BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF JEFF HOUSEHOLDER

ON BEHALF OF THE FLORIDA DIVISION OF

CHESAPEAKE UTILITIES CORPORATION

DOCKET NO. 000108-GU

ORIGINAL

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Jeff Householder. I provide energy consulting and business development services to natural gas utilities, propane gas retailers and government agencies. My business address is 2333 West 33rd Street, Panama City, Florida, 32405.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. Prior to beginning my consulting business in January 2000, I was Vice President of Marketing and Sales for TECO Peoples Gas from 1997 to 1999. I joined Peoples Gas subsequent to the 1997 TECO Energy acquisition of West Florida Natural Gas Company. At West Florida Natural Gas, I served as Vice President of Regulatory Affairs and Gas Management from 1995 to the TECO merger. Before that, in 1994-1995, I was Vice President of Marketing and Sales at City Gas Company, a division of the NUI Corporation. Prior to joining City Gas, I served from 1984 to 1994 as Utility Administrative Officer for the City of

Tallahassee. During my ten years with the City, I also held positions as Assistant Director of the Consumer Services Division and managed the Energy Services Department, a marketing and demand-side management unit. From 1981 to 1984, I was a Section Manager with the Florida Department of Community Affairs, responsible for administering the Florida Energy Code and related construction industry regulatory standards. I also served from 1980 to 1981 as an Energy Analyst in the Governor's Energy Office. From 1984 to 1995, concurrent with my other positions, I provided part-time consulting services to the natural gas, propane gas and homebuilding industries involving a variety of building code, marketing and energy regulatory matters. I am a 1978 graduate of Florida State University with a Bachelor of Science Degree majoring in Economics and Government.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I will provide an overview of the current market environment in which the Florida Division of Chesapeake Utilities Corporation (the Company) competes for business. I will include an analysis of the significant market risks currently facing the Company. My testimony will also elaborate on two significant elements of the Company's business plan: the recent expansion into Citrus County and the offer of unbundled transportation service to all commercial customers. I will describe the methodology used to forecast sales, customers and revenues for the Historic Base Year + 1 and the Projected Test Year. I will also sponsor the Company's fully embedded cost of service study and its proposed permanent rate design.

Q. ARE YOU SPONSORING ANY EXHIBITS TO YOUR TESTIMONY?

A. Yes. Composite Exhibit No. JMH-1 consists of the following: "A" is a list of MFR schedules I am sponsoring. "B" is a comparison of present and proposed rates by rate classification. "C" is an analysis of competitive fuel costs in the Company's service areas. "D" is a map of the Citrus County distribution system expansion. These MFR Schedules and other exhibits were prepared under my direction, supervision and control.

Market Environment

Q. HAVE THERE BEEN SIGNIFICANT CHANGES IN THE MARKET ENVIRONMENT IN WHICH THE COMPANY COMPETES FOR BUSINESS?

A. Yes. In the eleven years since the Company's last base rate filing, the natural gas industry experienced dramatic changes in its operating practices. Federal initiatives, culminating in FERC Order 636, substantially altered the long-standing market relationships between producers, transporters, distributors and customers. Gas marketers became major new entrants in the marketplace and interjected themselves into the traditional relationships between Local Distribution Companies (LDCs), interstate pipelines and end-use customers. Gas trading on the commodities market, the development of pricing indices, access to hedging and other risk management strategies, along with the emergence of an active secondary capacity market, are all relatively recent products of the new gas marketplace.

This "re-regulation" of the gas industry requires gas distributors to operate in a significantly more competitive business environment. The LDCs' historical role of operating the distribution pipe system is now substantially more complex. As interstate pipelines discontinued gas merchant functions, LDCs assumed a variety of new responsibilities, including purchasing gas supplies, reserving capacity on the interstate pipeline, and scheduling and controlling daily gas flows. The costs of providing such services were also shifted to the LDCs.

Q. HOW HAVE THESE CHANGES AFFECTED THE LOCAL MARKETS IN WHICH THE COMPANY DOES BUSINESS?

A. Following the federal model of unbundling, over the past seven years the Florida Public Service Commission (Commission) has approved several LDC tariff proposals to provide various levels of open access transportation service. Most regulated companies in Florida, including the Company, offer unbundled service to larger customers. Some Florida companies have expanded their transportation options, establishing consumption threshold eligibility for smaller commercial customers. In today's marketplace, commercial customers at all consumption levels routinely express interest in unbundled service options. The general publicity that has surrounded telecommunication and electric industry restructuring issues fuels the customer interest in natural gas unbundling. In response to this growing consumer interest in transportation service, the Commission recently adopted Rule 25-7.0335, F.A.C., requiring LDCs to offer transportation service to all non-residential accounts. As greater numbers of low-volume end-use customers elect transportation service, the interface between

the LDC, the interstate pipeline, a myriad of commodity providers and the customer grows in complexity. LDCs must be prepared to seamlessly provide service to customers under a dynamic set of operating conditions.

The local marketplace is in a state of transition. The interstate pipelines transferred the merchant function to LDCs. The LDCs, through their transportation tariffs, are transferring the merchant role directly to end-use customers, or to gas marketers providing a merchant service to customers. In many ways the LDC is caught in the middle. It must provide reliable distribution service to all customers connected to its pipe system. For certain types of customers, the LDC is currently obligated to provide merchant services for which it must hold long-term capacity contracts and reliable gas supply agreements. As more customers shift to unbundled transportation service, the LDCs finds itself responsible for maintaining gas supply and capacity holdings to serve the remaining bundled accounts. The load factors of the smaller customers are generally low and exhibit a higher degree of weather sensitivity. Shifting the higher load factor accounts to transportation makes it more difficult for the LDC to acquire reasonably priced gas supplies, and inevitably results in higher allocations of capacity costs to the smaller, low load factor customers.

Q. WILL THE INCREASE IN UNBUNDLED TRANSPORTATION SERVICE REDUCE THE LDCs' ADMINISTRATIVE OR OPERATIONAL RESPONSIBILITIES?

A. No. For a growing number of customers the LDC only provides transportation access for the shipment of the customers' gas. On the surface, it

may appear that transportation service relieves the LDC of many administrative concerns. However, in the FERC-approved interstate pipeline tariff, the LDC is the designated "Delivery Point Operator" for the interconnection between the interstate pipeline and the local distribution system. As such, the LDC has substantial responsibility for the gas volumes that are scheduled for delivery into its system. The actions of transportation customers on the LDC's system can result in imbalance situations with the interstate pipeline. The Delivery Point Operator is ultimately responsible for resolving these imbalances, including payments to the pipeline for overruns and penalties.

In the current market environment, the LDC must strive to provide high quality service to several distinct groups of customers. These customers exhibit radically different load profiles and usage characteristics. Some want to buy gas directly from the LDC, some only want transportation service. Some transportation customers want to use the LDC's interstate pipeline capacity, others want to acquire their own capacity. Some customers have alternate fuel capabilities, and others are close enough to the interstate pipeline to bypass the LDC's system completely. Effectively operating a distribution system in the present business environment requires that the LDC develop a far more comprehensive understanding of individual customers' gas requirements. It must maintain frequent communication with customers, marketers and the interstate pipeline. The LDC must also have the manpower and administrative tools necessary to manage the complicated contractual and operational activities

necessary to meet the different transportation service needs of all non-residential customers, regardless of size or rate class.

Q. IS IT POSSIBLE TO PROVIDE TRANSPORTATION SERVICE TO SMALL VOLUME CUSTOMERS AT A REASONABLE COST?

A. Yes. Aggregated transportation service groups several customers together in a "Customer Pool". From an administrative and operational perspective, the LDC views the pool as it would an individual transportation customer. The Customer Pool may include customers from many rate classes. Aggregation of individual customer volumes is solely for the purpose of extending transportation eligibility to small customers. Aggregation of volumes is not provided as a means to qualify for the lower rates afforded individual larger volume customers. Although the Company continues to maintain separate accounts with each member of the pool, providing typical account maintenance services, the gas supply and capacity requirements of customers in the pool can be aggregated. For example, nominations, scheduling and end-of-month balancing activities are handled on a pooled basis, rather than for each customer. Aggregated service enables smaller customers to transport without the LDC incurring the substantial cost of individually administering their commodity shipments. While administrative burdens for the LDC are less with an aggregated tariff than they would be providing unaggregated service, they are by no means eliminated. LDCs implementing such programs will require additional resources to effectively transition their customers to transportation service. Not only are additional personnel and equipment required, but significantly different administrative and

customer service skills are needed to ensure the seamless transition that transportation customers expect. In the current competitive market, LDCs simply cannot afford the risk of providing anything less.

Q. CAN YOU DESCRIBE IMPACTS, SPECIFIC TO THE COMPANY, THAT EXIST IN AN UNBUNDLED SERVICE MARKET?

A. The changing market environment is encouraging larger customers, with alternate fuel or bypass options, to challenge the traditional cost allocation methods that support the gas industry's rate designs. The Company's 1997 Rate Restructuring filing with the Commission (Order No. 98-0455-FOF-GU) is illustrative of this point. Two large industrial customers threatened to bypass the distribution system unless they received a rate decrease. The decrease ultimately approved by the Commission required a redistribution of the Company's revenue requirement among the other customers.

Expanding customer access to unbundled transportation service leads to increased customer purchasing sophistication. Open markets also attract new entrants looking for profit opportunities. The combination of expanded market access, more sophisticated purchasers and competitive suppliers places a downward pressure on margins in many rate classes. As local distribution systems expand transportation service options, margins in the larger rate classes will be difficult to maintain. In traditional cost of service rate design, larger customer groups frequently subsidized smaller groups. Maintaining these cross-class rate subsidies has become increasingly challenging. The Company is more exposed to the risks of potential rate shifts than most Florida LDCs in that its

industrial and large volume commercial (>100,000 annual therms) customers make up almost half of its total margin revenue. As margins shrink for the large customers, the Company must work hard to control costs. It must also look for opportunities to increase system throughput in an economically feasible manner as a means of recovering fixed operating costs and minimizing the need for future base rate increases.

Q. YOU CONTEND THE MARKET ENVIRONMENT FOR LDCs IS INCREASINGLY COMPETITIVE. CAN YOU ELABORATE ON THIS POINT?

A. Competition between LDCs for new service areas is substantially greater than at any time in my twenty years in the energy business. Gas-on-gas competition at the individual customer level has emerged as larger customers look for by-pass and margin reduction opportunities. It is not at all unusual to find a marketer, or gas consultant, working to direct connect an industrial customer with the interstate pipeline or leverage a rate reduction from the LDC. Further, competition from alternate fuel providers continually places the Company's throughput and margins at risk. While competition from alternate fuel providers is not new, it is at an unusually intensive level especially among electric utilities and propane retailers. Many fuel providers, primarily electric utilities, are offering products and services, in addition to fuel, that strengthen their competitive position. For example, energy audits, equipment servicing, voltage surge suppression, performance contracting and appliance leases are offered by various fuel providers, their unregulated affiliates or trade allies as a means of retaining the core energy business.

The reactions of energy providers to the new marketplace fall into two general categories. First, concern over potential revenue loss results in intensive efforts by regulated utilities to retain load and secure current account relationships, especially with large customers. These phenomena are evident across the country in both natural gas and electric utilities. The long-term, reduced price electric service contracts currently offered by several Florida electric providers to their larger customers are excellent examples of this reaction. Natural gas utilities have also addressed customer retention issues, for example, through flexible rate filings and special contract provisions.

The second major reaction to the opening of the energy market is a search for new customers. The opportunity to add new load is viewed by some as a hedge against likely load loss in a "re-regulating" environment. Other companies view substantial growth as the only means of survival in the emerging marketplace. As regulated energy providers search for new customers or attempt to add products and services for existing customers, alternate providers develop strategies to protect their revenues and increase their own market share. These strategies elicit responses, and so it goes.

Of course, competition has always existed in the energy industry. It is the intensity and pervasiveness of competition among all fuel providers that sets today's marketplace apart. In his testimony, Mr. Geoffroy provides specific examples that illustrate the level of competition experienced by the Company over the past few years.

Q. PLEASE IDENTIFY KEY RISKS, SPECIFIC TO THE COMPANY, IN THE CURRENT BUSINESS ENVIRONMENT.

A. There are at least six primary business risks facing the Company in today's market. First, and by far the most critical, is the risk that the Company will not be able to respond to the needs of its customers by providing the services and products they demand. Second, economic downturns in the primary industries served by the Company can have a significant impact on earnings. Third, if the Company is unable to grow its earnings base by feasibly expanding into new service areas, rates will ultimately become non-competitive. Fourth, to ensure earnings stability, the customer base must become more diversified and less dependent on non-captive, cyclical, and in some cases, declining industrial accounts. Fifth, market competition from alternate fuel providers poses an increasing risk to the Company's market share. Sixth, significant potential exists that the proposed interstate pipeline expansions into Florida will enable some of the Company's industrial customers to bypass the distribution system and direct connect to the pipeline.

Q. PLEASE DESCRIBE THE MARKET RISK ASSOCIATED WITH THE FAILURE TO MEET CUSTOMER NEEDS.

A. The fundamental goal of any company should be to provide products and services based on the needs of its customers, as defined by the customers. The Company invests significant time and resources contacting customers to discuss potential service options and operating procedures. Natural gas has always been an optional fuel choice. As the marketplace becomes more competitive,

customers in all rate classes will be exposed to multiple service options from a variety of energy providers. Gas marketers, interstate pipelines, fuel oil dealers, propane retailers and electric utilities have all responded to the re-regulating gas industry by expanding and refocusing their marketing efforts. The market is already operating in this manner at the large volume customer level.

Operating in an unbundled, competitive market exposes a regulated utility to challenges it is not typically prepared to handle. For example, the frequent and rapid adjustment of price to respond to (or create) market pressure is not a feature of a traditional regulated environment. It is, however, a reality in today's fuel business. Gas utilities and the Commissions that regulate them must seek to establish an operational framework that protects the interests of ratepayers while allowing the utility to meet customer needs in a competitive market.

Q. CAN YOU PROVIDE AN EXAMPLE OF THE COMPANY IDENTIFYING A CUSTOMER NEED AND WORKING TO PROVIDE A SOLUTION?

A. Recently, Company personnel contacted all customers using more than 50,000 annual therms to discuss improving and expanding existing transportation service options. It has also become apparent in discussions with smaller consumers that there is significant interest in transportation service at the lower consumption levels. The greatest interest was expressed by the national chain accounts, primarily in the food service and hotel industries. These accounts represent over 25% of the Company's commercial customers. The Company used the feedback provided by the customer contacts to develop the unbundled service plan included as part of this rate filing.

Q. THE SECOND RISK YOU IDENTIFIED INVOLVED ECONOMIC DOWNTURNS. WHAT IS THE ECONOMIC OUTLOOK FOR THE COMPANY'S SERVICE AREAS?

A. With the exception of the phosphate industry, the outlook is reasonably positive. Population growth, as forecast by the Florida State University Center of Population Study, will continue to increase in the Company's service areas. This forecast indicates that over the next ten years, population in Polk County will increase by almost 70,000 residents. The areas of Polk County served by the Company are expected to experience much of this growth, according to municipal population statistics published by the Polk County Economic Development Council. The Center for Population Study also forecasts that Citrus County will continue to grow, with an estimated increase in population of close to 30,000 by 2010. The areas of Hillsborough and Osceola served by the Company are also projected to experience substantial growth. The University of Florida's Bureau of Economic and Business Research (BEBR) projects that housing starts and non-residential construction activity can be expected to continue at a strong pace in each of the four counties served by the Company. The Company's primary service areas in Polk and Citrus counties are projected to grow at approximately 2880 and 1100 annual housing starts, respectively. Non-residential building activity in both counties is also forecast to increase through 2010, according to BEBR projections. Each service area provides excellent opportunities for increasing residential gas connections and serving the commercial businesses that typically follow residential development.

The Company's forecast of customer growth in the residential and small commercial markets were based on assessments of individual development projects and known conversion opportunities. The projections developed from the Company's independent market assessment, and used in the preparation of the MFRs, appear consistent with the building activity forecasts of the BEBR. While the recent increase in home mortgage rates may have an impact on future housing starts, no significant reductions in starts for 2000 are currently projected by any of the major developers contacted by the Company. Obviously, if interest rates continue to climb, one could expect that housing starts will slow. Interviews with several developers and mortgage lenders indicate only minor contractions in the Company's targeted upscale residential markets assuming interest rates remain in the 8-9% range. It is reasonable to conclude that residential growth in the Historic Base Year +1 and the Projected Test Year will be achieved as projected.

Q. THE PHOSPHATE INDUSTRY IN POLK COUNTY HAS HISTORICALLY BEEN THE COMPANY'S CORE INDUSTRIAL MARKET. WHAT ARE THE PROSPECTS FOR THIS IMPORTANT CUSTOMER GROUP?

A. The economic condition of the central Florida phosphate industry is not as positive as the homebuilding industry. Discussions between Company representatives and various managers of local phosphate plants, and a review of industry literature, indicate several factors contributing to a significant downturn in the industry. The U.S. Geological Society (USGS) publishes a variety of Mineral Industry Surveys. Its 1998 Annual Review of Phosphate Rock (published

in July 1999) provides an excellent overview of the industry that is consistent with the insights derived from the Company's discussions with local plant managers.

According to the USGS, world demand for phosphatic fertilizers is expected to grow over the next 5-10 years. However, much of the growth is in foreign markets. Brazil, India and China were the leading importers of phosphate in 1998. New phosphate production facilities are expected to come on line in Australia, Canada, China, India, Morocco and Jordan in 2003. These facilities will increase world phosphate production by 10%, and are expected to impact U.S. exports. Domestic marketable phosphate production has decreased over the past several years (a 4% decrease was experienced in 1998). As noted by the USGS, "U.S. mines operated at 80% of rated production capacity owing to several mines in Florida that were closed or operational for part of the year to reduce inventory and conserve reserves." The price of Di Ammonium Phosphate (DAP), the principal product of most central Florida mines, has been depressed over the past three years. Apparently, China significantly increased exports and drove the market price down, affecting exports from central Florida. Mr. Geoffroy's testimony provides additional information specific to the phosphate industry in the Company's service area.

