BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of	:	DOCKET NO. 000108-GU
REQUEST FOR RATE INCREASE BY FLORIDA DIVISION OF CHESAPEAKE UTILITIES CORPORATION.	:	

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VOLUME 1

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PROCEEDINGS: **HEARING**

BEFORE: CHAIRMAN J. TERRY DEASON
COMMISSIONER E. LEON JACOBS, JR.
COMMISSIONER LILA A. JABER

DATE: Monday, October 16, 2000

TIME: Commenced at 9:30 a.m.
Concluded at 2:15 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: KORETTA E. STANFORD, RPR
Official FPSC Reporter

APPEARANCES:

WAYNE L. SCHIEFELBEIN, P. O. Box 15856, Tallahassee, Florida 32317-5856, appearing on behalf of Florida Division of Chesapeake Utilities Corporation.

ROBERT V. ELIAS, Florida Public Service Commission, Division of Legal Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0870, appearing on behalf of the Commission Staff.

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P R O C E E D I N G S

CHAIRMAN DEASON: Call the hearing to order. Could I have the Notice read, please.

MR. MAILHOT: I think, Bob has gone to get some copies of the prehearing order.

CHAIRMAN DEASON: All right. We'll just wait for just a moment until he returns.

Bob, if you could, read the Notice, please.

MR. ELIAS: Notice issued by the Division of Records and Reporting advises that a hearing will be held in Docket Number 000108-GU; that is, the request for a rate increase by the Florida Division of Chesapeake Utilities Corporation at 9:30 a.m., Monday, October 16th, 2000, in Room 148 of the Betty Easley Conference Center in Tallahassee, Florida.

CHAIRMAN DEASON: Thank you. Take appearances.

MR. SCHIEFELBEIN: Good morning, Commissioners. My name is Wayne Schiefelbein. I'm appearing on behalf of the Florida Division of Chesapeake Utilities Corporation. My address is P.O. Box 15856, Tallahassee 32317-5856.

MR. ELIAS: And I'm Robert V. Elias appearing on behalf of the Commission Staff. The address is as stated in the prehearing order.

CHAIRMAN DEASON: Okay. Thank you.

Preliminary matters?

MR. SCHIEFELBEIN: Commissioner, if I may.

CHAIRMAN DEASON: Please.

MR. SCHIEFELBEIN: As the prehearing order just issued indicates, there are a very narrow group of issues that remain for stipulation in this case. And subject to your agreement, I would propose that we stand down and continue our meeting with Staff that has been going on and off for the last couple of weeks and see if we might not wrap this up.

I think that there are, essentially, four areas, other than fallout areas, that remain where there are differences. And I don't think that sitting down and discussing those and attempting to resolve them would be terribly time consuming. Subject to Bob's input, the only relatively time-consuming matter that I could see would be if we were to reach a full stipulation, whether or not Staff would need time to conjure up the supporting spreadsheets or schedules, but that would be my suggestion, that we stand down.

CHAIRMAN DEASON: Okay. Mr. Elias?

MR. ELIAS: I'm advised that we have those schedules, but for the issues that remain in dispute, prepared and that we would need about a half hour once we've reached an agreement to run the schedules and verify the numbers. And so that we would support the opportunity to discuss with the company before we pledge headlong into the remaining issues.

MR. SCHIEFELBEIN: Not to disagree, but I wonder if that also would include the ultimate rates that would fall out of the schedules.

CHAIRMAN DEASON: That would just be revenue requirements, not the actual rates?

MR. SCHIEFELBEIN: Yes, sir.

I would suspect that the Staff and the company could collaborate, if there were a stipulated revenue requirement, in attempting to derive the appropriate rates that would generate that revenue requirement.

MR. WHEELER: This is David Wheeler with the Commission Staff. Half an hour would be pushing it in terms of actually producing rates. What we'd like to have is an opportunity to sit down with the company and put our heads together and make sure that we have the rates exactly right before we bring them back. I would anticipate that we would be able to do it today, but not within a half hour.

CHAIRMAN DEASON: Okay. Mr. Schiefelbein, how much time are you talking about, at least for the initial consultations to take place?

MR. SCHIEFELBEIN: I would estimate, Commissioner, 30 to 45 minutes. That would be not including the actual production of revised schedules and, of course, not the revised rates.

CHAIRMAN DEASON: Why don't we just stand down until 10:30. We'll reconvene at that time. And we'll see where we are. And if more time is needed -- if it looks like more time would yield fruitful results, well, then, we'll entertain that at that time.

MR. SCHIEFELBEIN: Thank you.

CHAIRMAN DEASON: So, we'll stand in recess until 10:30.

(Brief recess.)

CHAIRMAN DEASON: Call the hearing back to order. Mr. Elias.

MR. ELIAS: Yes, Mr. Chairman. We did meet and believe we've reached a tentative agreement on the issues that were remaining, which I'm going to ask Mr. Devlin to explain and then give the company an opportunity to comment, and then we can discuss the procedure from this point forward.

CHAIRMAN DEASON: Very well. Mr. Devlin?

MR. DEVLIN: I guess, there are three revenue requirement issues. We'll do one at a time. One is always our most fun issue, return on equity. And it's part of reaching agreement in all three, but dealing with one at a time.

We've agreed to 11.5% return on equity. The company -- I don't know how much background you want, Commissioners, but the company had proffered a 12% return in their testimony and Staff had proffered an 11.3% return in their testimony, so 11.5.

CHAIRMAN DEASON: 100 basis points?

MR. DEVLIN: 100 basis points on both sides. So, I can do them one at a time or just all three of them together. Any further discussion on that issue by the company?

CHAIRMAN DEASON: No?

MR. SCHIEFELBEIN: (Inaudible response.)

CHAIRMAN DEASON: You may continue. Commissioners, any questions?

MR. DEVLIN: The second item relates to rate case expense. And what we did in our talks earlier this morning is to adjust rate case expense by those dollars that would not be experienced, if the case is settled. In other words, if we litigated and we had briefs and we had further legal expense, the amount of rate case expense would be higher than otherwise.

And so, we adjusted the dollars rate case expense from 179,000, approximately, which is in the prehearing order, I believe, to $266,000. Primarily, that relates to legal expense and some cost of capital expense.

It's about a $13,000 reduction, and that would be amortized over a 4-year period.

COMMISSIONER JACOBS: Could you give me the amount again?

MR. DEVLIN: The amount was adjusted from, approximately, $279,000 to approximately -- well, actually, right on the nose, $266,000.

CHAIRMAN DEASON: This is a savings of $13,000 by not having to go forward with the hearing and briefs?

MR. DEVLIN: Primarily, correct. Primarily, legal expense, as I understand it. Anything you want to add to that, Wayne?

MR. SCHIEFELBEIN: No, that is correct.

MR. DEVLIN: That's number two.

And the third issue is probably the most complicated esoteric issue is this late testimony regarding two customers that will be dropping off the system; one via bypass, one just closing up shop.

And there's two concessions that we entered into here. One is the revenues associated with those two customers would still be included in our calculation of revenue requirements, but the billing determinants would be computed as if those customers were not on the system. It is somewhat of a compromise in doing that.

Also, we will reflect that a certain level of costs would decline as a result of these customers leaving. And we agree to a $30,000 figure. Therefore, a reduction expense of $30,000 would be included in our calculation of revenue requirements.

CHAIRMAN DEASON: Let me make sure if I understand. You have reduced operating expenses by $30,000 to recognize savings associated with these two customers leaving the system?

MR. DEVLIN: Recognize that expenses would go down, mainly administrative type expenses would go down; maintenance, perhaps. It's somewhat of a judgment call, but we wanted some recognition that expenses would decline as these two customers drop off the system, and $30,000 was agreed upon for that purpose. Anything you want to add to that, Wayne?

