligations such as failing to deliver gas for an extended period without prior approval, force majeure, or re-relinquishing capacity outside the contract limits; engaging in price gouging, slamming or other improper or unlawful activities; and, failure to maintain financial viability.

Chesapeake would implement procedures and provide the oversight necessary to ensure continuity of service to the pool customers in a default situation. If the Pool Manager defaults during Phase One, the Company would act to terminate the TTS Pool Manager and, as the supplier of last resort, would recall the interstate pipeline capacity, arrange for gas supply, and perform all other necessary functions to ensure delivery to affected customers. If during Phase Two, either of the two TTS Pool Managers defaults, the non-defaulting Pool Manager would assume gas delivery responsibilities for all customers until arrangements to qualify a replacement Pool Manager could be made. If both Pool Managers default, the Company would act as the supplier of last resort, would recall the interstate pipeline capacity, arrange for gas supply, and perform all other necessary functions to ensure delivery to affected customers, until arrangements to qualify replacement Pool Managers could be made.

For the residential and small commercial customers transiting from sales to transportation service, the Company would maintain the customer service function, maintain customer account transaction records, and provide gas supply billing and collections indefinitely. Customers would continue to receive one monthly bill, and the Pool Managers' charges would appear in lieu of the Company's purchased gas adjustment. The Company would follow a prescribed hierarchy in applying customer payments. All payments would first be applied to any taxes and fees imposed by government; second, to Pool Managers' charges for gas supply; and third, to the Company's regulated transportation charges. Customers currently the transportation tariff (primarily large commercial and industrial customers) would have the option of getting billed directly from the marketer serving them or through Chesapeake

This payment hierarchy would enable the Company to retain the capability to disconnect customers for non-payment in the event of a partial payment. Applying the payment to the Pool Manager's gas supply cost prior to the Company's regulated charges would prevent customers from taking advantage of the absence of the Pool Manager's service disconnect authority by paying only the regulated charges. However, this arrangement would not provide protection to the Pool Manager in the event that the customer failed to pay at all. The Pool Manager would have the authority to appropriately secure customer accounts through cash deposits or similar means.

Chesapeake currently has the authority to collect a charge from Pool Managers opting to receive customer billing and payment processing services from the Company, in the amount of $5.00 per bill, applicable to the limited number of non-residential customers receiving transportation service. The Company proposes to reduce this charge to $2.00 per account per month applicable to all accounts receiving service from Pool Managers. The charge would be mandatory for the TTS Pool Managers, but remain elective for Pool Managers and other gas marketers serving non-residential accounts in the Company's aggregated or individual transportation service programs. The revenue generated by this charge will go to offset the costs needed to implement the computer systems necessary to accommodate a total customer transportation service environment.

As the Company prepares to exit the merchant function, participation in the purchased gas cost recovery proceedings will no longer be necessary. The Company filed its final true-up for the calendar year 2001 in the PGA docket in May 2002, indicating an over-recovery. Projected filings are due in September 2002, to determine the PGA cap for the year 2003. However, upon the activation of service by the Phase One TTS Pool Manager, there would cease to be any need for the Company to have an active PGA mechanism. Whatever over or under-recovery may have accrued at that time will be reviewed by the Commission for appropriate disposition by the Company. Chesapeake proposes to address that matter in a subsequent filing within ninety days of the termination of its gas sales merchant function. Based on the most recent data, it appears that the company will be in an over-recovery state for the period ended August 31, 2002.

The Company has submitted revised tariff sheets that incorporate the changes necessary to implement transportation service to all remaining sales customers.

Based on the Company's petition, Staff believes that Chesapeake's proposal to convert all remaining sales customers to transportation service and to exit the merchant function is appropriate and reasonable, and should be approved, and should become effective August 20, 2002.

ISSUE 2: Should this docket be closed?

RECOMMENDATION: Yes. If no protest is filed within 21 days of the issuance fo the Order by a person whose substantial interests are affected, the docket should be closed upon the issuance of a Consummating Order. (STERN)

STAFF ANALYSIS: If a protest is filed within 21 days of the Commission Order approving this tariff by a person whose substantial interests are affected, the tariff should remain in effect pending resolution of the protest, with any charges held subject to refund pending resolution of the protest. If no protest is filed, this docket should be closed upon the issuance of a Consummating Order.