The longer term concern related to the mines in Polk County is the depletion of the phosphate rock that has been their principal product. According to the USGS, "The mines in central Florida are shifting from exporting phosphate rock to higher value fertilizer materials, enabling some Florida mines to continue production." It appears that phosphate rock mining is shifting to areas south of

the Company's service area in Polk County. As reported by the USGS, IMC-Agrico Co. has purchased phosphate reserves in Hardee County, and is locating two new mines farther south of the current mining areas in DeSoto and Hardee counties, outside the Company's current service area. Although the Company intends to expand into Desoto County in the Arcadia area, it is not likely that it can feasibly serve the new IMC plant within the forseeable future.

Q. THE THIRD PRIMARY MARKET RISK YOU IDENTIFIED WAS RELATED TO THE COMPANY'S NEED TO GROW ITS CURRENT CUSTOMER BASE. PLEASE EXPLAIN.

A. In the April 15, 2000 issue of Public Utilities Fortnightly, Gerald Keenan, who heads PricewaterhouseCoopers' energy strategy practice in the United States, observed that, "... companies that don't grow, die." Mr. Keenan was discussing the need for companies to innovate, to find new ways to reach new customers and new markets. He points to industry restructuring and the emergence of new e-commerce technology as drivers, "requiring energy companies to find opportunities to create new wealth or watch others loot their markets." I could not agree more.

As noted above, the Company is already experiencing competition in its traditional markets. Added to the competitive threats is the downward pressure on margins from the larger volume customers and the decline in the local phosphate market. The restructuring activities in the gas industry do not drive the need to grow, they merely raise the stakes. Under any set of market practices, companies that fail to grow find themselves spreading the fixed costs of the

system over a stable, or more likely, a declining customer base. Rates increase, costs are cut, service is reduced, customers look for alternatives and the downward spiral begins. Another predictable feature of non-growth companies alluded to by Mr. Keenan is that innovation stops. The motivation to search for ways to serve customers better, quicker and smarter is lost, accelerating the decline in business. Fortunately, population growth in Florida provides ample opportunity to feasibly expand gas systems to serve incremental loads. The Company is actively pursuing such opportunities. The results of this focus on growth are included in the Company's forecast of customers and revenue.

Q. YOU INDICATE THAT THE LACK OF DIVERSITY IN THE COMPANY'S CUSTOMER BASE IS A BUSINESS RISK. PLEASE EXPLAIN.

A. The original business purpose of the Company's natural gas distribution system, under its prior owners, was to serve industrial customers in Polk County. Today, revenues from industrial accounts provide close to half the Company's margins. The Company's industrial revenues have traditionally cycled with the phosphate and citrus industries. The decline in the local phosphate industry and the margin erosions resulting from restructuring dictate that the Company find ways to reduce its dependence on industrial volumes. The expansion into Citrus County and the redirection of traditional sales resources signal a move by the Company to serve more diversified markets. This strategy is being implemented in two ways. First, the Company is investing in prudent system expansions to serve areas outside its historic territory. Second, a more aggressive marketing and sales approach is focused on capturing a greater share of the residential and

small commercial markets. Over time, these strategies will diversify the revenue base and help protect the Company and its ratepayers from the heavy reliance on industrial customers.

Q. PLEASE DESCRIBE THE MARKET RISKS FROM ALTERNATE FUEL COMPETITION.

A. Natural gas is not a monopoly fuel. All natural gas customers have fuel alternatives. Even the territorial protection from gas-on-gas competition offered by the traditional regulatory compact does not hold up for individual large volume accounts targeted by unregulated marketers willing to install pipe. In today's market, many large customers have viable access to #2, #5 or #6 fuel oil, propane or, in some instances, coal. Smaller customers, including residential customers, may elect propane service. All customers have access to electric service. I have already noted the significant increase in competitive focus by alternate fuel providers. In many cases the regulated LDC has difficulty meeting not only the alternate fuel price, but also the package of additional services that accompany the fuel. For example, the propane retailers often package a free equipment service offer in their price per gallon. They may also provide free interior piping or free appliances. These offers are difficult to counter in a regulated world, in which a LDC is limited to the customer incentives approved by the Commission in its conservation programs.

The market risks posed by alternate fuel competition can be distilled to three basic questions. One, can the LDC react to the price signals of the market in a manner that keeps customers burning natural gas? Two, can the LDC

provide sufficient additional services to compete with alternate fuel providers where fuel cost differences are marginal? Three, will the LDC have sufficient staff and customer education resources to actively compete for business?

Q. SEVERAL PROPOSED INTERSTATE PIPELINE EXPANSION PROJECTS HAVE BEEN ANNOUNCED. WHAT ARE THE POTENTIAL RISKS ASSOCIATED WITH THESE PIPELINE EXPANSION PROJECTS?

A. The Williams Company and Duke Energy recently announced a partnership to construct a new transmission pipeline (Buccaneer Pipeline) across the Gulf of Mexico to serve central and south Florida. ANR Coastal also has announced plans to construct a similar cross-Gulf project (Gulfstream Pipeline). FGT is pursuing a Phase 5 expansion of its system in Florida, and is considering a Phase 6 expansion. In addition, El Paso and Enron have announced plans to construct a pipeline from the Elba Island LNG terminal south to the Jacksonville market area. These projects have projected in-service dates between 2002-2004. All of the pipeline projects are targeting electric generators as their primary customers. The forecast need for increased electric capacity, coupled with limitations in import transmission capabilities, will apparently require significant generation additions in the near term.

The announced pipeline projects, if constructed, will impact Florida's natural gas distributors. The greatest risk to the Company is the possibility that existing customers will directly connect to the pipeline. For example, the current proposed route for the Gulfstream pipeline is in close proximity to several large industrial customers served by the Company in Polk County. In at least one case,

Gulfstream has requested an easement across the property of a large customer in the Bartow area. The potential loss of industrial customers to the pipeline would have obvious revenue effects on the LDC, but it also could result in potential stranded costs (capacity) and increased rate pressure on remaining customers. While the new pipelines offer LDCs the potential to serve new areas, there is no guarantee that the Company will successfully secure these areas. Competition for new territory already exists from Peoples Gas, City Gas and several municipal distributors.

Q. YOU HAVE FOCUSED ON A NUMBER OF RISKS IN THE MARKETPLACE. DOES THE NEW MARKET ALSO PROVIDE OPPORTUNITIES?

A. Absolutely. Many of the risks described above, especially those related to unbundled service, are being effectively managed. The Company's business strategies and marketing approach are already in transition, adapting to the new environment. A focused effort to provide extraordinary customer service at all levels of the Company is underway. Steps have been taken to minimize the stranded cost potential inherent in unbundled transportation service. The Company is actively seeking feasible system expansion opportunities to both grow revenue and diversify its customer base. This rate filing seeks Commission approval of several tariff revisions (unbundled transportation service, new rate schedules, changes in flexible pricing provisions) designed to better position the Company to compete in the new market arena.

The Company sees unbundled service as an opportunity. Providing additional choices to customers is consistent with the Company's move to provide premium service to all customer classes. Transportation service provides lower cost energy to the accounts that have alternative fuel options, helping to ensure that they continue to burn gas. The gas marketing companies operating in the Company's service area are viewed as business allies, helping to strengthen existing customer relationships and establish new accounts. Today's gas market environment provides excellent opportunities to retain existing accounts, add load and compete for new business. Mr. Geoffroy, in his testimony, provides several examples of the new business opportunities currently being pursued by the Company. He also elaborates on the resources required to effectively take advantage of such opportunities.

Citrus County Expansion

Q. PLEASE PROVIDE AN OVERVIEW OF THE COMPANY'S EXPANSION EFFORTS IN CITRUS COUNTY.

A. In 1995, Florida Gas Transmission Company (FGT) activated its "Phase Three" system expansion, significantly increasing natural gas pipeline capacity into Florida. The "west leg" of the FGT expansion includes a pipeline segment that runs through Citrus County, between the cities of Inverness and Crystal River. The Company conducted an extensive review of the market area. The existing commercial and small industrial markets offered substantial natural gas conversion opportunities. The population growth estimates, and the construction

activity projections from the BEBR, indicated steady increases in the residential and commercial new construction markets. Based on the information obtained in the market assessment described below, the Company determined that it could feasibly open a new natural gas service area in Citrus County.

The Company successfully negotiated franchise agreements with the incorporated cities of Inverness and Crystal River. The unincorporated cities of Lecanto and Homosassa Springs as well as the populated areas of the county were also targeted for service. The Company completed a pipeline interconnection with FGT in February 1999, and immediately began installing primary main facilities to serve Citrus County.

Q. HOW DID THE COMPANY ASSESS THE MARKET POTENTIAL OF CITRUS COUNTY PRIOR TO INITIATING THIS EXPANSION?

A. The Company conducted an extensive assessment to identify opportunities in the Citrus County market. Five primary elements of the market were evaluated.

1. The Company identified opportunities to convert existing commercial businesses and industrial facilities to natural gas.
2. Residential market potential was evaluated.
3. The future growth of the County was assessed.
4. Potential competitive threats were analyzed.
5. The reaction of the communities targeted for service was considered.

Q. PLEASE DESCRIBE THE COMPANY'S EVALUATION OF THE COMMERCIAL AND INDUSTRIAL MARKETS.

A. The Company performed a survey of existing commercial and industrial businesses. Company representatives spent considerable time identifying and contacting commercial business owners. For obvious reasons, businesses with existing propane gas and fuel oil facilities were targeted. In total, the Company identified 111 existing commercial/industrial businesses as potential natural gas customers. When converted to natural gas, these accounts were projected to consume approximately 1,975,000 therms per year. The Company utilized only the commercial customer sales estimates to prepare the initial feasibility analysis for Citrus County.

Q. PLEASE DESCRIBE THE COMPANY'S ASSESSMENT TO DETERMINE THE POTENTIAL RESIDENTIAL MARKET.

A. The second component of the Company's market assessment involved a review of the residential market. Company representatives met with several developers and builders active in the Citrus County market. Based on these discussions, and observations of propane use in existing neighborhoods, the Company determined that natural gas could obtain a significant share of the residential market. The sites of two major multi-phase developments are located along the route of the initial primary feed system. The Black Diamond Ranch development is an upscale project of approximately 385 existing homes, with a total of 792 homes anticipated at build-out in 2005. Its developer became very interested in the extension of natural gas service to his project. He is a strong supporter of natural gas. His company allowed access to the private

development and provided right-of-way easements that significantly reduced the Company's gate station and main installation costs.

The second large development, Citrus Hills, includes twenty-two separate residential subdivisions and a number of commercially zoned land parcels. There are 2500 existing homes in the Citrus Hills subdivisions, with another 15,000 homesites to be developed over the next twenty years. The Citrus Hills developer also agreed to allow the installation of gas mains in all of his subdivisions, and provided right-of-way access for mains and a distribution system rectifier facility which provides corrosion protection for the Company's steel gas mains throughout the system. The Black Diamond and Citrus Hills developments are strongly committed to providing all gas homes.

As noted above, the initial feasibility analysis for the Citrus County primary feed included only commercial customers. All of the residential service has been separately evaluated.

Q. HOW DID THE COMPANY CONSIDER FUTURE GROWTH OPPORTUNITIES IN CITRUS COUNTY?

A. An analysis of future growth opportunities was the third component of the Company's market assessment. One of the elements in deciding to serve Citrus County was the level of sustained growth projected over the next ten years. The Florida State University Center for Population Study projects the Citrus population will increase from its current population of 118,800 to over 145,000 by 2010. The county's cost of living price level index is below the state average in all categories. Housing costs are particularly attractive compared to metropolitan

Tampa. The tax rates are relatively low. Essential services, especially schools and health care, are developing on pace with population increases. Generally, the county appears to be encouraging growth and development. An Economic Development Council, with full time staff, was recently organized to begin actively promoting business and industrial development.

There are a number of road improvement projects both underway and in the planning stage that will promote continued growth. The most notable of these is the extension of the Sun Coast Parkway north from Tampa. The Parkway is currently under construction. According to the Florida Turnpike Office, the Parkway will connect to the existing Veterans Expressway in north Hillsborough County, and extend approximately 80 miles through Pasco and Hernando counties. The present phase of construction, terminating at State Road 50, is scheduled to open to the public in January 2001. A second phase of construction north to Highway US 98 at the Hernando/Citrus County Line is scheduled to open in July 2001. An additional extension of the Parkway is included in the Governor's Mobility 2000 Plan. If approved, the Parkway would be extended through Citrus County intersecting with US 19 north of Red Level within the next ten years. For Citrus County residents, the Parkway will shorten the commute to Tampa to about an hour. Citrus County planners are anticipating a substantial population migration from Tampa, as is already occurring in Pasco and Hernando counties.

The Citrus County Economic Development Council continues to project that most of the county's growth will come from retirees moving from the mid-

west and northeast. Discussions with local builders indicate that substantial numbers of these individuals are moving from communities served by natural gas systems. These customers desire gas service in their new homes. Developers in Citrus County have for years provided propane gas options as a substitute for natural gas. Many believe the inclusion of natural gas as a standard will increase the marketability of their homes.

Company marketing personnel frequently meet with local developers and builders to review their plans for future development. Both the Black Diamond and Citrus Hills developers have expansions to their current developments underway that will add approximately 2000 building lots over the next eighteen to twenty-four months. They also have several new projects in the design phase. Both developers have already acquired property for these projects and plan to begin construction on them in the next 3-4 years. These new projects will result in the addition of over 5000 building lots to the Citrus County inventory. Other large-scale developments are underway in the Homosassa area. Sugarmill Woods is a PUD of over 6500 lots off US19. Another section of Sugarmill Woods, with over 3000 lots, is planned subsequent to the Parkway construction. The buildout period for this development is scheduled for 2015. Other smaller developments are planned throughout the county. The Company tracks the pace of these projects through frequent contact with developers, builders, county planners, local engineers and utility contractors. As the population base increases, the service industries that follow will be prime candidates for natural gas.

Q. PLEASE DESCRIBE THE COMPANY'S ANALYSIS OF THE COMPETITIVE SITUATION IN CITRUS COUNTY.

A. The Company invested significant time in the evaluation of competitors in the Citrus County market. The primary competition in Citrus County comes from propane gas retailers and electric utilities. At present there are five national and seven local or regional propane companies operating in the county. Most of these companies have an active homebuilder program and each is very competitive in the commercial market. Surveys were conducted with customers and builders to identify price levels and incentive offerings. The Company determined that its rates, program incentives and the non-price advantages of natural gas would be able to compete with propane in all customer classes.

The Company also analyzed potential competition from the electric utilities operating in Citrus County. Electric service is provided by Florida Power Corporation and two rural electric cooperatives: Withlacoochee Electric and Sumter Electric. The REAs will likely provide the greatest competitive challenge. REAs are free to offer cash and other incentives to homebuilders and commercial customers without regulatory scrutiny. Their pricing policies are also not regulated to the same extent as those of Florida Power. For example, Withlacoochee Electric has a developed a program that penalizes homebuilders through increased underground electric service fees if gas is used for heating and water heating. Most of the developing areas in the service territory, however, are served by Florida Power. The operating practices and pricing policies of Florida Power are regulated in the same general manner as are those of the

Company. The Company has experience competing with regulated electric companies. The pricing mechanisms and conservation incentive programs offered by the Company are reasonably competitive. The Company concluded that it could effectively compete for business in the great majority of the Citrus County territory.

Q. DID THE COMPANY INVESTIGATE THE REACTION OF THE COMMUNITY TO ITS EXPANSION INTO CITRUS COUNTY?

A. Yes. The fifth component of the Company's market assessment was an evaluation of the probable political and community reaction to the construction of a natural gas pipeline system in the county. Company representatives met with key community leaders as well as potential customers. Franchise agreements were pursued with each incorporated city. Discussions on natural gas operations were held with city and county public works and building inspection departments. The Company met with a number of local plumbers, appliance dealers and air conditioning contractors to solicit their participation in providing gas service to the county. Meetings were held with community groups and media coverage encouraged.

Q. HAS THE RESPONSE FROM THE COMMUNITY BEEN POSITIVE?

A. The response has been overwhelming. Community leaders are endorsing natural gas as an important component in their efforts to attract clean industry to the area. The Company's franchise agreements are approved and in effect. As the primary main is installed and activated, business owners are converting to natural gas. Residential developers are requesting gas service in all new projects

and are interested in retrofitting existing subdivisions, where feasible. The two major developments targeted for service, Black Diamond and Citrus Hills, are building all gas homes in every area and the Company has installed distribution piping. The biggest challenge faced by the Company to date is keeping pace with the demand for service.

Q. CAN YOU BE MORE SPECIFIC ABOUT THE OPPORTUNITIES TO ADD BUSINESS IN CITRUS COUNTY?

A. Let me start out by saying that the Citrus County gas expansion is in the first stages of development. The great majority of the system has been active less than ninety days. At the end of April 2000, the Company had installed 113 services. The Company's 2000 Budget forecasts 252 residential accounts and 56 commercial/small industrial accounts will be added this year. Based on the reception received during a mid April sales contact of all commercial customers on the primary main, the Company is confident that the commercial service goals will be achieved. The Company is also on target to connect the forecast residential customer goal.