MR. SCHIEFELBEIN: That aptly summarizes our agreement.

MR. ELIAS: The only thing that I might add to it is inherent in that agreement is that when we get to the rate design part, no customer class would receive an increase percentagewise than was any greater in the company's filing.

CHAIRMAN DEASON: So, there will be no percentage increase greater than what the customers were noticed was a possibility.

MR. ELIAS: That's correct. That's agreed.

CHAIRMAN DEASON: I have a question concerning the billing determinants. Now, I understand that one customer will be leaving the system sometime middle of next year; is that correct?

MR. SCHIEFELBEIN: That's correct.

CHAIRMAN DEASON: Okay. This was a Citrus producer or processor?

MR. SCHIEFELBEIN: Yes, sir.

CHAIRMAN DEASON: If you're going to go ahead and calculate the billing determinants as if this customer were not on-line, is this going to result in any potential overearnings in the short period of time or not? Has Staff looked at that?

MR. DEVLIN: Well, I'll address it, until somebody else chimes in. It was somewhat of a compromise. For that short period of time, I would think that billing determinants would be somewhat understated for six months or so. But at the same time, we're including the revenues associated with two customers. One customer, apparently, is already gone.

CHAIRMAN DEASON: So, you think in the spirit of compromise, it's a fair compromise, especially given the fact that no customers are going to receive an increase greater than what was --

MR. DEVLIN: Right, that's correct.

MR. ELIAS: And there's another aspect to it, too. And that is the projection of therm sales for next year, but the revenue requirement is based on new customers being added to the system and how those actually shake out as to whether or not they're all going to show up and whether they're going to take it to their anticipated volumes is something that without a crystal ball, nobody's going to be able to say for sure. But in the spirit of compromise and reasonableness, we think this is appropriate.

CHAIRMAN DEASON: Okay.

MR. SCHIEFELBEIN: If I might, Commissioners, I think, it's fair to point out that it is the company's intention at a later date to file for a limited proceeding. We do so with our eyes open that there are no assurances, but it is our intention to get the pot right, to recognize the loss of those two customers in a limited proceeding. That is not an explicit part, I don't believe, of the stipulation, but I think fairness calls for me to point that out.

MR. ELIAS: And as we indicated to the company, that in the event they did so, we would, of course, raise such issues as we believe were necessary to treat the customers and the shareholders fairly, because we're dealing with uncertain future events. There may be adjustments that cut both ways.

And in the event of some future filing, we want to make sure that the door is open to address issues that may not be apparent at this point, but may work the other way in terms of a revenue adjustment.

MR. SCHIEFELBEIN: We recognize that. And I also should state that we have every intention, to the extent that the Commission will allow us, in the interest of avoiding unnecessary expense in recycling, as it were, the audited data in this proceeding, we hope to use the same test years and so forth so that we can use, essentially, the MFRs in this case rather than creating a case out of whole cloth. So, I'm not looking for any assurances on that, but I just think that fairness calls for us to disclose that.

CHAIRMAN DEASON: Are you going to give these rates an opportunity to be in effect for a while before to see what shakes out or are you immediately going to turn around and file for a limited proceeding?

MR. SCHIEFELBEIN: It's our intention, I think, inherent in the process in a limited proceeding, as I understand it, there would be a regulatory lag involved. So, we would not expect, no matter how persuasive our filing may be, that you would all turn around and not suspend them and put them into effect immediately. That is not our expectation. I don't think we have settled on precisely what the time frame would be.

In candor, I would say it would be sooner, rather than later, but I think there is a regulatory lag component there, which is understandable to us. And I certainly think that that limited proceeding would recognize the timing of the revenue loss associated, for example, with that Citrus customer.

CHAIRMAN DEASON: Well, the purpose of my question, pretty straightforward, and that is if we're going to immediately find ourselves back in a proceeding, even though you may call it a limited proceeding, are there really going to be segments, why don't we just go ahead and litigate everything at some point and come to a conclusion as opposed -- I do not want to see there be increases in costs to customers, rate case expense, and things of that nature. While we're all here and convened, if we're going to be in that posture immediately being in a limited proceeding, why not just deal with it as is?

MR. SCHIEFELBEIN: Again, I think, our intention is in a limited proceeding to do everything, and I'm quite serious about this, in our power, to avoid unnecessary additional litigation expense that would be involved by recycling that which we have already done. And, I think that an awful lot of what we've already done will be perfectly usable in the new proceeding, subject, of course, you all looking at it, but it's not our intention to plow new ground.

COMMISSIONER JABER: But is it quite possible you don't need to file for limited proceeding at all?

MR. SCHIEFELBEIN: I think, and Mr. Geoffroy will correct me if I'm wrong, but I think the magnitude of the revenues associated with the loss of these two customers are such that we have to take a serious look at filing that limited proceeding.

COMMISSIONER JABER: Staff, is it possible that this company could have two rate increases in a 12-month period?

MR. DEVLIN: I mean, I suppose, it's possible. I don't know how practical it is considering the time frame it takes to review and not knowing exactly what the nature of the request would be.

COMMISSIONER JABER: And is that permissible in the statute?

MR. ELIAS: Yes.

COMMISSIONER JABER: I guess, the reason I had a concern, Chairman Deason, is I don't know if you all discussed as part of your stipulation and agreement that the company would not file a limited proceeding before a certain amount of time.

MR. ELIAS: We didn't discuss that.

CHAIRMAN DEASON: Well, my concern is that while it is attractive that there is savings attributable to stipulating this case, and I don't mean to minimize that, in reality it's only $13,000. If we can create rates that are going to have some longevity to them, would it be more cost-effective for customers to go ahead and do it as opposed to stipulating this case, save $13,000, but then find ourselves right back in another proceeding?

Even though you may call it a limited proceeding, Staff has just indicated, every issue is going to be fair. In all honesty, what they're telling you is they have given up on some things. And if you're going to bring up the issue that you want that you think you're going to win on, they're going to bring up return equity again. They may shoot for something lower than 11.3 next time. They may bring up other issues that they're giving up on, but we're going to be in a rate proceeding again in a short period of time.

And what Commissioner Jaber is saying is that to make this attractive, it may be that we have some assurance that we're going to live with these rates for some period of time and see what happens. And if you can't live with that, let us know. And we're willing to go forward with going ahead and litigating this case. I mean, that's what we're trying to balance here.

COMMISSIONER JACOBS: I'm a bit novice here, but it sounds like the critical link here is how to get the input numbers correct reflecting the loss of the customers, and we don't have that here. If we wanted to proceed here, how would we do that? I don't think we can do that, can we?

MR. SCHIEFELBEIN: We do have the information here.

COMMISSIONER JACOBS: Okay.

CHAIRMAN DEASON: But the question is as to whether we reopen this case to take that.

COMMISSIONER JACOBS: Yeah.

CHAIRMAN DEASON: But there's already been a ruling by the prehearing officer that there's not going to be supplemental testimony in these issues.

MR. SCHIEFELBEIN: Yes, sir, that was issued Friday afternoon.

MR. STALLCUP: Commissioner, in Mr. Householder's deposition, we did cover some of this ground, and so we could get it on the record if the Commission chose to hear it.

MR. ELIAS: I might have a different take on that.

COMMISSIONER JABER: Is your problem noticing?

MR. ELIAS: Yeah. It's fairness to the customers and the potential for rates higher than were proposed in the company's MFRs.

MR. SCHIEFELBEIN: If I may respond to that. And again, I'm inviting my colleagues here to poke me or cause pain in any number of ways, if I misspeak.

Our first choice here, under all the circumstances, would be to go with and stipulate the settlement. But, I think, I can represent to you, and if given an opportunity, we could prove up that given the other stipulated adjustments in this case, of which there are numerous ones, that there would be no class of customer, even were we allowed to recover the revenues associated with the two lost customers, there would be, in fact, rates no higher than those in the multitude of customer notices that have gone out.

COMMISSIONER JABER: Let me ask Staff a question. Can those kinds of concerns be addressed by making the new issues PAA?

MR. ELIAS: Yes. Tentatively, yes. I'd like a chance to think on that in longer term, you know, just go back and toss it around, but that wasn't what the company proposed in its filing. And there's a different set of time frames associated with addressing something as proposed agency action than in the 8-month clock.

COMMISSIONER JABER: I guess, I'm thinking -- let me just throw this all out at you and let you react.

In terms of considering these stipulated numbers, I envisioned that Staff would come back with a recommendation that included the actual rates and the actual revenue requirement and all the fallout from proposed stipulations.

And if you had to include the supplemental information in that recommendation as a PAA, is that feasible? And does that satisfy the legal concerns with respect to, you know, customers and interested persons or it should be afforded the opportunity to give us their arguments with respect to any issue in a rate case.

MR. ELIAS: Well, couple things.

Number one, the company's got a petition on the table that asks for a certain kind of relief, which we have to address, depending on whether or not they would be willing to amend it to incorporate that change.

And then, the thing, I think, we'd have to take a look at and make a decision on is whether this materially changed the request and whether it would be more appropriate to go back to square zero and start the clock again to provide adequate notice to the customer. With all these adjustments, I'm just not sure how that shakes out.

COMMISSIONER JABER: Let me make sure I understand. It's our obligation to afford interested persons an opportunity to respond. So, what difference does it make what form or fashion the utility filed its request for supplemental information? If we think there is a legal concern, aren't we obligated to make that decision PAA?

MR. ELIAS: Well, except that they didn't ask for the case to be PAA. And under the statute, the Commission has got to make a final decision within a time certain. There's a different procedure for a PAA case than there is for one where they've requested the Commission to set final rates based on 366.063, I think, it is.

And the notice question goes to the customer classes that are advised by the utility early on that they filed for a rate increase, that the MFRs are available in certain places for review and inspection and the information that's contained in the MFRs with respect to the overall revenue increase and the rate increases that each class is looking at.

That's the concerns that we have, you know, as to whether or not -- how the final numbers shake out with respect to each class. Part of our stipulation here was that no class would receive -- implicit in it was that no class would receive an increase that was higher than what was proposed in the MFRs.

MR. SCHIEFELBEIN: And we -- I beg your pardon.

COMMISSIONER JABER: I guess, I'm thinking, Mr. Schiefelbein, you can't have it both ways. There's something to be said about administrative efficiencies and looking at the entire picture at one time. But as I read your motion for supplemental testimony, you acknowledge that this is a significant change -- or a change in the case. It's certainly new information that has a new impact on your case. And in that regard, I think, we have to afford people an opportunity to respond to those issues.

MR. SCHIEFELBEIN: It would -- it's a very interesting area that we have looked at very closely. There are very good arguments that Mr. Elias and, I think, Commissioner Jacobs have offered on this reasoning, as far as notice to customers. We certainly have responses to those. And if need be, we would make them.

But, I think, given all of the procedural due process aspects to both the company and customers on that, I think, it's our belief that the best thing to do is to try to settle the case on the terms that we have put forward today and move forward.

CHAIRMAN DEASON: When do you anticipate filing your limited proceeding?

MR. SCHIEFELBEIN: May I have a minute or two?

Thanks for that moment. Again, in the spirit of compromise, what we would be willing to agree to is that any rate increase, additional rate increase, that may be justified by a limited proceeding, regardless of when we file it, not take effect prior to one year from the resolution of this case.

So, if we were looking at a situation where -- and I realize it comes with no guarantees of any increase or the scope of the proceeding, but it would be our intention to, if we were to file tomorrow or next month or January or whenever is appropriate, and things were to go swimmingly well from our point of view, then, it would still be with the understanding, and we would confirm that in our petition, that it would not go into effect until one year -- at the earliest, one year from the date of the resolution of this proceeding.

CHAIRMAN DEASON: Okay. Staff, do you have anything to add? Let me ask you this. Procedurally, there are no issues that at least are in dispute between Staff and the company, and we have no other intervenors.

MR. ELIAS: That's correct.

CHAIRMAN DEASON: So, Staff, what do you

recommend that we do next procedurally?

MR. ELIAS: I'll give you at least two alternatives that come to mind immediately.

I'm sure that the company would probably prefer that you took up the stipulations now, voted to approve them, and we would come back to you either later on this afternoon or perhaps tomorrow as an additional item on the agenda with detailed schedules showing the impact of the adjustments and final rates for your approval; or we could prepare the schedules, certainly as far as the revenue requirement, bring that back to you this afternoon. And depending on the timing of it, also have final rates available for you today or tomorrow, depending on what your pleasure is.

CHAIRMAN DEASON: Well, let me -- is it possible to put together both the revenue requirements and the rates themselves in one package for consideration later today?

MR. DEVLIN: I'll speak while they're talking there. Revenue requirements, we should be able to put together in a very quick fashion. The rate structure's going to be a little more complicated, especially in that we're going to have to spread these billing determinants over different customer classes. Our preference would be to come back tomorrow, but if the Commission felt strongly that you wanted to resolve this today, we would try to do that today, but it would be later in the afternoon.

CHAIRMAN DEASON: Mr. Schiefelbein.

MR. SCHIEFELBEIN: I just would like to state on behalf of the company, into the record, that we are fully appreciative of how difficult it is to calculate those rates, and we're not looking to rush the system where that might result in an error.

So, we would accept any direction from you and the Staff on that. We will make our rate design person available in whatever seems to be the most expedient way to approach it, as far as that package. It's not an easy job.

COMMISSIONER JABER: That was my question, Mr. Chairman. Help me understand the urgency, Staff. What's actually wrong with the very next agenda? What's the next agenda?

MR. ELIAS: The next agenda's November 7th, and that's not a problem for us.

MR. SCHIEFELBEIN: We would not oppose that.

COMMISSIONER JABER: Because, I think, mistakes can happen when you're --

MR. ELIAS: Oh, yes. And that's why we're more comfortable with tomorrow than this afternoon.

MR. SCHIEFELBEIN: Would it be possible, though, to get some sort of an indication today, as far as obviously you're in no position to make a decision on the rates, but can we have a vote to approve the principles of the settlement, which I would envision as being approval of the stipulated issues in the prehearing order as effected or adjusted by our verbal stipulation today?

And also -- I beg your pardon, if I might continue very quickly.

CHAIRMAN DEASON: Sure.

MR. SCHIEFELBEIN: Possibly today creating by motion the record moving into evidence the company prefiled, the Staff prefiled and, I think, Staff has a mega exhibit, moving that in.

CHAIRMAN DEASON: Yes. Regardless of what we do after today, we've got to go ahead and establish the record. So, we need to do that. And as soon as we get to an appropriate time, we'll go through that process. I don't think it will take an inordinate amount of time to do that, but yes, the record needs to be completed.

The question is does the Commission -- do we desire to go ahead and get a recommendation, a calculation, of the revenue requirement with all of the stipulated issues as well as what has been stipulated to today; get that number established and then, based upon that number, then billing determinants and the rates can be calculated and brought back at a later time, perhaps, to the November 7th agenda.

Is that doable?

MR. ELIAS: Yes. As we said before, I think, we need about a half hour to run the schedules to reduce it to a revenue requirement.

CHAIRMAN DEASON: Well, let's don't rush that either, okay? We've got all day today. If we come back, say, at 2:00 this afternoon for that, is that -- I assume, you have all day scheduled for today or is 2:00 not an appropriate time?