The five-year customer growth forecast assumes additions of 250 residential accounts and 14 commercial accounts per year through 2004. Black Diamond Construction is planning to complete 80 new homes in 2000 and projects an additional 100 in 2001, all on main. The Citrus Hills developments anticipate closing 300 homes in 2000, growing to 400 in 2001. Of these units, the Company estimates that 150 and 200 respectively will be on main and served by gas. Citrus Hills anticipates increasing its annual closing rate to over 500 homes

by 2002. Both the Black Diamond and Citrus Hills developers continue to project increases in home starts, even in the face of rising interest rates. On the commercial side, most of the accounts the Company will serve are food service, laundry, clubhouse and medical facilities. There is a hospital and five assisted living facilities along the route of the primary main. In total, the Company anticipates connecting 1250 residential and 111 commercial customers, with annual consumption of 2,224,600 therms, by the end of 2004.

Q. CAN THE COMPANY FEASIBLY SERVE THE RESIDENTIAL MARKET IN CITRUS COUNTY?

A. Yes. The residential accounts added in Citrus County are expected to consume an average of 485 therms per year. Some of the home models currently being constructed will consume twice that amount. Most of the residences targeted to receive natural gas service are large, upscale homes with several gas burning appliances. Over 60% of these residences will have gas pool heaters. Most have gas fireplaces and grills in addition to the water heater, dryer and range. The Company is working with several local HVAC contractors to encourage the use of gas furnaces and are beginning to see an increase in furnace installations. The builders want gas service in their homes and have demonstrated a willingness to work with the Company to control costs and add burner-tips.

Each extension of the existing distribution system to serve residential accounts is subject to a cost feasibility analysis in accordance with the Company's existing Extension of Facilities tariff requirements (Sheet No. 33). To

date, each residential extension has produced sufficient estimated revenues over the current five-year analysis period to easily exceed projected capital expenses.

Q. PLEASE DESCRIBE THE CITRUS COUNTY DISTRIBUTION SYSTEM IN PLACE AT THIS TIME.

A. At the end of December 1999, the Company had completed 33 miles of main in Citrus County. At that time, the primary main infrastructure was approximately 80% complete. Construction on Phase One of the project began in October 1998. The Company acquired property and constructed a gate station along the FGT main line on CR 486 near Lecanto, Florida. A six-inch steel main runs east on CR 486 to the Brentwood subdivision. A four-inch main is in operation south on CR 491 to SR 44. A four-inch plastic main extends west from the gate station along CR 486 to SR 44, and continues toward Crystal River. Prior to reaching Crystal River, the main loops around the northeast side of town, intersecting US 19, at the Crystal River Mall. A four-inch plastic main runs north on US 19, terminating at the Comfort Inn Motel. Due to the right-of-way congestion along US 19 through Crystal River, the main has been installed on side streets one block west (Cutler Spur) and east (2nd Avenue) of US 19. The main returns to US 19 south of Crystal River and continues into Homosassa Springs.

Phase Two construction began in August 1999. The Company installed a six-inch steel main from the Brentwood subdivision east along CR 486. The main turns south through the Citrus Hills development, ultimately intersecting SR 44 at Kensington Street, and continues east for 1.5 miles on SR 44 toward Inverness.

Q. IS ADDITIONAL INVESTMENT REQUIRED TO COMPLETE PHASE ONE AND PHASE TWO OF THE PRIMARY FEED SYSTEM?

A. Yes. The final segments of the initial primary feed system are scheduled for completion by mid-summer of 2000. There are two remaining segments that will be installed. A planned one-mile extension along CR 491 from SR 44 to the County Jail awaits the completion of a county road widening project, anticipated by the end of May 2000. This segment will complete Phase One of the primary feed. The five-mile extension into Inverness along SR 44 that will complete Phase Two of the project has been designed and permitted. Construction will begin in May 2000. Both projects are funded in the Company's 2000 capital budget. In the future, the Company anticipates constructing a second interconnect with FGT below Homosassa Springs and tying the existing distribution system to the new gate station. The additional interconnect would significantly increase system reliability and would also enable the Company to serve the anticipated customer growth in south Citrus County.

Q. PLEASE DESCRIBE THE DISTRIBUTION SYSTEM EXTENSIONS BEYOND THE PRIMARY FEEDS.

A. The primary feed was designed to serve the commercial loads along SR 44, CR 486, CR 491 and US 19, the areas of concentrated commercial development. In addition, there are several distribution system extensions that are providing service to customers off the primary feed. The feasibility of each of the distribution system segments was determined with separate evaluations. The first is providing service to the Black Diamond development on CR491. The

distribution system has been extended to the majority of the existing streets in the development. The Company plans to serve new sections of Black Diamond as they are developed.

The second distribution network is under construction in the large Citrus Hills development between SR 44 and CR 486, west of Inverness. As noted above, Citrus Hills currently includes twenty-two residential subdivisions. Citrus Hills is a mixed-use project that is constructing multiple home types and commercial occupancies. Three Citrus Hills subdivisons were targeted for immediate service: Hillside, Brentwood and Belmont. The developer estimates that approximately 50% of the development in Citrus Hills over the next 2-3 years will occur in these subdivisions.

Smaller scope extensions are underway to serve the Pine Lake Middle School and to extend service from the primary main to serve customers along US 19 in Crystal River.

The projects listed above complete the distribution system currently planned for Citrus County. There are several opportunities to provide service to additional residential subdivisions and to commercial customers off of the primary feed route. For example, the Seven Rivers Hospital is two miles north of the terminating point of the primary feed on US 19. Discussions with the hospital indicate a strong interest in converting from propane to natural gas. The hospital extension, and any other extensions to serve areas of development beyond the primary feed route, will be considered on an individual basis in accordance with the five-year MACC requirements included in the Company's existing tariff.

Q. HOW DID THE COMPANY ASSESS THE INVESTMENT COSTS REQUIRED TO SERVE CITRUS COUNTY?

A. A fundamental part of the overall feasibility analysis of the Citrus County expansion was the determination of the costs required to install the gate station and primary feeder main system. The primary feed project was divided into three major phases for analysis. Phase One included the construction of a gate station interconnect with FGT and the installation of approximately 25 miles of steel and plastic gas main generally following CR 486, SR 44 and US 19. The initial phase of construction was designed to provide service to Crystal River, Lecanto, Homosassa Springs and commercial customers outside these cities along the pipeline installation route. Phase Two was projected to continue the primary feed main an additional 13.5 miles from the Brentwood subdivision on CR 486, through Citrus Hills to SR 44 and west into Inverness. Phase Three analyzed the opportunity to install approximately 5 miles of main east from Citrus Hills to SR 41and then north on SR 41 to Hernando. Exhibit No. JMH-1 (D) provides a map of the Citrus County expansion project detailing the construction activities to date.

Two residential developments, Black Diamond Ranch and Brentwood, were evaluated for feasibility concurrent with Phase One of the primary feed. Although not part of the Phase One analysis, the subdivisions were individually determined to be feasible and were incorporated into the overall design of the initial system. Phase Two of the primary feed was similarly designed recognizing that service to several subdivisions in the Citrus Hills development was feasible.

As noted above, feasibility for these subdivisions was separately evaluated. None of the construction costs or projected revenues from residential developments were used in the Phase One or Phase Two primary feed feasibility determination.

The Company's operations and engineering personnel invested substantial time in Citrus County evaluating main installation options. In concert with the results from the marketing assessment, routes were established that optimized the customer connection opportunities at the lowest construction cost. A review of demand requirements resulted in a determination of pipe size and operating pressures. The Company negotiated with property owners and government agencies to establish site selections for the gate station and rectifier system. Local engineering firms and underground utility contractors were contacted to assist with design, permitting and construction issues. The Company's overall plan was reviewed with FGT to determine gate station costs, operational parameters and capacity availability. Based on the information gained during this operational assessment, the Company prepared detailed cost estimates for each phase of the project.

Q. PLEASE PROVIDE SPECIFIC INFORMATION ON THE COST ESTIMATES AND FEASIBILITY DETERMINATIONS FOR EACH PHASE OF THE CITRUS EXPANSION PROJECT.

A. The Company evaluated the initial investment to serve Citrus County using an Internal Rate of Return (IRR) model. The model's primary inputs include capital structure, debt and equity costs, capital investment costs, revenues from

projected sales, a composite depreciation rate and an analysis term. The revenue stream follows the life of the assets over a thirty-year period. Annual cash-flows are calculated. Given the assumptions, an IRR percentage is computed and compared to the Company's weighted cost of capital. Projects exhibiting IRR results above the capital costs are judged to be feasible.

Phase One capital costs were estimated at $1,211,000. This estimate included the costs of service lines and meters to serve the commercial customers associated with Phase One. The marketing assessment forecasted annual sales of 800,000 therms from 64 commercial customers. Projected annual revenue from Phase One customers was $184,000, at current rates. The IRR model generated a 10.11% return. The weighted cost of capital was 9.34%.

The additional phases of the primary feed system were evaluated using the same IRR model. Phase Two capital costs were estimated at $1,356,000. Forty-three commercial customers were projected to consume 1,105,000 annual therms. Annual revenues from sales were estimated to be $234,000 at current rates. The IRR model generated a 10.88% return. The weighted cost of capital assumed for Phase Two was 9.16%

Phase Three capital costs were estimated at $440,000. Annual margin revenue from customers was estimated at $16,000. The project could not be cost justified and has been placed on hold. The future development of an industrial park in the Hernando area could result in this project achieving an appropriate return.

The results of the IRR for the primary feed system generated a reasonable return on investment for a start-up system expansion. The Company was conservative in its IRR analysis. The revenue projections (and costs) used to calculate the IRR are exclusively from existing commercial customers adjacent to the primary feed route. Residential market opportunities, commercial customers off the primary route and commercial customer growth projections were not included.

All of the extensions beyond the initial investment in the primary feed have been evaluated in accordance with the Company's existing Extension Of Facilities tariff and meet the Maximum Allowable Construction Cost (MACC) requirements for extensions of an existing distribution system.

Q. WHAT IS THE COMPANY'S TOTAL CAPITAL INVESTMENT, TO DATE, IN CITRUS COUNTY?

A. As of December 31,1999, the Company's total capital investment in the Citrus County expansion was $2,267,328. The gate station, including the FGT tap and odorization equipment, totaled $129,453. The Company invested $2,008,417 in the primary feed and distribution mains. The investment in vehicles, office and field equipment and other general plant items totaled $129,459. Additional capital expenditures through April 2000, are approximately $474,800, bringing total project capital investment to $2,742,128.

Q. WHAT IS THE PROPOSED LEVEL OF CONSTRUCTION SPENDING THROUGH THE PROJECTED TEST YEAR IN CITRUS COUNTY?

A. The Company estimates that capital spending for Citrus County will total approximately $5,000,000 at the end of the Projected Test Year. The 2000 and 2001 projected expenditures are included in the Company's construction budget, as outlined in MFR Schedule G-1, pages 23 and 26, respectively.

Q. SHOULD THE COMPANY'S INVESTMENT IN CITRUS COUNTY BE INCLUDED IN RATE BASE?

A. Yes. All of the facilities and equipment located in Citrus County are used and useful in the public service. At the end of April 2000, the Company had installed 113 services in Citrus County. By the end of the Projected Test Year, 65 commercial accounts and 502 residential accounts are projected to be on-line. As noted above, both Phase One and Phase Two of the primary feed meet a reasonable and conservative Internal Rate of Return hurdle for this type of long-term infrastructure investment. All investments beyond the primary feed system were determined to meet the existing tariff's MACC requirements for system extensions.

Unbundled Transportation Service

Q. THE COMMISSION RECENTLY ADOPTED RULE NO. 25-7.0335, F.A.C., REQUIRING LDCs TO FILE UNBUNDLED TRANSPORTATION SERVICE TARIFFS BY JULY 1, 2000. HOW WILL THE COMPANY RESPOND TO THIS NEW REQUIREMENT?

A. Included in the Company's rate case filing are tariff revisions that will provide unbundled service choices to all non-residential customers. In developing

its proposed transportation program, the Company invested considerable time discussing various service options with customers. Additionally, a number of transportation programs offered by gas utilities in Florida and across the country were investigated. The Company's conclusion is that larger volume accounts (over 100,000 annual therms) should be provided an opportunity to transport on an individual basis. Smaller accounts are most cost effectively served through a transportation mechanism that aggregates a number of accounts together in "customer pools". Aggregation will reduce the administrative cost of providing transportation service to small users principally through the pooling of nomination, scheduling, capacity release and balancing activities. The Company's proposed unbundled service plan provides an aggregated transportation option to all non-residential customers and both an individualized transportation and aggregated transportation option to all non-residential customers meeting a minimum annual consumption threshold of 100,000 therms.

The Company will welcome active participation by qualified marketers in all its transportation service programs. The Company is proposing straightforward program requirements that should encourage customer participation. A customer awareness campaign to educate non-residential customers on transportation service opportunities is also proposed. All non-residential customers would be contacted through direct mailings or by Company personnel to review their transportation options. The Company plans to provide a list of the non-residential accounts in its service areas to all qualified marketers. Of course, the Company will contact all non-residential accounts to seek

individual customer approval prior to including a customer on such a list. The Company is also willing to provide a list of qualified gas marketers to all contacted customers. Company personnel are prepared to schedule regular meetings with customers and gas marketers to ensure an appropriate venue for the discussion of operational policies, service issues and program improvements.

Q. PLEASE DESCRIBE THE COMPANY'S CURRENT UNBUNDLED TRANSPORTATION SERVICE PROGRAM.

A. The Company currently offers transportation service under the provisions of five existing rate schedules. There are thirty-five total transporters on the Company's system at this time. The first option, provided under the Firm Transportation Service (FTS) Rate Schedule, offers firm transportation service to any individual customer transporting at least 200,000 therms per year. The transportation and monthly customer charges are the equivalent of the Industrial Sales Service (ISS) rate. The Company currently serves twenty-four customers under the FTS rate schedule.

The second unbundled service option is the Contract Transportation Service (CTS) rate schedule. This service option provides transportation service to customers with alternate fuel capabilities transporting at least 200,000 up to 20,000,000 annual therms. The CTS transportation charge is flexible. The base rate is negotiated with the customer based on alternate fuel market conditions, and can range from $0.00 per therm to 90% of the customer's currently applicable firm rate. A monthly customer charge of $350.00 is billed to all CTS accounts. A base transportation charge of 5.312 cents per therm is applicable

under this schedule. These charges are identical to the Company's Interruptible Sale Service (ISS) rates. At present, five customers transport on the CTS rate schedule.

The third transportation option is available to customers transporting over 20,000,000 therms per year on a firm or interruptible basis. The Large Volume Contract Transportation Service (LVCTS) rate schedule has no monthly customer charge. Billing rates are negotiable, but must recover no less than the fully allocated cost of service as determined in a base rate proceeding. The Company has no customers in this rate class, and is proposing to discontinue this rate schedule.

The Company's fourth option is provided through Special Contracts. Currently there are six Special Contracts with existing customers. A seventh has been recently signed with a customer who is scheduled to begin service late this year, subject to Commission approval of the contract. All seven Special Contracts are for transportation service. Each Special Contract customer exhibits characteristics that require individualized terms and pricing outside of the Company's existing Rate Schedules.

Finally, the Company's Flexible Gas Service rate schedule offers a transportation service option for those circumstances where the Company elects to not include the investment to serve the customer in rate base. The Company must demonstrate that serving a customer under this rate schedule will not cause the remaining customers to bear any additional cost. At present, the Company has no customers on this rate schedule.

Q. PLEASE OUTLINE THE MAJOR PROPOSED CHANGES TO THE COMPANY'S TRANSPORTATION SERVICE OFFERING.

A. First, the Company is proposing to reduce the eligibility threshold for individual customer transportation from 200,000 to 100,000 therms per year.

The second proposal would establish a non-residential aggregated transportation service program for all proposed customer classifications below 100,000 annual therms. This action effectively provides unbundled service to all non-residential customers.

The third proposal would offer aggregated transportation to accounts above the 100,000 annual therm threshold. All such customers would have the option, depending on their circumstances, to transport individually or as part of an aggregation pool.

The fourth proposed revision involves the administrative realignment of the FTS and CTS and LVCTS Rate Schedules. The Company proposes to eliminate the FTS Rate Schedule. Customers would continue to have the option to elect an FTS-like service option under the Transportation Service provisions contained in the General Terms and Conditions section of the Company's proposed tariff. Additionally, the Company proposes to convert the existing CTS Rate Schedule to a Rider CTS. Customers with alternate fuel capabilities would continue to have the flexible price transportation service offered through Contract Transportation Service. The Company is also proposing to eliminate the LVCTS Rate Schedule. No customers are currently in this rate class. Any customer

transporting at the 20,000,000 annual therm and above would be served under a Special Contract.

The fifth proposed revision would allow alternate fuel customers transporting under the CTS Rider to acquire interstate pipeline capacity from sources other than the Company. Large customers often want to contract directly with the interstate pipeline for all or a portion of their capacity requirements. In addition, customers with alternate fuel options frequently require price discounts to continue natural gas service. Capacity discounts, periodically available on the secondary market or from marketers, could keep a customer's natural gas price competitive with alternate fuels. With the turnback of FTS-2, the Company's capacity holdings for these traditionally "interruptible" customers are minimal. There are limited stranded capacity issues raised by this proposal. The Company would be prepared to provide capacity to CTS customers, if available.

The sixth unbundled service proposal establishes penalties for Gas Marketers who fail to deliver scheduled gas volumes to the Company's distribution system. The Company expects that Gas Marketers qualified to ship on the interstate pipeline will provide reliable service. However, if gas supplies are not delivered, the Company does not have the operational capability to discontinue service to the affected end-use customers. Obviously, it is in the best interest of both the Company and the customer if service is uninterrupted. If a marketer does not deliver, the Marketer's customers would, by default, receive service from the Company's system gas supply. Such a situation could adversely impact the Company's in-balance status with the pipeline. In addition, the non-

delivery of gas creates an administrative morass largely left to the Company to resolve. In addition to the cost of delivered gas supply, the Company proposes a $10.00 per MMBtu charge for gas volumes that are not delivered as scheduled. Any penalties collected would be credited to the Company's Purchase Gas Adjustment. The Company reserves the right to discontinue service if it is unable to provide system supply service.

Finally, the Company is proposing to eliminate the current practice of allowing customers to split their total volumes between transportation and sales service. Customers electing transportation service should, in the Company's view, transport 100% of their total requirements. Imbalances would be subject to the Company's cash-out provisions. Additional administrative revisions to the Company's transportation service options are addressed below.

Q. HAS THE COMPANY ESTIMATED THE NUMBER OF ADDITIONAL CUSTOMERS THAT WILL ELECT NON-AGGREGATED TRANSPORTATION SERVICE?

A. Yes. The Company currently serves 58 customers using more than 100,000 therms per year. Of these, 35 are individual transportation customers, including 6 Special Contract customers. The Company has signed service agreements to add 13 new customers above 100,000 annual therms by the end of 2001. Conversations with both existing and newly signed customers were held during the Company's market assessments conducted in January and April 2000. Based on these assessments, the Company estimates an additional 14

customers above the 100,000 annual therm level will elect to transport on an individual basis in the Projected Test Year.

Q. PLEASE OUTLINE THE COMPANY'S AGGREGATED TRANSPORTATION SERVICE PROPOSAL.

A. The Company proposes to adopt an aggregated transportation program for small non-residential customers similar to the current Peoples Gas Firm Transportation Service Experimental Tariff Rider FTA, approved for use through May 31, 2001, by the Commission in Order No. PSC-99-0487-FOF-GU. Further, the Company proposes to adopt a monthly balancing procedure for transportation aggregation program similar to that used by FGT to balance pipeline shippers. As noted above, the Company is proposing to provide aggregated transportation service to all non-residential customers under 100,000 annual therms. Each of the Company's proposed volumetric customer classes below 100,000 annual therms ties to a Transportation Service (TS) rate schedule. Customers in these volumetric classes would have the option to elect aggregated transportation service. Large volume users would also have an aggregated transportation service option, and could elect such service through the Company's proposed Aggregated Transportation Service Agreement.

The proposed aggregated transportation program would group customers into pools. Each Customer Pool would include no less than ten individual customers with an aggregate transport quantity no less than 100,000 therms per year. The Company proposes that each Customer Pool be administered by a designated Pool Manager. An Aggregated Transportation Service Agreement,

detailing the administrative provisions, terms and conditions of the service, would be required of all Pool Managers. Customers would be required to provide letters of authorization to the Company electing service under the aggregated transportation program and designating their Pool Manager selection. The proposal provides that Customers may change their Pool Manager selection upon a thirty-day notice to the Company. Similarly, customers may also elect to return to system sales service at any time with a thirty-day notice. The Company is proposing to allow one change of Pool Manager or rate class without charge to the customer within a rolling twelve-month period. Additional changes would be permitted upon payment of a twenty-five dollar ($25.00) administrative charge for each change.

Under the Company's proposal, Pool Managers must meet credit-worthiness standards sufficient to be accepted as a shipper on the upstream interstate pipeline. The Company proposes no limit on the number of Pool Managers other than the minimum customer and therm limits required to establish a Customer Pool.

The proposed Aggregated Transportation Service Agreement will stipulate capacity release, scheduling and operational balancing procedures, along with other general tariff requirements. The proposed agreement assigns responsibility for most transportation activities to the individual Pool Managers. Capacity would be released to the Pool Managers for the aggregated requirements of their respective customers on an average daily requirement basis. The Company would be responsible for determining MDCQ and nomination requirements based

on historical monthly consumption data for each customer in a pool. The Company proposes to release capacity at a weighted average maximum tariff rate based on the Company's permanent capacity holdings at the time of release.

Nominations, scheduling and periodic adjustments tied to pipeline events such as OFOs, Alert Days or out-of-balance situations, are proposed to be handled directly by the Pool Managers. Aggregated transportation customers below the 100,000 annual therm threshold would not be electronically metered. Meters for these customers can be read in their normal cycle. The Company has a policy to electronically meter all customers (sales or transportation) whose annual volume exceeds 100,000 therms. Meter readings for electronically read transportation customers are currently taken on the last day of the month.

The Company is proposing to balance the Customer Pools using a cash-out process. As noted above, the cash-out procedures and gas cost indices are intended to mirror those of FGT. Actual metered usage for all customers in a pool would be totaled and compared to the Pool Manager's scheduled volumes to determine imbalances. All balancing transactions would be between the Company and the Pool Managers, not the individual customers in the pools. Penalties collected for substantial out-of-balance situations or related to Operational Flow Order or Alert Day events, in accordance with the Company's approved tariff, would be credited to the Purchased Gas Adjustment.

It should be noted that aggregation combines customers solely for the purpose of transportation eligibility. Under the Company's proposed rate design, the base rate applicable to a customer's volumetric class of service does not

change when the customer elects aggregated transportation. The Company's transportation rates for individual customers are based on individual customer volumes, not the aggregated volumes of the Customer Pool.

Q. HOW MANY CUSTOMERS WILL SHIFT TO AGGREGATED TRANSPORTATION SERVICE?

The Company's forecast estimate calls for 150 total aggregated transportation accounts, approximately 15% of the total non-residential customers at the end of the Projected Test Year. The Company estimates that 130 non-residential customers using less than 50,000 annual therms will migrate to transportation aggregation in the projected test year. The forecast also assumes that ten accounts in the 50,000 to 100,000 annual therm category will join an aggregated customer pool. Finally, 10 accounts above the 100,000 annual therm level are projected to elect aggregated transportation service. The Company's estimates of transportation migration could significantly accelerate if marketers actively solicit the smaller accounts. Additional information on the projections of aggregated transportation customers is found in the Forecast of Customers, Sales and Revenues section of this testimony.

Q. IS THE COMPANY PROPOSING ADDITIONAL TARIFF MODIFICATIONS RELATED TO TRANSPORTATION SERVICE?

A. Yes. The Company is proposing revisions to the Billing Adjustments portion of the tariff, specifically to Section (4) Operational Balancing Account. There are two primary revisions. First, imbalance cash-out procedures for the aggregated transportation customer pools are proposed to be added to the tariff.

Second, the cash-out indices have been modified to parallel those of the interstate pipeline.

An additional revision related to Operational Balancing proposes the elimination of the current practice of allowing customers to split their requirements between transportation and system sales volumes. Historically, the Company's Transportation Service Agreement has allowed customers to establish transportation service at less than 100% of their requirements. Typically, customers scheduled transportation gas volumes as much as twenty percent below their expected total burn volume. If the customer overburned its scheduled volume, the overrun was billed as system sales gas at the applicable tariff rate up to an established MDCQ. Volumes above the MDCQ were cashed-out in accordance with the Company's existing tariff provisions. Although this balancing practice provided a simple, effective transitional service to help large volume customers initially shift to transportation, it is no longer necessary or appropriate. Individual transportation customers, and their marketers, have gained sufficient experience with transportation service to be able to utilize the balancing procedures that are now common practice in the industry. In addition, using the Company as a backup supplier for significant portions of a customer's volume is not appropriate. The Company does not recover the cost of providing this service, and therefore, continuing to provide it places an undue cost burden on the non-transporting ratepayers. Customers electing transportation service would be required to transport 100% of their requirements. A monthly cash-out procedure will be used to balance all accounts.

There are several proposed transportation service revisions to the General Rules and Regulations section of the tariff. The Company, as part of this filing, is submitting an updated Transportation Service Agreement to reflect the new cash-out and scheduling procedures. Also a separate Aggregated Transportation Service Agreement will be used to establish the small non-residential customer pools.

Q. IS THE COMPANY PROPOSING A PHASE-IN PERIOD FOR IMPLEMENTATION OF THE INDIVIDUAL TRANSPORTATION TARIFFS OR THE FIRM TRANSPORTATION AGGREGATION TARIFFS?

A. If the Commission approves the recovery of capital and staff costs related to providing expanded transportation service, the Company believes it can implement new tariffs soon after the conclusion of this rate proceeding. All of the individual customer transportation tariffs can be implemented immediately upon approval by the Commission. The required administrative adjustments, procedure modifications and staff training necessary to offer aggregated transportation service to small non-residential accounts can be in place no later than ninety days after Commission approval of this filing.

Q. WILL THE COMPANY INCUR ADDITIONAL COSTS TO PROVIDE AN EXPANDED UNBUNDLED TRANSPORTATION PROGRAM?

A. Yes. The Company outlined these costs to Commission Staff in a February 14, 2000 letter. The Company will need to modify its current computerized Customer Information System (CIS) to accommodate the particular features of transportation service billing, and to ensure that appropriate

accounting and customer service records are maintained. The Company is proposing to hire two additional employees to support the increased administrative and customer contact requirements of providing transportation service to small commercial customers. The management of several customer pools will require significant and frequent contact with Pool Managers and customers on a variety of gas scheduling, billing, balancing and customer service issues. If existing transportation services are expanded, the Company will incur training costs for its staff, as well as costs to educate customers and marketers on the specific provisions of the transportation service.

Q. PLEASE DESCRIBE THE SPECIFIC COSTS.

A. The Company estimates that it will incur one-time costs of approximately $275,000 and annual recurring costs of approximately $81,800 to implement an expanded transportation service program. The capital costs for revisions to the Company's CIS are estimated between $200,000 and $225,000. Capital expenses to purchase office equipment for the two staff positions are estimated at $15,000. Initial staff training and educational expenses are estimated at $10,000. Consumer education materials and other costs related to informing customers and marketers about the program offerings are estimated at $25,000. The one-time legal and administrative costs to modify the Company's tariff are estimated at $4000. Additional legal fees related to the substantive preparation and review of the Company's unbundled service proposal are included in rate case expenses. It should be noted that the estimates of "one-time" costs

represents the Company's best current assessment of cost requirements. As the program is implemented, additional, unanticipated costs may be incurred.

Recurring expenses to administer the expanded transportation program are estimated at approximately $81,800 per year. Annual customer awareness expenses are estimated at $5,000. The recurring staff expense for two additional employees is estimated at $75,000 per year on a fully loaded basis. Depreciation expense on office equipment is estimated at approximately $1800 annually.

Based on the forecast of customers by class, the Company expects to be transporting to approximately 199 customers by the end of 2001 (150 aggregated and 49 individual transporters). In addition, the Company expects that, over time, most, if not all, of the non-residential customers will migrate to transportation. The cost of providing transportation service to all non-residential customers will not fully materialize by the end of the Projected Test Year, but will increase as migration to transportation continues. The total costs itemized above will not be required to handle the migration of customers at the forecast levels for the Projected Test Year. For example, under current estimates of customer participation in the transportation service program, the complete upgrade of the Company's CIS is, in the Company's view, more appropriately implemented in 2002, after the Company gains experience in providing aggregated service. It is possible to manually administer an aggregated transportation program and an expanded individual transportation program at the customer levels forecast for 2001.

If the Commission approves the expanded transportation program, the Company will need to fill both of the proposed staff positions, conduct the employee training and meet its obligations to inform customers of the new service options. The staff positions are of particular concern. The prudent delay in modifying the Company's CIS will necessitate the manual administration of transportation accounts. One of the new employees would fill a Scheduler position, required to handle the scheduling, nominating, balancing and tracking of gas management information. The other employee would fill a Customer Service Representative position, responsible for telephone inquiries, customer information activities, account initiation and maintenance activities, providing an interface with Pool Managers on specific customer issues, and the maintenance of appropriate program records. These new employees will ensure a smooth transistion to transportation service for all parties. The capital expenses for office furniture and equipment for the new positions would be required immediately. The capital amortization, the recurring staff expense and the training and customer awareness expenses are included in the Company's cost of service analysis.

Q. PLEASE DESCRIBE THE RATE DESIGN PROPOSED BY THE COMPANY TO RECOVER THE ANNUAL RECURRING COSTS OF PROVIDING EXPANDED TRANSPORTATION SERVICE.

A. The Company's proposed rate design recovers transportation service administrative costs solely from transporting customers. The proposal establishes identical non-fuel base rates for transportation and sales customers.

However, the additional cost of providing transportation service is allocated to customers electing such service through an increase in the monthly customer charge. There is precedent in Florida for such cost recovery treatment. In its two most recent base rate cases (Order No. PSC-96-1404-FOF-GU and Order No. PSC-94-1570-FOF-GU), City Gas Company was authorized to collect significantly larger cost-based customer charges for transportation service than for sales service.

Q. HOW FIRM ARE THE CURRENT NON-RECURRING COST ESTIMATES FOR IMPLEMENTING TRANSPORTATION SERVICE?

A. Current cost estimates, outlined above, total $275,000. As the Company implements its transportation service program for small non-residential customers, the actual costs may vary substantially from the original estimates. For example, the cost estimate to upgrade the Company's Customer Information System and related accounting systems may prove to be understated. In addition, the need for enhancements to the Company's SCADA system, improvements to the web site, purchases of computer hardware and other cost requirements related to transportation service cannot be completely assessed without actually implementing the program.

The Company's rate filing does not seek recovery of the estimated $275,000 "one-time" capital and expense costs. As noted above, the majority of the activities generating the "one-time" costs, especially the modification of the Company's computer system, should not be incurred until additional aggregated transportation experience is acquired. Given that the new transportation options

will not be in place until 2001, the "one-time" costs will not likely be incurred during the Projected Test Year. Therefore, the Company does not seek recovery of these costs in the rate filing.

The Company finds itself in a somewhat awkward position. The Commission has ordered that all non-residential customers shall have the opportunity to receive transportation service. The Company will incur certain costs to provide expanded transportation service options. It is reasonable and appropriate that the Company be allowed to recover such costs. The Company has no direct experience in providing transportation service to small customers, and therefore, the cost estimates, prepared in good faith by the Company, may not appropriately represent the actual cost to comply with the Commission's mandate. Further, the timing of the non-recurring costs preclude their inclusion in this rate filing. However, it should be reasonable to expect recovery of prudent costs incurred in complying with the Commission's order.

Q. HOW DOES THE COMPANY PROPOSE TO RECOVER THE NON-RECURRING COSTS?

A. The Company proposes a Transportation Cost Recovery (TCR) mechanism to address the recovery of non-recurring costs. It is envisioned that the TCR would operate in a similar manner to that of the current Energy Conservation Cost Recovery (ECCR) billing adjustment. Under the TCR provisions, the Company would prepare an annual estimate of the costs directly related to the implementation and expansion of the transportation service program. Such costs would not include recurring costs related to personnel or

other A&G expenses. Rather, the recoverable costs would be limited to non-recurring costs associated with computer system modifications and other one-time expenditures necessary to effectively provide service to transporting customers.

Following the general procedure of the ECCR program, the Company would submit an annual filing to the Commission estimating the TCR expenses for the coming year. Subject to approval of the projected costs by the Commission, the Company would establish a base rate billing adjustment amount for each transportation service customer class. The proposed TCR billing adjustment would apply solely to the transportation classes; no general sales customers would be subject to an adjustment. The Company would recover the approved TCR amount in rates over the period of the ensuing year. The Company's accounting records would be maintained to separately account for all TCR revenues, and allow for an annual audit of such revenues by the Commission. At the time of each subsequent annual filing the Commission would true-up the TCR account based on actual expenses, actual revenues and the Company's forecast of future costs.

Q. IS THE COMPANY PROPOSING THAT THE TCR BILLING ADJUSTMENT MECHANISM BE PERMANANTLY ADOPTED?

A. No. The Company proposes that the TCR mechanism be approved for a period not to exceed five years. This time period should provide sufficient time for the Company to appropriately recover reasonable transition costs to unbundle its non-residential customer base.

Q. DO YOU BELIEVE THE EXPANSION OF THE COMPANY'S EXISTING TRANSPORTATION SERVICE OPTIONS WILL MEET THE EXPECTATIONS OF THE COMPANY'S CUSTOMERS?

A. Yes. The Company is committed to providing an easy transition to transportation service for all non-residential customers. One of the Company's most important business objectives is to provide a level of customer service far beyond the typical utility. The Company views the shift to transportation service as an opportunity to solidify relationships with existing customers, and develop business ally relationships with marketers. The Company believes the transportation options included in this filing are reasonable and meet both the Commission's requirements and the current expectations of customers. As the market continues to evolve and customers' needs change, the Company stands ready to offer new service options to meet those needs.

Sales, Customer and Revenue Forecast

Q. HAS THE COMPANY PREPARED A FORECAST OF SALES, CUSTOMERS AND REVENUES FOR THE BASE YEAR + 1 AND PROJECTED TEST YEAR?

A. Yes. I prepared, on the Company's behalf, a forecast of sales, customers and revenue by customer classification, for the Base Year +1 and the Projected Test Year. The results of this forecast are displayed on MFR Schedule G-2, pp. 6-9. The forecasts of revenues for both the Base Year + 1 and the Projected Test Year were computed using net customer and sales growth (loss) and the

Company's existing rates. As detailed on page 9 of MFR Schedule G-2, the total Projected Test Year revenues from the sale and transportation of natural gas, at current rates, are projected to be $7,630,737. Other income for the same period is projected, at current rates, to total $60,333. The revenue requirement deficiency addressed in this case was established based on the above forecast.

Q. DOES THE COMPANY PREPARE FORECASTS OF CUSTOMERS, SALES AND REVENUES AS A STANDARD COURSE OF BUSINESS?

A. Yes. An annual forecast is prepared for budget purposes. Traditionally, the Company has maintained a five-year rolling forecast of customer growth and sales volumes. These forecasts are utilized in a variety of planning activities. Capital requirements, gas supply and capacity commitments, earnings forecasts and strategic business planning all rely, in part, on the periodic growth forecasts.