MR. SCHIEFELBEIN: We can work with you on that. The only caveat that I know of is I do have our cost of capital witness, I think, has a 3:40 flight.

CHAIRMAN DEASON: In just a moment, we're going to insert all the testimony and there's going to be all cross examination waived and that gentleman or lady, whomever it may be, I didn't recall, can certainly make their flight.

MR. SCHIEFELBEIN: Thank you.

CHAIRMAN DEASON: Okay.

Okay. Well, let's go through the process of establishing the record in this proceeding. Mr. Elias.

MR. ELIAS: I believe, first it would be for the utility to offer its witnesses and exhibits.

CHAIRMAN DEASON: Okay, Mr. Schiefelbein, you've got 1, 2, 3, 4 -- you've got five witnesses on direct, correct?

MR. SCHIEFELBEIN: Yes, sir.

CHAIRMAN DEASON: If you would just name those, for the record.

MR. SCHIEFELBEIN: Those witnesses are Thomas Geoffroy, James Williams, Jeff Householder, Paul Moul, and Williams Pence.

CHAIRMAN DEASON: Okay. What we will do is -- I assume, you're moving in the prefiled direct testimony for those five witnesses, correct?

MR. SCHIEFELBEIN: Yes, sir.

CHAIRMAN DEASON: Okay. Show that that testimony will be inserted into the record.

CHAIRMAN DEASON: And then, we need to establish exhibit numbers for their prefiled exhibits. Can we just do a composite number?

MR. SCHIEFELBEIN: I would be open to your suggestion.

CHAIRMAN DEASON: Okay. The prefiled exhibits for witness Geoffroy will be composite Exhibit Number 1, for witness Williams will be composite Exhibit 2, for witness Householder that will be composite Exhibit 3, for witness Moul will be 4, and for Pence will be 5.

And without objection, those exhibits will be admitted into the record.

(Exhibits 1, 2, 3, 4, and 5 marked for identification and admitted into the record.)

CHAIRMAN DEASON: And that should conclude your direct case. What about your MFRs, do they need to be identified as an exhibit or is that part of the prefiled exhibits?

MR. SCHIEFELBEIN: If we could refer to the MFRs as Exhibit 6, then.

CHAIRMAN DEASON: Staff, is that fine? MFRs will be composite Exhibit 6.

MR. ELIAS: That's fine.

COMMISSIONER JACOBS: I assume that those Exhibits 2 and 3 aren't complete?

CHAIRMAN DEASON: Accompanying the prefiled testimony?

COMMISSIONER JACOBS: Right.

CHAIRMAN DEASON: Just to be sure, if there's some duplication, fine. But just to be sure, we will identify the entire volume of Minimum Filing Requirements as composite Exhibit 6. Staff, you have no objection entering those MFRs into the record?

MR. ELIAS: No.

CHAIRMAN DEASON: Okay. MFRs, then, will be

Exhibit 6, and Exhibit 6 will be admitted.

(Exhibit 6 marked for identification and admitted into the record.).

BEFORE THE FLORIDA PUBLIC SERVICE COMISSION

DIRECT TESTIMONY

OF THOMAS A. GEOFFROY

ON BEHALF OF THE FLORIDA DIVISION OF

CHESAPEAKE UTILITIES CORPORATION

DOCKET NO. 000108-GU

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

A. My name is Thomas A. Geoffroy. I am the Assistant Vice President of the Florida Division of Chesapeake Utilities Corporation (the "Company"). My business address is 1015 6th Street N.W., Winter Haven, Florida 33882.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND RELEVANT PROFESSIONAL EXPERIENCE.

A. I have a Bachelor of Science Degree in Accounting from the University of Florida. From 1983 through 1996, I was employed by Gainesville Gas Company, prior to its acquisition by the City of Gainesville. During my tenure there, I worked in various capacities, including Special Services Manager, in charge of customer service, accounting and information services. Next, I held the position of Controller and then Gas System Operations Director. I have been employed by the Company since 1996, first as the Florida Regional Manager and currently as the Assistant Vice President, in charge of all of the Florida operations.

Q. PLEASE DESCRIBE YOUR CURRENT DUTIES.

A. My duties as the Assistant Vice President include managing all facets of the Florida operations of the Company, including strategic planning, preparation of capital, revenue and operation and maintenance budgets, natural gas operations, engineering, unregulated operations, including propane and gas marketing activities, sales and marketing, customer service, accounting functions and regulatory activities.

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

A. My testimony will cover many areas, including a general overview of the Company, its customer base, and the need for rate relief. I will discuss the business risks the Company is facing, including the threat of bypass, the loss of industrial load, and competition. I will describe how the Company proposes to continue its strategic efforts to manage these risks, through local and statewide expansion, diversification of customer base, and reductions to the cross-subsidization of customer classes. I will address the Company's response to the recently approved Transportation Rule (Rule No. 25-7.0335 F.A.C.). I will identify specific aspects of the projected capital expenditures and expenses. I will assess certain historical expenses, elaborate on the benefits of the Company's affiliation with Chesapeake Utilities Corporation (CUC), and review appropriate allocations from the Company to its unregulated activities. I will also describe a variety of tariff changes being proposed by the Company in this case. And finally, I will discuss the manufactured gas plant site clean-up and the continuation of funding for this project.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes. Exhibit No. TAG-1 is a list of MFR schedules I am sponsoring. These schedules were prepared under my direction, supervision and control. In response to MFR Schedule E-9, the Company is submitting an entirely reconfigured proposed tariff, Original Volume Number 3. The tariff, together with a new section entitled Forms of Service, is offered as Exhibit No. TAG-2. Finally, Exhibit No. TAG-3 is a summary of the activity in the amortization reserve for the Manufactured Gas Plant site clean-up since 1989.

Q. PLEASE GIVE A GENERAL OVERVIEW OF CHESAPEAKE UTILITIES CORPORATION.

A. Chesapeake Utilities Corporation (CUC) is a diversified utility company engaged in natural gas distribution and transmission, propane distribution and marketing, and advanced information services.

The natural gas distribution and transmission segment consists of three natural gas distribution divisions and the transmission business of Eastern Shore Natural Gas Company. The three divisions serve approximately 39,000 residential, commercial and industrial customers. The Company operates as Chesapeake Utilities throughout central and southern Delaware and Maryland's Eastern Shore, and as Central Florida Gas Company in Florida. The Company's propane distribution and marketing segment includes the operations of Sharp Energy and Xeron. Sharp Energy, based in Salisbury, Maryland, distributes propane to approximately 35,300 customers in central and southern Delaware and the Eastern Shore of Maryland and Virginia.

Xeron, based in Houston, Texas, markets propane to large independent oil and petrochemical companies, resellers and southeastern retail propane companies. United Systems Inc., the advanced information services segment, provides consulting, custom programming, training and development tools for national and international clients from offices in Atlanta, Georgia and Detroit, Michigan.

The Florida Division's core operations are in the central Florida area, serving customers in Winter Haven, Plant City, St. Cloud and many other nearby small communities. In addition, recent expansions have occurred in Gadsden County, where two large industrial customers are served, and in Citrus County, where a recently constructed distribution system is now primarily serving residential and commercial customers in this rapidly growing area. Through a recently approved territorial agreement, the Company is now serving two State prisons in Gilchrist and Union counties. Additional expansion is now underway to serve additional State and industrial facilities in Holmes, Jackson and DeSoto counties.