Q. HAVE YOU UTILIZED THE COMPANY'S TRADITIONAL FORECASTING METHODS TO PREPARE THE HISTORIC BASE YEAR + 1 AND PROJECTED TEST YEAR FORECASTS OF DEMAND AND REVENUE?

A. Yes. However, recognizing that the 2000 budget forecast, including the 2001 – 2004 projections, was prepared in June, 1999, I updated the Company's forecast for purposes of this rate case filing. The rate case forecast also adjusts projected customers, sales and revenues to conform to the proposed revisions to the Company's customer classifications.

Q. PLEASE DESCRIBE THE COMPANY'S TRADITIONAL FORECASTING PROCESS.

A. The fundamental basis for all of the Company's forecasting is a periodic assessment of market conditions. These assessments involve several activities. They include both on–site and telephone customer interviews, discussions with residential and commercial developers, discussions with local building industry contractors, research on the trends in specific industries (phosphate, citrus and homebuilding, etc.), direct involvement in local Economic Development Councils and Chambers of Commerce, and a variety of contacts with Building Officials, Planning Boards and other agencies with knowledge of future development. The data obtained in the market assessment are formally and informally compiled. For example, a written log of industrial customer visits, including specific comments from customers, has been maintained since the late 1970's. Information on new residential developments, lot inventories, historical housing starts by project and build-out schedules for existing developments is compiled in a series of informal workpapers.

Data from the market assessment are used to prepare the Company's annual budget. Chesapeake Utilities Corporation requires each of its operating divisions to prepare a detailed revenue, operating expense and capital budget. A forecast of customer growth and loss is prepared for each customer class. Sales and transportation volumes are projected by class for both existing and new customer additions. Average sales volumes for the residential and small commercial classes are calculated from historical patterns and used in the forecasts to trend existing accounts. Consumption for new customer additions for these classes is also projected based on historical averages, unless adjusted to

account for specific knowledge of individual customer additions. Weather effects for residential and small commercial customers are considered in the volume forecasts through the averaging of consumption over a ten-year period. Added load by existing customers and conversions of existing residences or businesses from electricity or propane are also forecast, and tied, as appropriate, to the Company's Energy Conservation program. Larger volume accounts are forecast on an individual customer basis. The net customer and sales forecasts are applied to an internal financial model that calculates projected revenues from sales for each customer class.

Q. CAN YOU DESCRIBE IN GREATER DETAIL THE ASSESSMENT EFFORTS THAT RESULT IN THE LARGE VOLUME COMMERCIAL AND INDUSTRIAL CLASS FORECASTS?

A Yes. Company personnel frequently visit or telephone all of the larger volume accounts, i.e. those consuming over 50,000 therms annually. These customers have historically accounted for over 90% of the Company's throughput and contributed over 50% of its revenues. The Company invests a significant amount of effort in developing and maintaining close relationships with the large volume customer classes. One of the Company's primary business strategies is the promotion of a business partner relationship with its key accounts. The Company positions itself to be more than a vendor. Developing this type of relationship requires a commitment to providing premium service including direct access to Company decision-makers. The payoff for this level of service is a

group of satisfied customers willing to candidly discuss the business issues that potentially impact the Company's sales.

Understanding the operational and competitive issues facing the Company's largest customers in their respective lines of business is a key element in projecting industrial and large commercial sales and transportation volumes. During customer meetings, the Company seeks specific information on the customer's plant or facility operations, financial status, expansion or retraction plans and competitive outlook. An assessment of future load requirements is also discussed. The Company prepares its forecasts based on the information provided during the customer meetings, coupled with historical consumption patterns and research on specific industry trends.

Q. PLEASE DESCRIBE HOW YOU DEVELOPED THE NUMBER OF CUSTOMERS BILLED IN EACH CLASS FOR THE BASE YEAR + 1 AND THE PROJECTED TEST YEAR.

A. The first step in developing the customer growth forecast was a determination of the actual number of customers in the Company's existing customer classes billed in December 1999. These bills by class formed the base upon which customer growth was added. As noted above, the Company produces a five-year customer growth forecast as part of its normal annual budget process. The 2000 budget forecast had been prepared in June 1999, and included estimated customer additions for the remainder of 1999, and for each year through 2004. I updated the 1999 projections using actual customer bill data from the Company's CIS.

I next interviewed several Company sales and operations personnel to validate the budgeted customer forecast for the Base Year +1 and the Projected Test Year. Based on these discussions the monthly budgeted customer projections were updated to reflect the Company's most recent market knowledge. The number of customers lost by class was also projected to derive net customer growth. The budget projections already reflected a seasonal pattern for residential customers to account for heat-only and seasonal customers and this pattern was continued in the updated forecast for rate case purposes.

Q. DOES THE COMPANY'S FORECAST CONSIDER THE RECLASSIFICATION OF CUSTOMERS BASED ON CHANGES IN THEIR ANNUAL CONSUMPTION?

A. Yes. The Company conducts an annual review of customer usage for the purpose of assigning appropriate customer classifications. I used the results of this review to account for customer migration between the Company's existing customer classes. In total, six customers were reclassified in 2000 based on increases or decreases in their annual therm consumption in 1999.

Q. DOES THE CUSTOMER FORECAST ACCOUNT FOR THE COMPANY'S PROPOSED REVISIONS TO ITS EXISTING CUSTOMER CLASSIFICATIONS?

A. The Company is proposing significant changes to its traditional customer classifications. The current residential, commercial and industrial classifications are proposed to be replaced in this filing by classifications tied to annual consumption without regard to customer type. The Company is proposing

nineteen new customer classifications. General Sales Service (GS) designators will provide traditional system supply sales options for customers and Transportation Service (TS) classifications are included for customers electing unbundled service. Each of the volumetric usage categories has both GS and TS options. The following chart displays the proposed volumetric customer classes.

Customer Classes	Annual Therm Usage
GS1/TS1	0 - 300
GS2/TS2	300 - 3000
GS3/TS3	3000 - 10,000
GS4/TS4	10,000 - 25,000
GS5/TS5	25,000 - 50,000
GS6/TS6	50,000 - 100,000
GS7/TS7	100,000 - 500,000
GS8/TS8	500,000 - 1,000,000
GS9/TS9	1,000,000 +

The current Flexible Gas Service and Off-System Sales classifications in the Company's existing tariff would be retained. Flexible rate options for large volume sales and transportation service customers with alternate fuel capabilities are provided in the Company's proposal, through a Contract Sales Service (CSS) Rider and a Contract Transportation Service (CTS) Rider. In addition, the Company proposes to continue its practice of providing service, when conditions warrant, through Commission-approved Special Contracts. A more complete discussion of these specific revisions is included in the rate design section of this testimony.

As previously noted, the rate case customer forecast was initially prepared by updating the Company's existing budget forecast for the Base Year +1 and the Projected Test Year using its current customer classifications. Subsequently,

both existing customers and projected customer additions were regrouped based on the proposed General Sales Service volumetric classifications and an estimate of the number of customers who would elect a Transportation Service classification. A data base was developed from the Company's CIS that sorted existing customers at December 1999, into the proposed customer classifications based on historical usage patterns.

The new customer additions projected in the updated budget forecast for 2000 and 2001 were assigned to a proposed volumetric class based on historical consumption trends for similar customer types and specific market knowledge of the projected new accounts. For example, 56 non-residential accounts are forecast to be added in Citrus County in 2000. The Company's market assessment of Citrus County produced estimated annual volumes for each of these accounts. Some account volumes could be estimated based on known historical propane or fuel oil volumes. Others were assigned based on comparisons to similar accounts currently served by the Company. The new customer additions in all service areas were assigned to a volumetric class based on this procedure.

The forecasts of customers, sales and revenues presented in the MFRs filed in this rate proceeding are consistent with the Company's proposed customer classifications and their respective rate schedules.

Q. HAS THE COMPANY PROVIDED BILLING DETERMINANT INFORMATION THAT WILL ALLOW THE COMMISSION TO COMPARE THE EXISTING CLASSIFICATIONS TO THE PROPOSED CLASSIFICATIONS ?

A. Yes. MFR Schedules E-2 and E-5 have been prepared to enable the Commission to compare bills, therms and revenues under the existing classes to the proposed classes. The proposed classifications (GS-1, TS-1, etc.) do not distinguish between customer types (residential, commercial, etc.). However, MFR Schedules E-2 and E-5 display the billing determinants both by proposed classification, and by existing customer type.

Q. HOW WAS THE MIGRATION OF CUSTOMERS TO TRANSPORTATION SERVICE ADDRESSED IN THE CUSTOMER FORECAST?

A. I estimated the number of customers that may take advantage of the Company's expanded unbundled transportation service offerings. Each of the proposed customer classifications were analyzed to develop projections of transportation customers by class. Estimates of both individual and aggregated transportation service customers were prepared.

Q. PLEASE EXPLAIN HOW YOU ARRIVED AT YOUR INDIVIDUAL TRANSPORTATION CUSTOMER ESTIMATES.

A I reviewed the results of the Company's market assessment discussions with each of the 58 existing customers using more than 100,000 annual therms. These customers will be eligible for individual (non-aggregated) transportation service under the Company's proposed tariff. There are currently 23 non-transporting and 35 transporting customers using more than 100,000 annual therms. Further, the Company's customer forecast of customers over 100,000 therms includes the addition of 13 new accounts by the end of the Projected Test Year, bringing total accounts in this category to 71. Given the probable cost

savings associated with transportation service, all 13 of the new large volume customers are assumed to begin service as transporters.

Based on the Company's market assessment discussions, I projected that 24 additional customers (including the 13 new accounts) using over 100,000 annual therms would elect transportation service by the end of the Projected Test Year. Fourteen of these customers are projected to transport individually, and ten are projected to elect the aggregated transportation service option. A total of 59 out of the 71 projected total customers over 100,000 annual therms are projected to transport in 2001. Seven of these large volume accounts will transport under the provisions of the Company's Special Contract customer classification.

Q. PLEASE EXPLAIN HOW YOU ARRIVED AT YOUR ESTIMATES OF AGGREGATED TRANSPORTATION PARTICIPATION.

A. I individually reviewed the 820 existing non-residential customers under 100,000 therms to assess the probability of a transportation service election by these smaller volume accounts. I also reviewed the 133 new non-residential accounts under 100,000 therms projected to begin receiving served by the end of 2001. Company sales and customer service personnel were interviewed to identify accounts likely to elect transportation service. Several of the customers in the 25,000-100,000 annual therm level, along with certain chain store accounts, were contacted to ascertain their interest in aggregated transportation. In addition, I reviewed the experiences of other Florida and national LDC unbundling programs. Based primarily on the market assessment information, the Company forecasts that 140 small volume non-residential customers will shift

to transportation service during the Projected Test Year. As noted above, I am projecting that 10 customers over the 100,000 annual therm level will elect aggregated transportation, bringing the total customers in this option to 150 at the end of 2001.

Q. CAN YOU PROVIDE ADDITIONAL INFORMATION ON THE FORECAST OF AGGREGATED TRANSPORTATION CUSTOMERS?

A. The Company currently serves 20 non-residential customers using between 50,000 and 100,000 annual therms. Each of these customers was individually contacted. I estimate that 10 of these accounts will transport by the end of the Projected Test Year. There are 135 existing non-residential customers that consume between 10,000 to 50,000 therms per year. I estimate that 50 of these accounts will transport in 2001. Additionally, the Company serves approximately 80 key account customers that consume less than 10,000 therms per year. For example, Pizza Hut, Burger King, Ramada Inn and Publix generally fall into this category. These accounts are participating in transportation service programs on other gas systems. It is likely that at least 50 of these accounts will transport in 2001. Of the remaining 677 small volume customers, I estimate that 30 will elect aggregated transportation service in the Projected Test Year. Approximately 500 of these small volume customers use less than 5000 therms annually. The great majority of customers at this level are small business owners focused on their daily operations. Energy issues are not their primary concern. In addition, these accounts have not been prime targets for marketers in other LDCs, small commercial programs. While it is probable that these customers will

eventually transport, they are deemed unlikely to elect transportation service during the Company's initial offering.

Q. HOW FIRM ARE THE AGGREGATED TRANSPORTATION CUSTOMER PROJECTIONS?

A. While no empirical data exists to quantify the estimated migration to transportation service, the Company has attempted to provide reasonable estimates based on a review of similar utility programs participation levels and an analysis of the individual customers eligible for aggregation service. Initial unbundled service participation levels experienced by other gas utilities around the country typically range from 5% to 20% of eligible customers. In Florida, Peoples Gas currently provides aggregated service to approximately 2,800 small commercial accounts, representing a little over 10% of its non-residential customers. Although participation in Peoples' experimental aggregation program was limited to customers applying within a specific timeframe, its 10% participation rate provides the best Florida-specific guidance on the potential migration rates. Given that the Company is not proposing restrictions on the timeframe in which customers may elect aggregated service, it is reasonable to assume a higher participation level.

As noted above, the Company also individually reviewed the existing 800 commercial service accounts. Over 10% of these accounts are national food service customers, hotel chains or other customer types (Publix) currently transporting on other gas systems. The Company believes it reasonable to expect that most, if not all, of these accounts will elect transportation service. The

Company has directly contacted all 20 active customers in the 50,000-100,000 annual therm class. Ten of these customers indicated that they would participate in an aggregated transportation service program. In addition, the Company's customer contacts with accounts above 100,000 annual therms indicate 10 customers will choose aggregated transportation. Based on the information available to the Company, the estimate of 150 aggregated transportation accounts by the end of 2001 appears reasonable.

Q. HOW WERE THE THERM SALES PROJECTIONS DEVELOPED?

A. Historical consumption data for the Company's traditional homogeneous customer classes (less than 100,000 therms per year) were used to develop monthly consumption estimates for each class. An average monthly consumption amount by class was developed using the actual monthly consumption totals for the period 1989 through 1999. The monthly consumption averages by class were divided by actual monthly active customers calculated over the same period, resulting in average monthly therms per customer. This computational method accounts for weather variability and seasonal customer fluctuations.

The customer forecast described above provided the number of customers billed each month during the Base Year + 1 and the Projected Test Year. Annual therm sales for the respective proposed homogeneous customer classes (GS1/TS1, GS2/TS2, GS3/TS3, GS4/TS4 and GS5/TS5) were estimated by multiplying the projected number of customers billed each month by the estimated usage per customer for the month, totaled for the year. If specific information was available that impacted the sales assumptions for a particular

customer group, it was utilized in the forecast. For example, the average annual therm consumption for residential occupancies added in Citrus County is significantly above the system average: 485 therms compared to 264 therms. The forecast reflects all Citrus County residences at the higher therm volume. The remaining customer classes (GS6/TS6, GS7/TS7, GS8/TS8, GS9/TS9 and Special Contract) were forecast on an individual customer basis utilizing data from the large volume customer market assessment.

Q. HOW DID THE COMPANY ESTIMATE REVENUES FOR THE BASE YEAR + 1 AND THE PROJECTED TEST YEAR?

A. Revenue projections displayed on MFR Schedule G-2 were prepared by applying the forecasts of customers and sales volumes described above for the respective periods to a gross margin computation model using the Company's existing rate structure.

Cost of Service and Rate Design

Q. PLEASE DESCRIBE THE PROCESS USED TO DESIGN THE PROPOSED RATES.

A. I performed a fully embedded cost-of-service study to determine the appropriate assignment of expense and investment costs to each of the Company's homogeneous classes of service. The cost study utilized information from all areas of the Company's operations, including customer billing and consumption records, engineering studies, forecasts of growth, and cost data from the accounting records. The total cost of service was assigned or allocated

to determine the revenue requirements of each class of customers. The results of my analysis were used to identify the Company's proposed rate design, which is detailed on MFR schedule H-1, and is summarized on Exhibit No. JMH-1 (B).

Q. WAS A PARTICULAR METHODOLOGY OR MODEL USED TO CONDUCT THE COST OF SERVICE STUDY.

A. The standard methodology traditionally used by Commission Staff formed the fundamental base of the cost of service study. The Company's study also follows the presentation format contained in the H Schedules of the prescribed MFR forms.

Q. HOW IS A COST OF SERVICE STUDY PERFORMED?

A. Traditional cost studies can be segmented into three individual activities: functionalization, classification and allocation.

Functionalization refers to the process of relating plant investments and associated operating expenses to four basic function categories. The functional categories are production, storage, transmission and distribution. Plant investments and related operation, maintenance, depreciation and tax expenses are assigned to the functional categories. The functional assignment of costs is a relatively straight-forward process. The Company maintains its accounting records in accordance with the FERC Uniform System of Accounts. FERC accounting assigns plant facilities and investments to cost of service functions. Related expenses follow the same functionalization. MFR Schedule H-3, pages 2 and 3 functionalize the overall cost of service and pages 4 and 5 functionalize rate base.

Classification refers to the process of dividing the functional costs into categories based on cost causation. Each local distribution system is designed and operated based on the individual and collective service requirements of its customers. The cost of providing such service is categorized in order to assign costs to the customer classes that are principally responsible for those costs. Typically, there are four categories used to group costs: capacity or demand costs, commodity costs, customer costs and revenue costs.

1. Capacity or demand costs are those costs incurred by the utility to meet the on-demand service requirements of the total customer base. Capacity costs are related to the peak or maximum demand requirements placed on the system by its customers. Capacity costs are incurred to ensure that the system is ready to serve customers at peak requirements levels. These costs are generally considered to be "fixed", and are incurred whether or not a customer uses any gas.

2. Commodity costs are variable and relate to the quantitative units of product consumed. Costs which can be linked to the volume of gas sold or transported fit into this category.

3. Customer costs are those costs incurred to connect a customer to the distribution system, meter their usage and maintain their account. In addition, other costs such as meter reading, which are a function of the number of customers served, should be included in this category.

4. Revenue costs are related to those costs items which can be assigned based on the percentage of total revenue received from each class of customer.

These costs vary with the amount of sales revenue collected by the Company. Gross receipts taxes and regulatory assessment fees fall into this category. I have utilized the cost classification methodology contained in the MFR model. The "classifiers" identified in the model were not altered. The classification of each functionalized cost component is contained in MFR schedule H-3, pages 2-5.

5. Allocation involves the distribution or assignment of the classified costs to the Company's customer classes. Those costs which can be directly attributable to a specific customer class are assigned to that class. The remaining costs are assigned by applying a series of allocation factors. The allocation factors attempt to distribute costs based on the causal relationships between the respective customer classes and the classified costs. The development and application of the allocation factors and direct assignment of costs is the final step in a cost of service study. MFR Schedule H-2, page 5, details the development of allocation factors by customer class.

Q. YOU INDICATED THAT COSTS WERE ALLOCATED BY CUSTOMER CLASS. PLEASE DESCRIBE HOW THE CUSTOMER CLASSES WERE DETERMINED.

A. Customers of a utility are grouped into relatively homogeneous classes according to their service characteristics. Consumption levels, pressure requirements, load factors, conditions under which service is provided (curtailment status, for example), and end-use application of the fuel can be considered when establishing customer classes. Typically, the utility incurs

different costs to provide service to each discrete customer class. Rate schedules are established by class to recover these costs.

The Company has reviewed the cost of providing service to customers of varying sizes and usage characteristics. Several cost breakpoints were identified which could generally be linked to annual volumetric requirements. Meter and regulator type and size, service line size and on-going maintenance costs are among the items that distinguish one service class from another. The Company could not identify substantive cost differences on the basis of customer type. Residential, commercial and industrial customers at a given therm threshold all exhibit the same general service requirements and costs to the utility. While I recognize that many of these costs are more a function of peak hour load requirements than of annual consumption volumes, it is possible to establish annual volumetric classifications based on the discernable cost differences. The Company's analysis of the facility costs by customer classification is included on MFR Schedule E-7.

The cost of service study includes nineteen proposed separate customer classifications for rate-making purposes. Each of the proposed classes has an associated rate schedule with separate pricing provisions. As discussed earlier in this testimony, the Company has identified nine primary categories of service based on annual consumption volume that exhibit distinguishable cost differences. Each of these nine service categories has a General Sales Service (system supply) option and a Transportation Service option. Both the sales and transportation service options are proposed to have the same base energy

charge for a given volumetric category. However, the transportation service rate schedules have higher proposed monthly customer charges to recover the increased cost of providing this type of service.

The proposed customer charge increases for transportation service require that the cost of service study display eighteen volumetric rate schedules, along with Special Contracts, for a total of nineteen separate cost allocation categories. The Company offers two additional Rate Schedules, Flexible Gas Service and Off-System Sales. Flexible Gas Service provides a means of removing from rate base an investment to serve a given customer in return for the ability to set rates at unregulated market levels. There are no customers currently utilizing the Flexible Gas Service schedule, or projected to do so in the Test Year. Off-System Sales are opportunity transactions for the Company that depend on market conditions. Given their non-predictability, no Off-System volumes have been forecast.

Q. HISTORICALLY, THE COMPANY HAS REMOVED INVESTMENT AND O&M COSTS RELATED TO ITS SPECIAL CONTRACT CUSTOMERS FROM THE COSTS ALLOCATED TO OTHER RATEPAYERS. DOES YOUR COST OF SERVICE STUDY ACCOUNT FOR THESE DEDICATED FACILITIES?

A. Yes. The Company has removed net plant and O&M costs attributable to its Special Contract customers from the costs allocated to other customer classes, either directly or through allocation factors. The seven customers included in the Special Contract category are as follows: IMC New Wales, Orange Cogeneration, Auburndale Power Partners, Alcoa (formerly Alumax),

Polk Power Partners, Citrosuco and a new customer, Peace River Citrus, scheduled to begin service in October, 2000.

Q. PLEASE DESCRIBE HOW YOU ALLOCATED CAPACITY COSTS IN THE COST OF SERVICE STUDY.

A. Capacity costs were allocated on the basis of peak and average monthly sales volume. An additional allocator was developed for assigning the cost of mains.

Q. HOW WERE COMMODITY COSTS ALLOCATED?

A. Commodity related costs were allocated on the basis of annual sales volumes.

Q. PLEASE DESCRIBE HOW YOU ALLOCATED CUSTOMER COSTS.

A. Customer costs were allocated based on the relative number of customers served in each customer class. The "weighted number of customers" allocator was used to distribute costs based on the recognition that larger customers exhibit higher customer costs. Meters, regulators and service lines are generally more expensive for larger customers. The weightings used were derived from the relative investment in meters, regulators and service lines required to serve representative customers in each class. The weightings can be found on MFR Schedule E-7.

Q. HOW WERE REVENUE COSTS ALLOCATED?

A. Revenue costs were allocated on the basis of gross revenues by customer class.

Q. PLEASE BRIEFLY DESCRIBE THE RESULTS OF THE COST ALLOCATION PROCESS.

A. The allocation of cost of service by customer class is presented on MFR Schedule H-2 pages 2 and 3. The allocation of rate base to each customer class is included in MFR Schedule H-2, page 4.

Q. IT WOULD APPEAR THAT A COST OF SERVICE STUDY IS PRIMARILY A MECHANICAL ACCOUNTING OF COSTS. ARE THERE OPPORTUNITIES TO APPLY JUDGEMENT, CONSIDER MARKET CONDITIONS OR OTHER MITIGATING FACTORS IN THE STUDY?

A. Yes. Cost studies are not simply formula based accountings of costs by rate classification. They require a substantial amount of judgement by the analyst to appropriately allocate and assign costs. An understanding of the utility's business strategy, market area and competitive position is necessary to complete an appropriate rate design. Within the cost of service study, the selection and application of allocation factors requires not only a mechanical understanding of the Company's costs, but also a common sense understanding of a variety of economic, social, regulatory and competitive considerations.

Q. SHOULD A COST OF SERVICE STUDY BE EXCLUSIVELY RELIED UPON TO ESTABLISH UTILITY RATES?

A. No. As noted above, there are a number of factors that must be considered when designing rates. One of the most critical is the competitive position of the Company in the marketplace. Customers in all rate categories have fuel alternatives. Increasingly, customers are demonstrating greater

sophistication in their consideration of energy options. The relative competitive position of the Company to several fuel alternatives by customer class was discussed earlier, and is displayed in Exhibit No. JMH-1 (C). The Company's system is especially vulnerable to price in its mid-volume non-residential and large volume industrial rate classes. Clear evidence of the industrial price vulnerability can be seen in the company's 1997 rate restructuring proceeding (Order No. PSC-98-0455-FOF-GU). Two large industrial customers with both fuel and by-pass alternatives threatened to leave the system. A rate reduction was negotiated which necessitated a reallocation of revenue requirements to other rate classes.

Price elasticity, proximity to the interstate pipeline and specific fuel alternatives vary greatly among customer classes. In the residential service class, energy decisions for new homes are typically made by the homebuilder, not the homeowner. Fuel price is only one factor homebuilders consider in evaluating appliance types. There are numerous non-price issues in all customer classes that effect fuel selections. Maintenance concerns, fuel storage, emissions levels, appliance efficiency, comfort and aesthetics all play a part in fuel decisions. The bottom line is that customers have choices. The Company's proposed rate design utilizes a cost of service study as a starting point, but the final rate recommendations consider the above issues and make appropriate adjustments.

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSAL TO MODIFY ITS CUSTOMER CLASSIFICATIONS.

A. The Company is proposing several significant modifications to its current customer classes. At present the Company differentiates customer classifications principally based on customer type (Residential, Commercial, Industrial, etc.) or Character of Service (firm or interruptible). The advent of unbundling at the distribution level resulted in the addition of transportation service Rate Schedules for selected customer classes. The Company's cost of service analysis in the current rate case determined that there were no significant cost differences between customer types at given volumetric levels. The results of that analysis for meter, regulator and service line costs are identified on MFR Schedule E-7. The Company is proposing to replace its existing classifications, currently based on customer type, with classes defined solely by annual consumption volume.

Q. IS THE COMPANY PROPOSING ADDITIONAL CUSTOMER CLASSES?

A. Yes. Significantly greater stratification in the customer classes is proposed, based on the cost of service differences identified at various annual consumption volumes. The volume differences among the existing classes are relatively large. For example, the existing Commercial Service class ranges from 0 to 50,000 annual therms. Within this volume range there are several distinct cost of service levels. Obviously, there are also substantial differences in the margin contributions of customers at various consumption levels within this class. This situation results in clear rate inequities within the current classes. Efforts to establish parity in the rates-of-return among customer classes is difficult to justify when there are major cost of service differences within a given class. Continuing

the current volume ranges in the Company's customer classes would perpetuate the undue subsidization of certain customer groups.

Rate class stratification is further warranted in order to empower the Company to effectively compete with the propane industry. The unregulated propane industry is free to customize rates for individual or small groups of customers to meet competitive market conditions. Certainly, rates of return are not at parity among propane customer groups. The Company needs the ability to more closely match propane industry pricing practices. Greater volumetric stratification in the Company's customer classes would be a significant step in the right direction.

Q. IS THE COMPANY PROPOSING TO CHANGE THE TRADITIONAL FIRM AND INTERRUPTIBLE CUSTOMER DESIGNATIONS?

A. Yes. The Company has traditionally designated a customer's Character of Service as firm or interruptible. These designations have been used, in part, to justify rates for large volume customers that enabled the Company to compete with alternate fuels. Theoretically, an interruptible customer receives a rate discount for receiving a reduced level of service. The Company receives a system operational benefit from the ability to curtail an interruptible customer's service to the benefit of other customers.

The Company is proposing to establish an alternate fuel customer type. Customers with legitimate fuel options other than natural gas would be eligible for the Company's flexible rate provisions. Rate discounts would be based on market competition, not system operational concerns. The interruptible nature of

the service provided to these customers would be defined by the Company's Curtailment Plan, as it is for all customers.

The current interruptible classification would be retained for those limited customers without alternate fuel capabilities which could have an effect on system operations. For example, an industrial facility at the end of the Company's distribution system may require periodic curtailment to maintain upstream pressure at acceptable levels. The Company proposes that rates and conditions of service for such customers be established through a Special Contract.

Q. IS THE COMPANY PROPOSING CHANGES TO ITS CURRENT RATE STRUCTURE?

A. Yes. The primary change the Company is proposing ties the design of its rate structure to the new proposed customer classifications. The Company would eliminate the majority of its existing Rate Schedules and replace them with Rate Schedules based on the volumetric classes proposed above. Service Riders establishing rate flexibility for customers with alternate fuel capabilities are also proposed. In addition, the Residential Load Enhancement Sales Service (RSLE) Rate Schedule is proposed for deletion. In its place, the existing Load Profile Enhancement Rider (Rider LE) would be applied to all Rate Schedules. The existing Flexible Gas Service and Off-System Sales Service Rate Schedules would be retained. Overall, the proposed rate structure is intended to begin a shift toward a Straight Fixed Variable (SFV) rate design. Finally, the current Residential Annual Contract Service Rate Schedule would be discontinued.

Q. PLEASE DESCRIBE THE PROPOSED FLEXIBLE RATE SERVICE RIDERS.

A. The Company currently provides flexible rates for both General Sales Service and Transportation customers under its Industrial Interruptible Service (IIS) and Contract Transportation Service (CTS) Rate Schedules. These Rate Schedules are limited to customers using over 200,000 annual therms, with alternate fuel options. The current ISS and CTS Rate Schedules establish a base rate of $0.05312 per therm. This rate may be adjusted to "an amount not less than 0.00 cents per therm nor greater than 90% of the currently applicable firm rate."

The Company is proposing to convert the existing IIS and CTS Rate Schedules to Riders, which would apply to the new GS-7, TS-7, GS-8, TS-8, GS-9, TS-9 schedules. Customers in these classes (over 100,000 annual therms) with alternate fuel options would be eligible for flexible rates. Two new riders, the Contract Sales Rider (Rider CS), and the Contract Transportation Service Rider (Rider CTS) are proposed.

Under the Company's proposal, rates for alternate fuel customers would be adjusted to track competitive fuel pricing. The current limitation that flex rates not exceed 90% of the applicable firm rate would be removed. Under the proposed Riders no upper limits would exist. The flex rate would reflect real-market price adjustments, both above and below the "firm" rate.

The Company also proposes a change in the flexible rate provisions related to the current tariff's "base non-fuel charge" ($0.05312). The proposed

CS and CTS Riders are applicable to several new rate schedules. The "base non-fuel charge" in the riders would correspond to the energy charge for the customer's applicable non-flexible rate schedule. For the purposes of this rate case proceeding, the Company used the applicable non-flexed rates to estimate revenue contributions from the alternate fuel accounts.

The proposed revision to the "base non-fuel charge" also affects the Company's Firm Rate Adjustment procedure, included on Sheet Nos. 74 to 76 of its existing tariff. The Firm Rate Adjustment presently allows the Company to adjust base rates for firm sales customers to account for surpluses or shortfalls in revenue from interruptible customers. In the case of a shortfall, the Company may increase rates to recover an amount not to exceed one-half the short fall. In the case of a surplus, the Company reduces rates to firm sales customers to credit them with revenues equal to one-half the surplus. The Firm Rate Adjustment determines revenue shortfalls or surpluses by comparing actual revenue to base revenue. "Base revenue" is defined as the revenue that would have been collected if all interruptible sales had been made at the base non-gas energy charge (currently $0.05312 per therm).

The Company is also proposing to retain the current Firm Rate Adjustment provision that credits or recovers 50% of surplus or shortfall revenues from non-flexed ratepayers. However, the proposed "base non-fuel charge" modifications proposed in the Rider CS and Rider CTS, would change the "base revenue" determinations in the Firm Rate Adjustment. The Firm Rate Adjustment would

establish "base revenues" using the non-gas revenue derived from the CS or CTS customer's applicable non-flexed rate schedule.

Under the Company's proposal, the Firm Rate Adjustment is renamed the "General Sales Service Rate Adjustment".

Customers would have the option to elect the CS or CTS Riders, or a non-flexible rate schedule. Once elected, the schedule would remain in force for a period of one year. The requirement of an annual contract period, with a 90-day notice to terminate, affords the Company the opportunity to effectively manage its capacity and supply holdings, and potential impacts on the PGA, when customers change rate schedules.

Q. TO WHAT EXTENT IS THE COMPANY PROPOSING TO MOVE TOWARD AN SFV RATE STRUCTURE?

A. The Company is proposing a rate design for small volume customers that incorporates the primary elements of SFV rates. The majority of the Company's proposed revenue requirement for the GS-1, TS-1, GS-2 and TS-2 classes would be collected through the fixed monthly customer charge. The margin recovered through the volumetric energy charge represents approximately 10% of total revenues for the GS-1,TS-1 class and 40% for the GS-2, TS-2 class.

The proposed rate design will ensure that low usage customers, regardless of customer type, equitably contribute toward the recovery of their cost of service. The current cross-class subsidization for these customers is significantly reduced with the Company's proposed rate structure. The rates of return for the low volume accounts under this proposal increase from negative or

marginally positive, to returns close to the Company's cost of capital. The improved rates of return for these customer classes are achieved at rate increase percentages that are below the Company's overall proposed increase.

Q. WHY IS THE COMPANY PROPOSING TO ELIMINATE THE RESIDENTIAL ANNUAL CONTRACT SERVICE (RACS) RATE SCHEDULE.

A. The Company historically provided an annual payment option for residential accounts. The rates are identical to the those in the Company's Residential Service Rate Schedule. The annual billing option was used primarily by seasonal customers with winter residences in the Company's service area. Processing the annual bills is a completely manual process. The RACS has been closed to new customer additions for a number of years. The Company has been working to shift customers out of this Rate Schedule. Currently only ten customers remain on RACS schedule. The Company is willing to continue providing annual billing to these customers as an administrative policy. There is no need, in the Company's view, for the RACS Rate Schedule to continue.

Q. IS THE COMPANY PROPOSING TO REPLACE ITS CURRENT OFF-SYSTEM SALES RATE SCHEDULE?

A. Yes. The Company proposes to adopt an Off-System Sales Rate Schedule with pricing provisions more reflective of current market conditions. The proposed tariff language is similar to that included in the current City Gas tariff (Sheet Nos. 91 to 93). The Company's existing off-system rate does not allow the pricing flexibility required to take advantage of off-system sales opportunities. Such opportunities occasionally enable the Company to sell excess gas supply

and capacity, generally to electric generators or large industrial plants. Off-system sales could help improve the overall system load factor, reducing the Purchase Gas Adjustment cost to the benefit of all sales customers.

Q. DID YOU CONSIDER THE COMPANY'S CURRENT RATE DESIGN IN YOUR ANALYSIS?

A. Yes. In preparing my final rate proposals I reviewed the results of the Commission-approved rate design in the Company's most recent base rate case (Order No. 23166), and its 1997 rate restructuring proceeding (Order No. PSC-98-0455-FOF-GU). In the 1989 rate case the rate of return for residential customers was designed at -3.52%. Also, in that case commercial accounts contributed at a 25.41% level and the industrial interruptible class was established at a 13.35% rate of return. The Company's 1989 weighted average cost of capital was set at 9.93%.

At the time of the 1997 Rate Restructuring, substantial rate of return disparities among classes had developed. Residential returns had plummeted to –10.77%. Commercial and Large Volume Commercial returns were at 3.47% and –0.63 %, respectively. Returns from Industrial customers had decreased to 5.33% with Interruptible accounts producing a –0.02% return. On the other hand, Special Contract customers were contributing at a 59.14% level. The overall return was 9.06%.