Q. PLEASE DESCRIBE THE CURRENT CUSTOMER BASE OF THE COMPANY.

A. The Company serves approximately 10,000 customers in the areas mentioned above. Large-use customers (over 100,000 therms annually) that comprise over 90% of the total system throughput dominate the system. Industrial segments served include electric generation, the phosphate and citrus industries, and a variety of other industrial applications, including aluminum extrusion plants, corrugated box plants and ethanol plants. The Company believes that this dependence on large industrial customers is unique within the industry. With the movement towards deregulation both at the federal and state levels, these large use customers have been afforded many new options and benefits. These customers, due to their size and relatively close proximity to the existing interstate pipeline system, have been able to threaten bypass of the Company and achieve lower margins. The bypass threat will likely be enhanced if the proposed Gulfstream pipeline system is built in Florida. The proposed route for this new, billion-dollar plus pipeline, is through the existing service territory of the Company, and within close proximity to existing large-use customers.

The Company, in executing its plan to diversify its customer base, has been growing its residential market by 3.5 to 5.0 percent per year since 1996 (see Schedule C-37) and is projecting a customer growth rate of nearly 10 percent per year for 2000 and 2001. This extraordinary growth rate (the industry average is about 2% per year) is achievable due to the rapid growth of the Orlando and Tampa regions which is now entering into the Company's service territory.

Q. WHAT LEVEL OF RATE RELIEF IS THE COMPANY SEEKING IN THIS CASE?

A. The Company is seeking approval of rates that will generate additional base revenues of $1,826,568 annually, or an overall increase of 23.75%. The total proposed increase, on an annual basis, is well below the compounded inflation rate of over 35% (see MFR Schedule C-37) since 1989, the historic base year in the Company's last rate case. The Company is proposing a return on equity of 12% that generates an overall midpoint rate of return of 8.89%.

Q. WHY IS THE COMPANY PROPOSING AN INCREASE IN THE AUTHORIZED RETURN ON EQUITY FROM ITS PRESENT AUTHORIZED RATE?

A. As discussed in Mr. Moul's testimony, the indicated return on equity for the Company is 13%, an increase of a full two percent from the currently authorized rate. Although the Company believes it can support a return on equity of 13%, the Company is limiting its request to 12%, due to the competitive market conditions in which the Company operates. The proposed return on equity of 12% would provide the Company the opportunity to attract the necessary capital to sustain its distribution system growth plans detailed in this proceeding.

The one percent increase in return on equity proposed by the Company is further justified by the superior level of management performance demonstrated since the prior rate proceeding in effectively dealing with the business risks of the Company, as detailed herein. The Company believes that recognition of its effective and skillful management of the identified business risks is appropriate through the authorized return on equity.

Q. WHAT HAS THE COMPANY DONE TO AVOID SEEKING A RATE INCREASE?

A. Since it last filed for rate relief in 1989, the Company has taken a two-pronged approach towards keeping rates from increasing. The first approach is to grow all sectors of its business: industrial, commercial and residential. As a result of these efforts, annual throughput has increased from about 71 million therms in the 1989 base year of the last case to over 119 million therms in 1999, or an increase of about 68%. The total number of customers has also grown significantly, having increased from an average of 6,954 customers in 1989 to 9,633 customers in 1999, an increase of 39%.

Simultaneously, the Company has aggressively pursued the overall containment of costs. Examples of cost containment are as follows:

- A 1999 audit of ad valorem taxes resulted in a 23% reduction in expenses, or a $71,000 annual savings.
- Beginning January, 1999, the Company outsourced the meter reading function. This eliminated two meter reading positions and the related vehicles previously needed to perform this function.
- Beginning in 1999, the Company installed new electronic flow measurement devices that will reduce operating and maintenance costs for large customers by about $30,000 annually.
- Higher interest cost debt was refinanced (as reflected on MFR Schedule D-8), thus lowering the overall cost of service for the Company's customers.

The Company has achieved a balance of controlling costs where feasible while incurring necessary and prudent costs to stimulate growth and provide for the reliable and safe delivery of service to its customers in a dynamic environment that has seen the shift of operational responsibilities from the interstate pipelines to the local distribution companies.

Q. WHY IS IT NECESSARY FOR THE COMPANY TO SEEK RATE RELIEF AT THIS TIME?

A. There are four primary reasons the Company is seeking relief at this time: 1) recent loss of industrial load and risk of additional loss due to bypass; 2) system expansion activities that need to be recognized in rate base so that the Company is afforded an opportunity to earn an adequate return on this investment; 3) new costs of providing service have arisen during the 10-year period between rate cases, some of which are directly attributable to federal deregulation of interstate pipelines; and, 4) the effects of attrition.

First, the Company has experienced significant, permanent loss of load, primarily through phosphate plant shutdowns. The Company also has had to manage customers who have threatened to bypass the Company and directly connect to the interstate pipeline system. The Company has skillfully negotiated with these customers, at least one of which already had a connection to Florida Gas Transmission Company (FGT), to the benefit of all concerned; large use customers rates have been reduced and all other customers continue to have a portion of the fixed system costs borne by these same customers. The Company believes that such scenarios will continue in the future. Although to date all customers who have threatened bypass remain on the system, the reduction in revenues from these customers necessary to retain them adversely impacts the Company's opportunity to earn the authorized return on its investment.

Second, the Company has incurred significant capital expenses in its efforts to diversify its customer base that need to be recognized in rate base so that an adequate return on this investment can be attained. These expansion activities, such as the start-up distribution system in Citrus County, are critical to the health of the Company and its customers as they spread the fixed costs over a larger base of customers. As the customer base grows, the impact of future increased revenue requirements on rates is lower for each customer. The Company believes that the underpinning of long-term success in its business is to expand its customer base through economically feasible projects. The alternative, remaining stagnant, would ultimately result in either the loss of large use customers to bypass, or their retention at reduced rates, and the subsequent flight of remaining customers to alternative fuels as the revenue requirements rise above what the market will support.

Third, the Company has incurred business costs that previously were borne by the interstate pipeline companies prior to federal deregulation that prohibited the pipelines from continuing in the merchant role. LDCs have new operational expenses, including injecting odorant into the system, and administrative expenses, such as Delivery Point Operator duties and responsibilities. The Company has responded to these new demands while allowing customers to purchase their supply of natural gas directly from marketers and producers.

Finally, in spite of the Company's cost containment and growth efforts, attrition has finally caught up to the Company. Earnings have eroded such that the actual rate of return for 1999 is 5.70%, compared to the minimum range authorized by the Commission of 8.26%. Without any relief, the Company projects that the achieved rate of return by the end of the projected test year will further erode to 3.79%.

Loss of Load and Bypass Risk

Q. YOU STATED THAT ONE REASON THE COMPANY SEEKS RELIEF AT THIS TIME IS DUE TO LOSS OF LOAD, PRIMARILY THROUGH PHOSPHATE PLANT CLOSURES. CAN YOU PROVIDE SPECIFIC EXAMPLES OF CONSTRICTIONS IN THE PHOSPHATE INDUSTRY THAT HAVE IMPACTED THE COMPANY?

A. Yes. The phosphate industry as a whole is growing. However, production in Polk County at the plants served by the Company is declining. Part of the decline can be attributed to the depressed price of Di Ammonium Phosphate (DAP) on the world market. An additional factor is the depletion of several Polk County mines. Finally, there have been changes in the production techniques that reduced gas consumption at two of the larger plants. The following list outlines gas load reductions at specific phosphate plants.

- Mulberry Phosphate: The Mulberry Phosphate plant produced DAP and has been closed since December 1999. Their product could not compete on the world market with Chinese exports. According to the plant operations manager the facility may not reopen. In 1999 this plant used 1,188,949 therms.