The 1997 Rate Restructuring was revenue-neutral to the Company. Rates were established that re-distributed existing revenues among the Company's current customer classifications. The rates established under the restructuring

moved the returns closer to parity, at that time. The rates of return for Residential service increased to -1.68%. The rates of return for Commercial, Industrial, and the corresponding transportation service classes were established at 9.08%. The industrial interruptible rate of return was set at 9.09%. A 23.62% rate of return was established for the Special Contract customer group. The overall cost of capital at the time of the rate restructuring was 9.06%. The rates of return in the Rate Restructuring proceeding, for most customer classes, appeared to be at parity. However, as noted above, significant rate of return disparities existed within the unstratified classes.

Q. PLEASE DESCRIBE YOUR PROPOSED RATE DESIGN.

A. The Company's proposed rate design results in each customer moving toward a more uniform contribution to costs compared to present rates. The rate design I am proposing on the Company's behalf establishes rates of return for each new customer class that remove much of the historical inequities within and between classes. My final design moves all of the classes closer to the Company's projected cost of capital of 8.89%. The proposed returns for the 0-300 annual therm customers (primarily residential) in the GS-1 class improve to 8.77%.

The next volumetric class, at the 301 to 3000 annual therm level, indicates a proposed return of 8.48%.

The customer classes at the 3,000 to 10,000 and 10,001 to 25,000 annual therm levels include customer accounts that are in highly competitive markets. Most of the food service and hotel accounts fall into these classes. Both market

segments are highly prized by the propane and electric industries. The proposed rates for both classes were set to ensure that the Company would be able to compete for business. The rates of return are proposed at 5.9% and 5.17%, respectively.

The proposed volumetric classes represented at the 25,000 to 50,000 and 50,000 to 100,000 therm levels are also highly competitive. The proposed rates for these classes were set to maximize customer retention and growth. Rates of return for the large volume classes would be established at levels ranging from 9.74% to 10.98%. Returns from the Special Contract class, previously set at over 23%, are proposed to be reduced to 10.22%.

Q. PLEASE SUMMARIZE THE CONCLUSIONS YOU HAVE REACHED BASED ON YOUR COST ANALYSIS AND RATE DESIGN.

A. The cost of service analysis provided a reasonable basis upon which to begin the design of rates by customer class. I compared the initial results of the cost study to the Company's historic rates, the competitive cost analysis and the Company's objective to reduce rate subsidizations among and within classes. My final rate design brought the rate of return for the small volume customer class close to the Company's cost of capital. The proposed rates substantially reduce the subsidy the commercial classes and Special Contract customers have been required to contribute to the overall rate of return. The rate design begins to shift toward a SFV structure for small volume accounts. In the Company's view, the SFV structure represents the future for LDC rate design. The proposed rate design produces rates which are in line with customer alternatives and positions

the Company to achieve its business objectives. I believe the proposed rate design is just and reasonable, producing fair and equitable rates for each customer class.

Q. HOW MUCH REVENUE WILL THE PROPOSED RATES PRODUCE?

A. The proposed rates are based on the cost of service by class as well as the market competitiveness considerations discussed above. The rates and charges are designed to produce additional revenues of $1,826,569. Target revenues under the proposed rates total $9,517,638.

Q. PLEASE COMPARE THE PROPOSED RATES TO THE PRESENT RATES.

A. A comparison of present and proposed base rates and customer charges by customer class is presented in MFR Schedule H-1, p. 6 of 6, and is summarized on Composite Exhibit JMH-1 "B".

Q. IS THE COMPANY PROPOSING CHANGES TO ITS OTHER OPERATING REVENUE CHARGES?

A. Yes. Connection charges for residential customers are proposed to increase from $22.00 to $30.00. Commercial connection charges are proposed to increase from $22.00 to $60.00. Reconnection charges are proposed at the same respective rates. The collection in lieu of disconnection charge is proposed to increase from $9.00 to $15.00. The return check charge is proposed to increase from $15.00 to $25.00 or 5% of the face value of the check whichever is greater, corresponding to the maximum charge allowed by Florida Statute. A change of account charge is proposed at $20.00. The proposed other revenue

charges are projected to generate $106,340 in the Proposed Test Year, compared to revenues from present rates of $60,333. These proposed charges are based on the Company's cost analysis displayed on MFR Schedule E-3.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

Exhibit No. JMH-1 (A)
Florida Division of Chesapeake Utilities Corp.
Docket No. 000108-GU

LIST OF MFR SCHEDULES SPONSORED BY JEFF HOUSEHOLDER

Schedule		Title
E-1	PP. 1-3	COST OF SERVICE
E-2	PP. 1-4	COST OF SERVICE
E-3	PP. 1-6	COST OF SERVICE
E-4	PP. 1-2	COST OF SERVICE
E-5	PP. 1-27	COST OF SERVICE
E-6	PP. 1-5	COST OF SERVICE
E-7	PP. 1-3	COST OF SERVICE
E-8	P. 1	COST OF SERVICE
H-1	P. 1	COST OF SERVICE-SUMMARY
H-1	P. 2	COST OF SERVICE-DERIVATION OF REVENUE DEFICIENCY
H-1	PP. 3-4	COST OF SERVICE-RATE OF RETURN BY CLASS
H-1	P. 5	COST OF SERVICE-PROPOSED RATE DESIGN
H-1	P. 6	COST OF SERVICE-PROPOSED RATES
H-2	P. 1	COST OF SERVICE-SUMMARY
H-2	PP. 2-5	ALLOCATION OF COST OF SERVICE TO CUSTOMER CLASS
H-2	P. 6	COST OF SERVICE-SUMMARY
H-3	PP. 1-4	COST OF SERVICE-FULLY ALLOCATED EMBEDDED COST OF SERVICE
H-3	P. 5	COST OF SERVICE-SUMMARY

Exhibit No. JMH-1 (B)
Florida Division of Chesapeake Utilities Corporation
Docket No. 000108-GU

Comparison Of Present Rates To Proposed Rates

Proposed Rate Schedule	Present Rates	Proposed Rates
GS-1 (Residential)		
Customer charge per month	$7.00	$15.00
Energy charge per therm	$0.46905	$0.10220
GS-1 (Commercial/Industrial)		
Customer charge per month	$15.00	$15.00
Energy charge per therm	$0.22115	$0.10220
TS-1 (Commercial/Industrial)		
Customer charge per month	N/A	$20.00
Transportation charge per therm	N/A	$0.10220
GS-2 (Residential)		
Customer charge per month	$7.00	$22.50
Energy charge per therm	$0.46905	$0.20038
GS-2 (Commercial/Industrial)		
Customer charge per month	$15.00	$22.50
Energy charge per therm	$0.22115	$0.20038
TS-2 (Commercial/Industrial)		
Customer charge per month	N/A	$32.50
Transportation charge per therm	N/A	$0.20038
GS-3 (Residential)		
Customer charge per month	$7.00	$32.50
Energy charge per therm	$0.46905	$0.29273
GS-3 (Commercial/Industrial)		
Customer charge per month	$15.00	$32.50
Energy charge per therm	$0.22115	$0.29273
TS-3 (Commercial/Industrial)		
Customer charge per month	N/A	$42.50
Transportation charge per therm	N/A	$0.29273

Exhibit No. JMH-1 (B)
Florida Division of Chesapeake Utilities Corporation
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Proposed Rate Schedule	Present Rates	Proposed Rates
GS-4 (Commercial/Industrial)		
Customer charge per month	$15.00	$40.00
Energy charge per therm	$0.22115	$0.24908
TS-4 (Commercial/Industrial)		
Customer charge per month	N/A	$55.00
Transportation charge per therm	N/A	$0.24908
GS-5 (Commercial/Industrial)		
Customer charge per month	$15.00	$100.00
Energy charge per therm	$0.22115	$0.19843
TS-5 (Commercial/Industrial)		
Customer charge per month	N/A	$125.00
Transportation charge per therm	N/A	$0.19843
GS-6 (Commercial/Industrial)		
Customer charge per month	$20.00	$175.00
Energy charge per therm	$0.17287	$0.16326
TS-6 (Commercial/Industrial)		
Customer charge per month	N/A	$200.00
Transportation charge per therm	N/A	$0.16326
GS-7 (Firm Commercial/Industrial)		
Customer charge per month	$40.00	$250.00
Energy charge per therm	$0.07889	$0.10627
GS-7 (Interruptible Commercial/Industrial)		
Customer charge per month	$350.00	$250.00
Energy charge per therm	$0.05312	$0.10627
TS-7 (Firm Commercial/Industrial)		
Customer charge per month	$40.00	$300.00
Transportation charge per therm	$0.07889	$0.10627
TS-7 (Interruptible Commercial/Industrial)		
Customer charge per month	$350.00	$300.00
Transportation charge per therm	$0.05312	$0.10627

Exhibit No. JMH-1 (B)
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Proposed Rate Schedule	Present Rates	Proposed Rates
GS-8 (Firm Commercial/Industrial)		
Customer charge per month	$40.00	$350.00
Energy charge per therm	$0.07889	$0.09675
GS-8 (Interruptible Commercial/Industrial)		
Customer charge per month	$350.00	$350.00
Energy charge per therm	$0.05312	$0.09675
TS-8 (Firm Commercial/Industrial)		
Customer charge per month	$40.00	$500.00
Transportation charge per therm	$0.07889	$0.09675
TS-8 (Interruptible Commercial/Industrial)		
Customer charge per month	$350.00	$500.00
Transportation charge per therm	$0.05312	$0.09675
GS-9 (Firm Commercial/Industrial)		
Customer charge per month	$40.00	$500.00
Energy charge per therm	$0.07889	$0.08287
GS-9 (Interruptible Commercial/Industrial)		
Customer charge per month	$350.00	$500.00
Energy charge per therm	$0.05312	$0.08287
TS-9 (Firm Commercial/Industrial)		
Customer charge per month	$40.00	$700.00
Energy charge per therm	$0.07889	$0.08287
TS-9 (Interruptible Commercial/Industrial)		
Customer charge per month	$350.00	$700.00
Energy charge per therm	$0.05312	$0.08287

Exhibit No. JMH-1 (B)
Florida Division of Chesapeake Utilities Corporation
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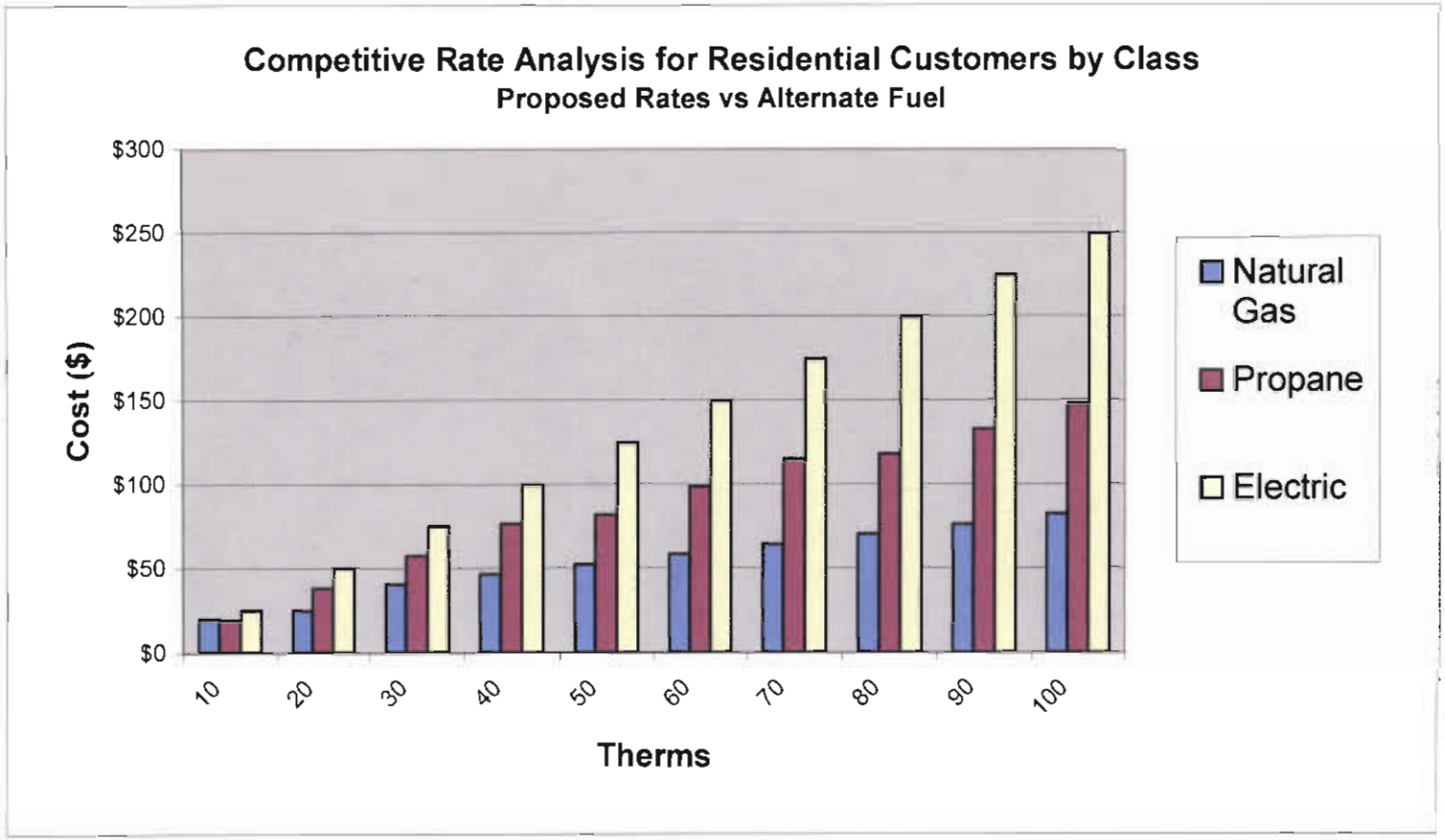
The Company is proposing substantial changes to its traditional customer classes and rate schedules. As proposed, the current residential, commercial and industrial classifications are replaced by 19 volumetric-based rate schedules, without regard to customer type. Attachment "B" provides information, similar to that included in MFR Schedules E-2 and E-5, to enable the Commission to compare rates under the existing classes to the proposed classes. For example, the proposed General Sales Service 0-300 therm volumetric class (Rate Schedule GS-1), does not distinguish between residential, commercial and industrial customer classifications. The information on Attachment "B", however, has been separated to display GS-1 residential rates and GS-1 commercial/industrial rates. The Company is not proposing two GS-1 rate classes. This information is provided solely for the purpose of clarifying the Company's proposal.

In addition, the existing Flexible Gas Service and Off-System Sales Rate Schedules are not included in the rate comparisons. Rates for both schedules are established by negotiation. There are no current customers in the Flexible Gas Service class. Off-System Sales are made on a periodic, opportunity basis. No Special Contract rate comparisons are provided.

Exhibit No. JMH-1 (C)
Florida Division of Chesapeake Utilities Corporation
Docket No. 000108-GU

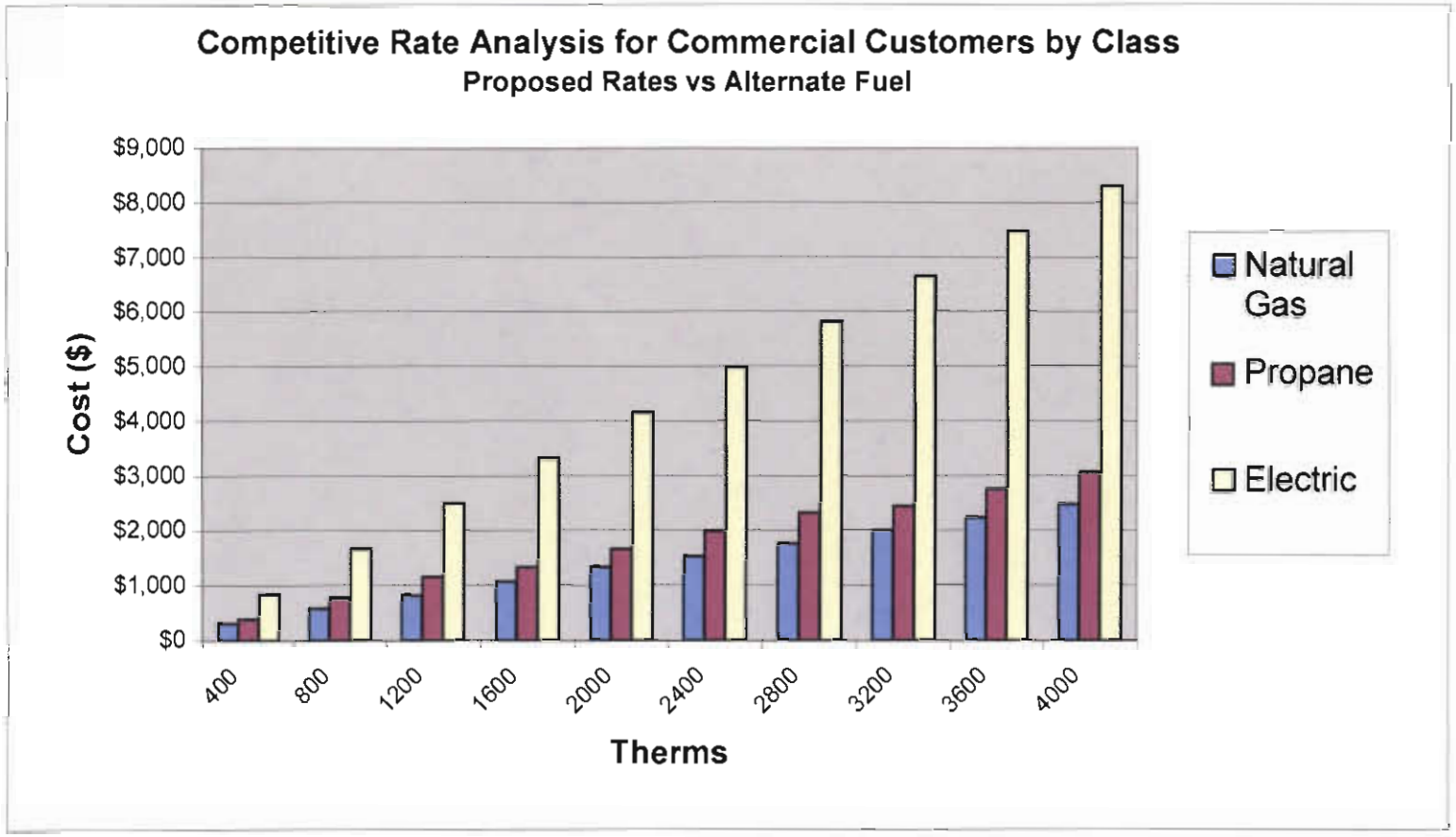
Analysis of Competitive Fuel Costs



Therm Usage	10	20	30	40	50	60	70	80	90	100
Natural Gas	$19.99	$24.97	$40.40	$46.37	$52.34	$58.31	$64.28	$70.24	$76.21	$82.18
Propane	$19.11	$38.22	$57.33	$76.44	$81.90	$98.28	$114.66	$117.94	$132.68	$147.42
Electric	$24.91	$49.81	$74.72	$99.62	$124.53	$149.43	$174.34	$199.24	$224.15	$249.05