- IMC Nichols: The Nichols plant also produced DAP. IMC confirms reports in the local press that the plant will not reopen and will likely be dismantled. In 1998 the plant used 1,876,769 therms; 1999 consumption was down in a partial year to 535,743 therms.
- IMC Mulberry: This facility dried wet limerock, an ingredient used in the phosphate industry. IMC indicates that the plant is closed and will not reopen. The limerock is now dried at another facility. In 1997, the facility's gas consumption totaled 1,593,181 therms; 1998 consumption dropped to 250,884, and no gas was used in 1999.
- IMC Norlyn: The Norlyn plant was originally scheduled to be closed in 1995. IMC has continued production at this plant with a process that consumes significantly less gas. The current projection from IMC management is that the plant will remain open through 2002. In 1997 the Norlyn plant consumed 2,964,359 therms, 1998 volumes dropped to 1,759,671 therms and 1999 volumes continued downward to 1,202,073 therms. It should be noted that at the time of the Company's 1989 base rate case this plant was burning almost 11,600,000 therms per year.
- IMC New Wales: The New Wales plant is the Company's third largest customer, using 16,391,000 therms in 1999. The plant's total fuel needs exceed 20,000,000 equivalent therms. New Wales burns #6 fuel oil for part of its processing when to do so is economically viable. The Company's gas sales have ranged from 11,000,000 to 19,000,000

over the past ten years. The forecast for 2001 indicates a one million therm increase in gas usage. The plant is adding a new kiln that will increase consumption. There are signs, however, that the New Wales facility is also changing its historical operational patterns. The production of granular triple superphosphate was moved to the IMC South Pierce plant in March of this year. The Company does not currently serve the South Pierce plant, and has no expectation of doing so, despite our best effort to extend service to the plant. The IMC Area Production Manager estimates that the New Wales plant will consume 9% less gas due to the relocation of the product line (the new kiln makes up for this consumption loss). At this time the Company is unable to forecast the long-term sustainability of the IMC New Wales load. It should be noted that the New Wales plant is only 4 miles from the FGT interstate pipeline and has a connection already in place. The Company's 1997 rate restructuring was precipitated in significant part by IMC's demand for a rate discount for this facility to avoid a system bypass.

- Agrifos: The Agrifos phosphate plant was scheduled to discontinue operations in May 2000. Employees of Agrifos have received notice of a layoff. According to plant managers, Agrifos became non-competitive in the export market as new foreign phosphate supplies came on line. Agrifos used 2,800,000 therms in 1999. The Company has retained Agrifos in its Projected Test Year forecast, but is not certain that the plant will be in operation next year.

Q. ARE THERE OTHER EXAMPLES OF CUSTOMERS OUTSIDE THE PHOSPHATE INDUSTRY REDUCING THEIR GAS CONSUMPTION?

A. There are several customers in other industries that have gone out of business over the past two years. Among these are three citrus packing houses that each used approximately 100,000 therms per year. Consolidated Stainless Inc., no longer in business, used over 260,000 therms in 1997. National Southeast Aluminum burned 120,000 therms in 1997, but ceased operation last year. By far the largest non-phosphate customer exhibiting a reduction in consumption is the Alcoa Company (formerly Alumax), with 1999 gas volumes of 4,799,310 therms, down from 6,143,854 therms in 1997. Alcoa was the second customer that received a substantial rate decrease as part of the Company's 1997 Rate Restructuring. The City of St. Cloud transferred the operation of its electric generating station to the Orlando Utilities Commission. OUC operates the plant as a peaking facility. Subsequent to OUC's assuming operation of the plant, gas consumption has dropped from over 3,000,000 therms to around 500,000. The Florida Distillers Company's Auburndale facility became the steam host for the Auburndale Power Partners cogeneration facility. Consumption at Florida Distillers, Auburndale has decreased from 1,550,000 in 1989, to 17,500 therms in 1999. The Florida Distillers, Lake Alfred plant moved a significant part of its production to the Caribbean. As a result, its consumption decreased by 1,200,000 since the last rate filing. Finally, OrangeCo, a large citrus processor, consumed almost 4,000,000 in 1989 but has fallen off to 1,650,000 in 1999. It is the Company's expectation, based on conversations with these customers, that these lower consumption levels will continue through the Projected Test Year.

Q. WHAT HAS THE COMPANY DONE IN RESPONSE TO THE THREAT OF BYPASS?

A. As the federal and state regulatory climate continues to promote the movement to deregulation, the Company's job of retaining large use customers becomes more and more difficult. It is imperative, however, that the Company continue to take appropriate action to reduce the likelihood of customer bypass. The Company has tailored its rates, terms and conditions of service to meet the needs of the large use customers through the use of Special Contracts, approved by the Commission. The Company has successfully demonstrated that each Special Contract clearly recovers the cost of providing service.

Over the past several years the Company made a number of modifications to its tariff directed at attracting (and retaining) large volume accounts. The addition of transportation service options, flexible pricing provisions for sales and transportation service, and a separate PGA for industrial accounts are all examples of actions focused on serving industrial customers.

Additional efforts by the Company include establishing the Flexible Gas Service tariff that provides additional flexibility to add or retain customers that have alternative fuel options, including natural gas directly from the interstate pipeline. The Company has also implemented transportation options for customers that consume more than 200,000 therms per year and is proposing in this case to expand its offerings to include Transportation Aggregation service. These options are designed to create enough flexibility for the Company to meet the needs of high usage customers while retaining the benefits these entities bring to all customers.

The Company has implemented a program designed to diversify its load and dependence on the large commercial and industrial customers by aggressively pursuing residential and small commercial customers. The Company is aggressively pursuing growth in two ways: 1) in its native territories; and, 2) through geographic diversity. Significant growth in population and corresponding small businesses is occurring in the Company's traditional service areas of Hillsborough, Polk and Osceola Counties. Since 1996, residential and small commercial growth has been at over 4% and is projected to increase to 10% or more through the projected test year. Further supporting the growth in the residential and small commercial sectors, the Company has established a new distribution system in Citrus County.

The Company has also diversified itself geographically into areas of the State less susceptible to bypass. In addition to the new system in Citrus County, the Company established another new system in 1998 in Gadsden County from which it serves two large industrial customers: Quincy Farms, a mushroom growing and processing facility, and Fernlea Nurseries, an ornamental plant nursery. This system has proven itself to be cost effective and favorably contributes to the overall return for the Company. State prisons in Gilchrist, Union, Holmes and Jackson counties are either in-service or are under contract to receive service before the end of the projected test year. A large citrus processing facility in DeSoto County is also under contract, and is anticipated to be in-service by October 2000. Expansion into areas throughout the State not only lowers the impacts of a potential bypass but also helps insulate the Company from a downturn in a particular industry or discrete region and its effects on the Company's opportunity to earn an adequate return.

Q. DOES THE LOSS OF LOAD OR THE BYPASS THREAT PUT THE COMPANY AT RISK FOR STRANDED SUPPLY OR CAPACITY COSTS?

A. The Company has virtually no commodity supply exposure related to the bypass or loss of load risks. The supply portfolio providing gas to the Company's current sales customers is flexible and short-term. The Company primarily holds highly valued FTS-1 capacity on the Florida Gas Transmission (FGT) pipeline. This capacity is the lowest priced capacity offered by FGT and is fully subscribed. Unless a current customer wishes to permanently release FTS-1 capacity, FGT can only offer high-priced FTS-2 capacity to newly connected customers. By having FTS-1 capacity available for those customers that pose the greatest risk of bypass, the Company has reduced its exposure to bypass. Additionally, the Company has taken steps to minimize its high-priced FTS-2 capacity holdings through the turn-back provisions in FGT's Phase 4 and Phase 5 pipeline expansion projects. By the in-service date of Phase 5 (projected for late 2001), the Company will have released back to FGT all of its unwanted FTS-2 capacity holdings.

Q. HAS THE COMPANY GROWN ITS SYSTEM IN NEW AREAS OF THE STATE SOLELY TO ADDRESS THE BYPASS THREAT?

A. No. The Company has grown its more traditional service territories as well.

The Citrus County system, described above, supplements the Company's aggressive efforts to capture the rapid population growth within its traditional service territory located between Orlando and Tampa. As these two metropolitan areas continue to expand, the effect has been felt within the service territory of the Company. Specifically, the area along U.S. 27 near Davenport has been booming with residential and small commercial growth that is being connected to the Company's distribution system. Within the last couple of years, the Company has obtained commitments from developers of many new developments, including Royal Ridge, Santa Cruz, and others, that together account for more than 2,000 planned homes along this growth corridor. The aggressive pursuit of this residential growth has provided the Company with other tangible benefits, as well: the opportunity to add other customers in the proximate areas, including a large hospital (connected), and a citrus processing plant and sand processing plant (both of which will be connected by the summer of 2000).

Q. WHAT ELSE HAS THE COMPANY DONE WITH RESPECT TO THE THREAT OF BYPASS?

A. The Company attempted to reduce the subsidization of the smaller customers through its 1997 Rate Restructuring proceeding. While this filing was precipitated by the actions of two very large customers, the Company took advantage of the opportunity to reduce the level of subsidization occurring on the system through the shifting of revenues towards the residential and small commercial customers. As a consequence of the rate restructuring, the percentage of total base rate revenues generated by the top 20 customers dropped from 41.8% in 1997 to 36.3% in 1998.

The load diversification and rate restructuring efforts of the Company are having the desired impact of mitigating the effects of potential customer bypass on the Company through the reduction of the percentage of revenues derived from large industrial customers.

Q. **DOES THIS MEAN THAT THE COMPANY INTENDS TO ABANDON ITS EFFORTS TO ADD NEW INDUSTRIAL LOAD?**

A. Not at all. The Company is vigorously pursuing opportunities to add large volume gas customers representing a variety of industries. It appears that phosphate related gas volumes will continue to decline as mines are depleted. The long-term objective of building a more diversified revenue base certainly applies to the large customer market. Company marketing and management personnel are active in local economic development efforts to attract large customers representing many industries to each service area. The industrial growth opportunities within our existing territories provide for significant revenue enhancements at reasonable costs. Despite the threats and difficulties mentioned above, natural gas is highly desired by manufacturing and production plants as an economical fuel source.

For example, the Company has signed a contract with the Peace River Citrus Plant in DeSoto County that is expected to bring an additional 3.0 million therms annually onto the system beginning on or about October 2000. In addition, the Company is an active participant in the State of Florida's program to convert its facilities from propane and fuel oil to natural gas. The Company has recently signed contracts for two correctional facilities, Holmes Correctional Institution in Holmes County and Appalachee Correctional Institution in Jackson County. The Company has also recently concluded a Commission-approved Territorial Agreement that results in the addition of two prisons, the Lancaster Correctional Institution in Gilchrist County and the North Florida Reception Center in Union County, to the Company's system. Along with these accounts the Company has added a building products manufacturer, Ytong of Florida; two Standard Sands plants, one each in Lake Wales and Davenport; Willamette, a box manufacturing plant; Bartow Memorial Hospital; United Container, another box manufacturer; and Clark Environmental, a soil reclamation processor. The expansions in Gadsden, Citrus and DeSoto Counties have the potential to serve other larger volume customers, principally hospitals and other industrial facilities. The new distribution facilities constructed to add these customers, and the significant load they bring to the system, as indicated in the projected test year forecast, will help diversify the Company's industrial customer base.

An additional benefit to the industrial and State facilities being pursued and added to the system is that these facilities have communities nearby which may be feasibly served by expansions of the distribution system. These communities, while usually rural and small, typically want natural gas service for residential and small commercial customers. Although none of these communities are projected to be served before the end of the projected test year, these potential new distribution systems will afford the Company the continued opportunity to diversify its load and geographical characteristics, thus reducing the risks associated with the bypass threat.

Q. **IN MR. HOUSEHOLDER'S TESTIMONY, HE DISCUSSES THE COMPETITIVE NATURE OF THE NATURAL GAS INDUSTRY. HAS THE COMPANY EXPERIENCED ANY OF THESE COMPETITIVE FORCES AS IT ATTEMPTS TO EXPAND?**

A. The "competitive nature" that Mr. Householder refers to is not limited to competition between natural gas utilities. Natural gas as a fuel competes literally every day with other fuel sources, including electricity, propane, fuel oil and coal. There are numerous examples that illustrate the competitive nature of the total energy market. I will provide six examples in which the Company was recently involved.

1. Three LDCs (Teco/Peoples Gas, City Gas and the Company) competed to serve customers in Citrus County. The Company emerged as the provider of natural gas service in Citrus County.

2. A gas marketing company (TECO Gas Services) successfully competed with the Company to serve a large citrus processor deep inside the Company's traditional service territory. Citrosuco North America, Inc., with the marketer's assistance, constructed its own pipeline. The Company was able to participate in the deal by offering gate station access and by leasing the pipeline from Citrosuco so that other customers in areas adjacent to the pipeline may receive service

from the Company, with the added benefit that the surrounding Company-owned distribution system can be reinforced and looped.

3. The Company and West Florida Gas competed to serve the Quincy Farms and Fernlea Nursery accounts in Gadsden County. The Company successfully negotiated contracts to serve these customers.

4. A nursing home targeted by the Company to convert to natural gas service as part of a main extension project received a propane gas price, guaranteed for a year, below the laid-in delivery price of propane. To date, the facility continues to use propane, although it is less than five hundred feet from the gas main.

5. The Company continually competes with electric utilities for business. In Polk County, there are numerous examples of residential subdivisions, within feasible reach of the gas system, that are all electric as a direct result of the electric utilities' marketing efforts.

6. IMC Agrico moved a portion of its phosphate production from its New Wales plant, a natural gas customer, to its South Pierce plant. The Company's main could be feasibly extended to the South Pierce plant. However, the plant continues to burn #6 fuel oil.

As exemplified above, energy competition is very keen in Florida. The challenges facing the Company come from other natural gas companies, gas marketers and alternative energy providers. The Company has had to be flexible and offer "value-added" services in order to be successful in capturing customers.

Q. MR. HOUSEHOLDER'S TESTIMONY ALSO REFERS TO SEVERAL CHANGES IN THE COMPANY'S STRATEGIC AND MARKETING OUTLOOK AS A RESULT OF THE NEW GAS INDUSTRY BUSINESS ENVIRONMENT. CAN YOU PLEASE BE MORE SPECIFIC.

A. Yes. Four key resource and regulatory issues directly relate to the Company's ability to effectively position itself to thrive in a competitive energy market:

- The Company must be able to raise the capital needed to extend its system and diversify its customer base in both the areas it currently serves and in new areas.
- The Company must add and realign personnel resources to meet the challenges and demands of the current business environment.
- The Company must develop new and enhanced programs designed to support its growth objectives.
- The Company must develop and implement a rate design that supports its business objectives.

Q. PLEASE DESCRIBE YOUR FIRST ISSUE.

A. The Company must be able to raise the capital it needs to extend its present system and to expand into new service areas with diversified customer groups. I have previously referred to several opportunities to grow the Company's distribution system, both within its native service territory and beyond. The Company's capital expenditure program over the past two years reflects a planned, strategic allocation of resources to feasibly grow its customer base. The capital projections for the Base Year +1 and the Projected Test Year, as indicated on MFR Schedules G-1, pages 23 and 26, will enable the Company to meet the growing demand for gas in its traditional service area, and fund expansion projects to continue the Company's strategic goal of diversified growth into new territory.