Percent comparison : Natural Gas to Alternate Fuel

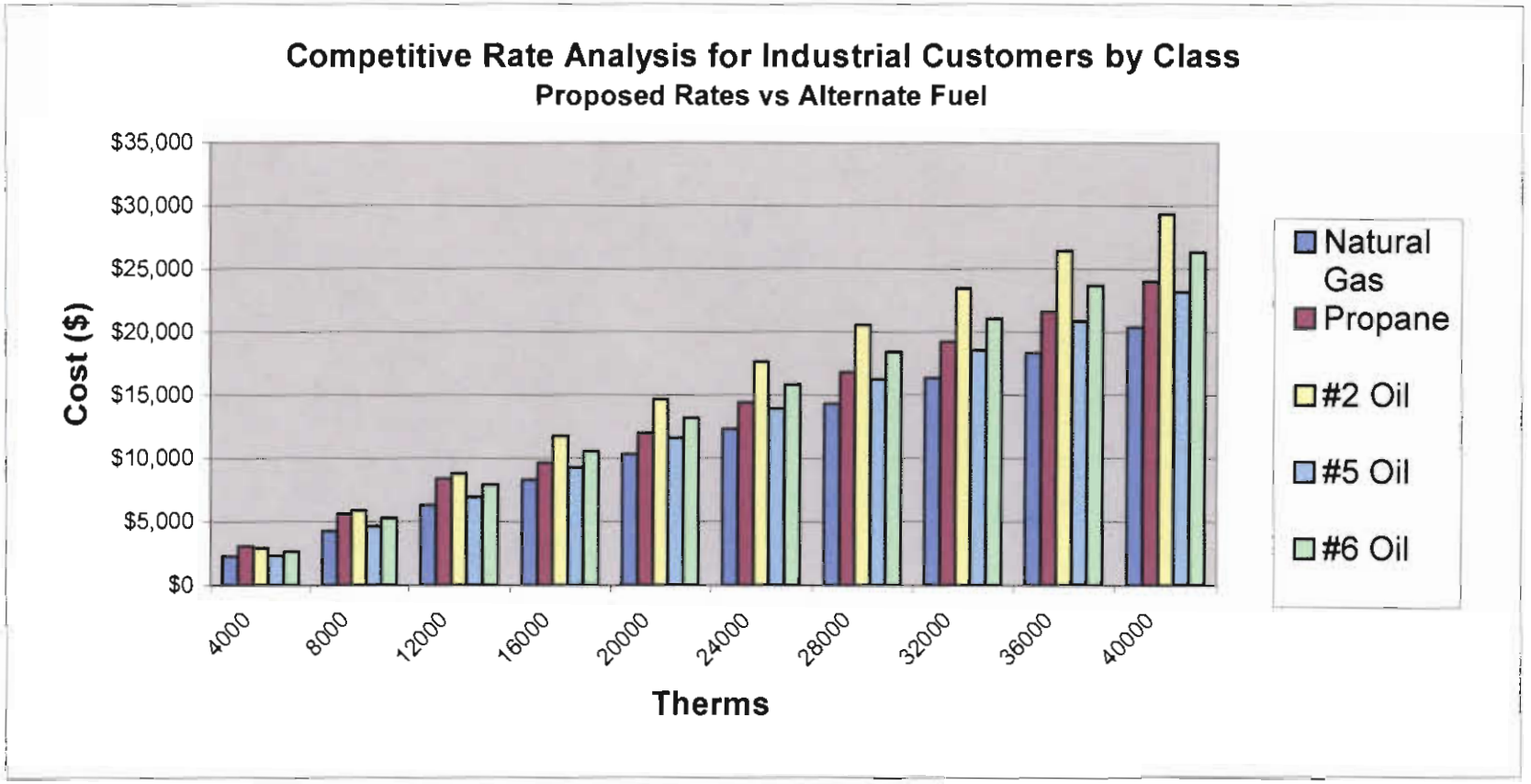
Propane	-4.6%	34.7%	29.5%	39.3%	36.1%	40.7%	43.9%	40.4%	42.6%	44.3%
Electric	19.8%	49.9%	45.9%	53.5%	58.0%	61.0%	63.1%	64.7%	66.0%	67.0%



Therm Usage	400	800	1200	1600	2000	2400	2800	3200	3600	4000
Natural Gas	$308	$584	$815	$1,073	$1,331	$1,528	$1,766	$2,004	$2,241	$2,479
Propane	$384	$769	$1,153	$1,328	$1,660	$1,992	$2,324	$2,446	$2,752	$3,058
Electric	$830	$1,660	$2,489	$3,319	$4,149	$4,979	$5,808	$6,638	$7,468	$8,298

Percent comparison : Natural Gas to Alternate Fuel

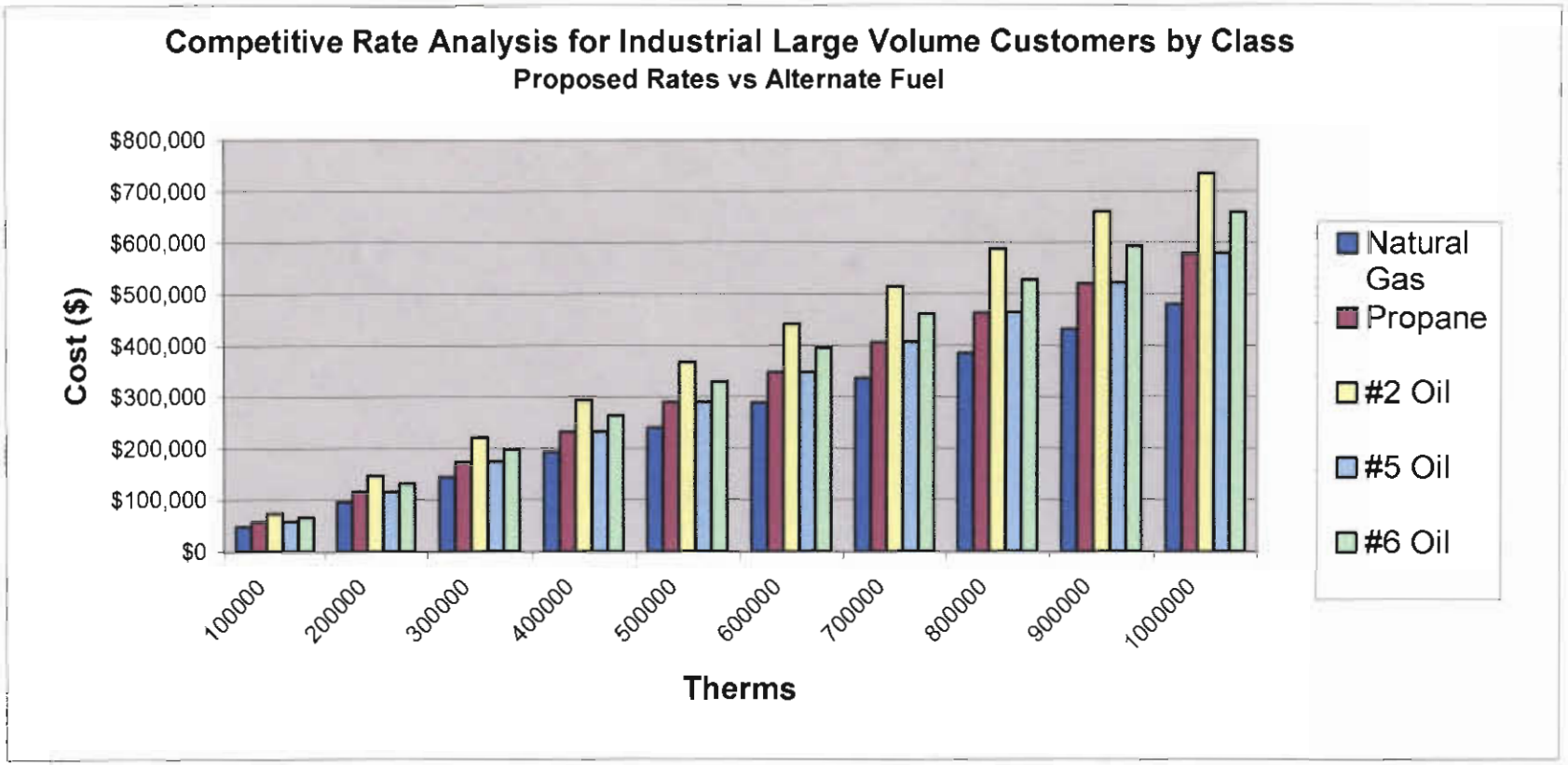
Propane	19.8%	24.1%	29.4%	19.2%	19.8%	23.3%	24.0%	18.1%	18.5%	18.9%
Electric	62.9%	64.8%	67.3%	67.7%	67.9%	69.3%	69.6%	69.8%	70.0%	70.1%



Therm Usage	4000	8000	12000	16000	20000	24000	28000	32000	36000	40000
Natural Gas	$2,261	$4,272	$6,282	$8,293	$10,304	$12,315	$14,325	$16,336	$18,347	$20,358
Propane	$3,058	$5,591	$8,387	$9,610	$12,012	$14,414	$16,817	$19,219	$21,622	$24,024
#2 Oil	$2,936	$5,872	$8,809	$11,745	$14,681	$17,617	$20,553	$23,490	$26,426	$29,362
#5 Oil	$2,320	$4,640	$6,960	$9,280	$11,600	$13,920	$16,240	$18,560	$20,880	$23,200
#6 Oil	$2,635	$5,270	$7,905	$10,540	$13,175	$15,810	$18,445	$21,080	$23,715	$26,350

Percent comparison : Natural Gas to Alternate Fuel

Propane	26.1%	23.6%	25.1%	13.7%	14.2%	14.6%	14.8%	15.0%	15.1%	15.3%
#2 Oil	23.0%	27.3%	28.7%	29.4%	29.8%	30.1%	30.3%	30.5%	30.6%	30.7%
#5 Oil	2.6%	7.9%	9.7%	10.6%	11.2%	11.5%	11.8%	12.0%	12.1%	12.3%
#6 Oil	14.2%	18.9%	20.5%	21.3%	21.8%	22.1%	22.3%	22.5%	22.6%	22.7%



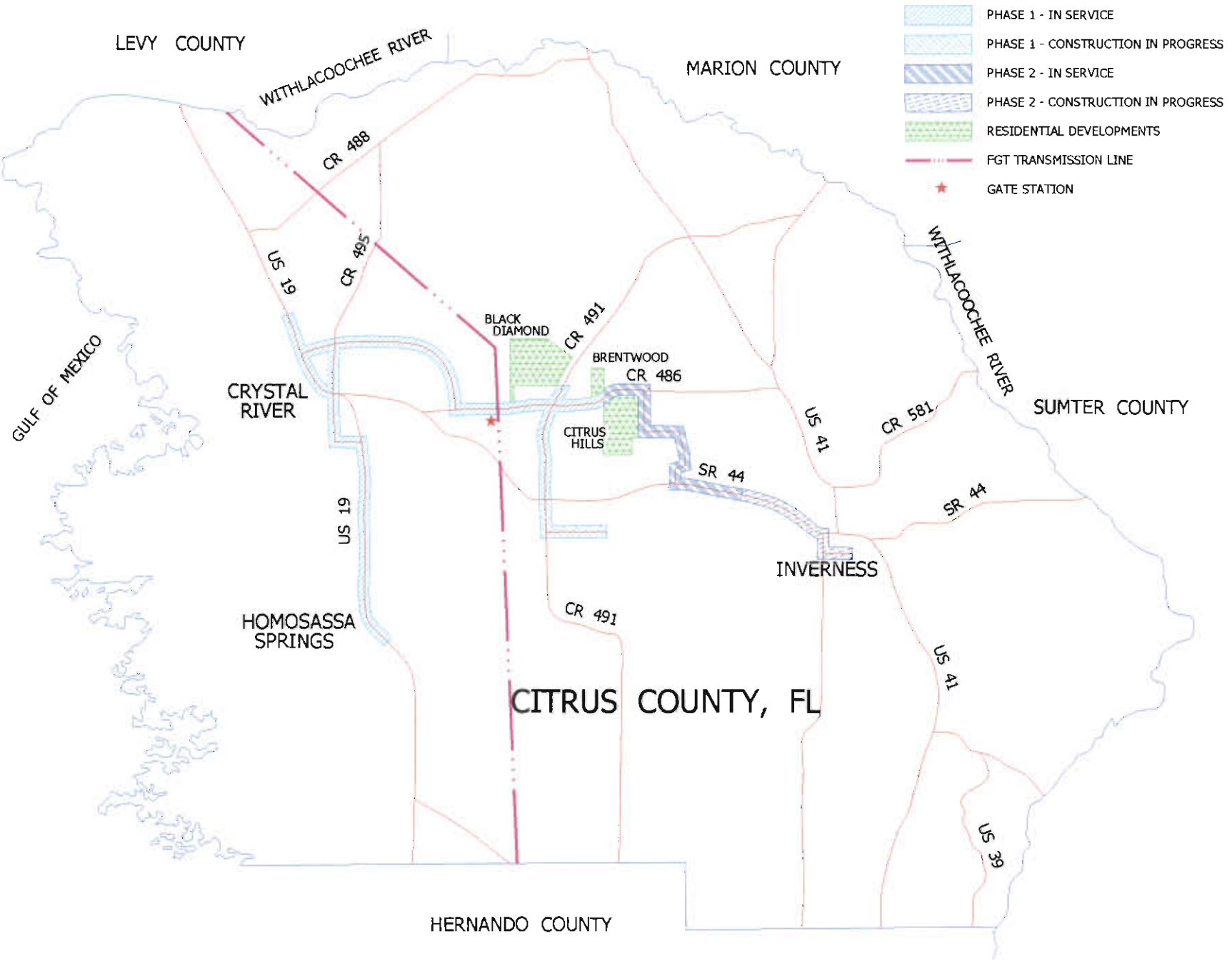
Therm Usage	100000	200000	300000	400000	500000	600000	700000	800000	900000	1000000
Natural Gas	$48,429	$96,358	$144,287	$192,216	$240,145	$288,074	$336,003	$383,932	$431,861	$479,790
Propane	$57,876	$115,752	$173,628	$231,504	$289,380	$347,256	$405,132	$463,008	$520,884	$578,760
#2 Oil	$73,405	$146,810	$220,215	$293,620	$367,025	$440,430	$513,835	$587,240	$660,645	$734,050
#5 Oil	$58,000	$116,000	$174,000	$232,000	$290,000	$348,000	$406,000	$464,000	$522,000	$580,000
#6 Oil	$65,876	$131,752	$197,628	$263,504	$329,380	$395,256	$461,132	$527,008	$592,884	$658,760

Percent comparison : Natural Gas to Alternate Fuel

Propane	16.3%	16.8%	16.9%	17.0%	17.0%	17.0%	17.1%	17.1%	17.1%	17.1%
# 2 Oil	34.0%	34.4%	34.5%	34.5%	34.6%	34.6%	34.6%	34.6%	34.6%	34.6%
#5 Oil	16.5%	16.9%	17.1%	17.1%	17.2%	17.2%	17.2%	17.3%	17.3%	17.3%
#6 Oil	26.5%	26.9%	27.0%	27.1%	27.1%	27.1%	27.1%	27.1%	27.2%	27.2%

Exhibit No. JMH-1 (D)
Florida Division of Chesapeake Utilities Corporation
Docket No. 000108-GU

Map of the Citrus County Distribution System


PHASE 1 - IN SERVICE
PHASE 1 - CONSTRUCTION IN PROGRESS
PHASE 2 - IN SERVICE
PHASE 2 - CONSTRUCTION IN PROGRESS
RESIDENTIAL DEVELOPMENTS
FGT TRANSMISSION LINE
GATE STATION
LEVY COUNTY
WITHLACOOCHEE RIVER
MARION COUNTY
CR 488
US 19
CR 495
BLACK DIAMOND
CR 491
BRENTWOOD
CR 486
GULF OF MEXICO
CRYSTAL RIVER
CITRUS HILLS
US 41
CR 581
WITHLACOOCHEE RIVER
SUMTER COUNTY
SR 44
SR 44
US 19
INVERNESS
HOMOSASSA SPRINGS
CR 491
US 41
CITRUS COUNTY, FL
US 39
HERNANDO COUNTY