Q. PLEASE OUTLINE YOUR SECOND ISSUE.

A. The Company must add and realign personnel resources to meet the challenges and demands of the current business arena. Subsequent to the 1997 Rate Restructuring, the Company recognized that it was not well positioned to grow and diversify its customer base. It also was aware that marketing, outside the core industrial customer group, in a non-monopoly, competitive environment required skill sets that were not typically available in a regulated utility. Three primary areas of improvement have been targeted.

- Customer service skills, of the type exhibited by companies in highly competitive markets, needed to be ingrained into each of the Company's departments. Several steps have been taken to develop a customer-focused, market-driven staff. A company-wide program, "The Chesapeake Choice Program," provides customer service and other skills training to all employees. Incentives to employees demonstrating superior service to customers are provided at all levels of the organization. Customer service goals are now part of each employee's personal performance evaluation.
- The Company must improve its technical capabilities to handle the more complex business interactions resulting from the restructuring of the gas industry. In Mr. Householder's testimony, he describes two new positions, and the associated equipment, required for the Company to implement the expansion of its proposed transportation

services to all non-residential customers. These two positions will supplement the two Transportation and Exchange employees who currently devote the majority of their time to customer- and system-related transportation service issues. Many, if not all, other positions in the Company have undergone significant changes both in workload and technical requirements. More sophisticated metering equipment, expanded and more detailed customer account information, complicated and specific billing procedures, complex accounting records and new system operation parameters affect the jobs of all employees. As unbundled service expands to more customers, the Company must not only have sufficient employees to handle the expanded workload, they must also have the experience and training to meet these customers' expectations.

- Marketing and sales skills must be developed or obtained that enable the Company to effectively compete for business. Over the past two years, the Company has been working to improve its marketing focus. A Marketing Manager position has been created to develop strategies to retain and add revenues that are aligned with corporate objectives, focused on results and coordinated throughout the Company. A Business Development representative is working to identify opportunities for system expansion and growth, both in traditional service areas and beyond. A Commercial and Industrial Sales Representative is assigned to attract new commercial accounts and to increase existing commercial and industrial loads with new gas technologies. Two Sales Representatives are focused on the new residential construction market in Polk and Osceola Counties. A Sales Representative is working the Citrus County market area. The Company's 2001 operating budget adds another Sales Representative to work the western Polk County and Plant City market. The Company has reassigned a Director level employee to oversee all aspects of its marketing and sales operation. In addition to the employees directly responsible for sales, the Company added a Project Coordinator position to facilitate customer/Company communications during the construction process. This position is also responsible for ensuring that the handoff between sales and operations is transparent to the customer. All of these positions are critical to meeting the Company's objectives of growth, diversification of its customer base and providing premier customer service.

The complementary programs that the Company currently has in place to assist in the growth of the customer base are the Commission-approved Energy Conservation Programs. These programs allow the Company to offer rebates to builders/developers for incorporating natural gas appliances into their homes, and rebates for existing homeowners changing out appliances from electric to natural gas. As the Company experiences accelerated growth in the residential market, as described above, it will incur increased expenses in the existing Energy Conservation programs that support this growth.

Q. WHAT IS THE THIRD ISSUE RELATED TO THE COMPANY'S ABILITY TO SUCCEED IN THE CURRENT MARKET?

A. Beyond the personnel resource issues related to increased marketing and sales activities, there are a number of new and enhanced programs that must be implemented to support the growth objective. The following list outlines the major elements:

- A commission or incentive pay plan is under development for all sales representatives.
- An incentive pay structure for operations employees to promote increased productivity is under development.
- As the Company grows its customer base, the incentives, advertising and promotional costs related to the approved energy conservation program are estimated to increase.
- A program designed to increase the number of burnertips in existing residential homes is under development. This program will utilize the approved energy conservation program to offset new appliance installation costs.
- Increased sales and technical training programs have already begun in 2000.
- Improvements are planned to the Company's Customer Information System to accommodate increasing the number of transportation service customers.
- The Company's Preferred Dealer network of gas appliance retailers will be expanded.

Q. PLEASE DESCRIBE THE FOURTH ISSUE.

A. The Company's current rate design does not adequately support the business objectives previously described. In order for the Company to effectively compete with the various alternative fuels in each market sector, the Company must differentiate customers based on annual usage, not on customer type. It is not at all uncommon in the unregulated energy marketplace (propane and fuel oil) to set prices based upon usage, not whether a customer is residential or commercial. To this end, the Company is proposing to eliminate most of the existing rate classifications in the current tariff, and replace these with rate schedules based solely on annual usage of each customer. Mr. Householder's testimony elaborates on the appropriate usage classifications.

Business Opportunities

Q. PLEASE DESCRIBE DEVELOPMENT ACTIVITIES IN THE COMPANY'S TRADITIONAL SERVICE AREA.

A. The historical service areas in Polk and Hillsborough Counties are growing. Since the last base rate case in 1989, the Company has experienced a 64% increase in residential customers. Over the next two years, the customer growth forecast included in the Company projections anticipates a 10% annual increase in residential customers. Part of this projected growth is due to a more aggressive marketing approach and the business strategy of expanding the Company's service territory. However, a significant portion of the growth in residential customers is due to increases in development in eastern Polk County around the Davenport area and along the US 27 corridor. Projections from the Hillsborough County Planning Department indicate that the Plant City area will grow as people continue to look for bedroom communities within driving distance of Tampa. Over time, the commercial development that historically follows residential development will provide additional service opportunities in the Company's historic territory.

Q. WHAT OPPORTUNITIES EXIST TO COMPETE FOR NEW BUSINESS.

A. There are many opportunities throughout the State for expansion and growth of any natural gas company. Increased demand for natural gas, primarily by electric generators, has resulted in newly built interstate pipeline capacity, with additional projects forecast for the immediate future. Florida Gas Transmission completed its Phase 3 expansion in 1996. The West Leg of the Phase 3 project followed a route generally along the coast of west central Florida. FGT anticipates placing the Phase 4 expansion in service by April 2001. Phase 4 will include a major pipeline extension to southwest Florida, primarily to serve the FP&L Ft. Myers generating plant. These transmission system expansions are providing opportunities for distribution companies to compete for new natural gas service areas. The Company's Citrus County expansion, discussed in detail in Mr. Householder's testimony, is an example of an opportunity resulting from the Phase 3 expansion. An agreement with the Peace River Citrus Company was recently signed to provide gas service subsequent to the FGT Phase 4 expansion to southwest Florida. FGT has committed by contract to having this section of the Phase 4 project available for FP&L to test their converted plant by October 2000. Thus, the Company has projected that the Peace River facility will be able to also begin receiving service in October 2000, even though the official in-service date of Phase 4 is not projected until April 2001. The Peace River agreement, along with opportunities to serve certain State of Florida facilities in the vicinity, will enable the Company to offer service, if feasible, to customers in the City of Arcadia. In both cases, the Company actively competed with other LDCs to provide service to these new areas.

Q. DO PIPELINE EXPANSION PROJECTS PROVIDE OTHER OPPORTUNITIES FOR THE COMPANY?

A. The construction of new pipeline capacity provides both risk and opportunity for LDCs. Opportunities will arise to compete with other distributors for new gas service territories along the routes of the new pipelines. The Company intends to aggressively compete to develop feasible system expansions off any new pipeline. In addition, competition among interstate pipelines may result in overall lower rates and improved operating conditions for pipeline customers, including LDCs. Increased pipeline capacity generally promotes economic development and enables LDCs to meet customer growth targets. LDCs and gas marketers may have the opportunity to more creatively and effectively manage their gas transportation activities (access to storage, backhaul options, segmentation of pipeline capacity, delivery point flexibility, access to new supply and receipt points, etc.) to the benefit of consumers. The probability of substantial excess capacity, especially during electric off-peak months, could provide opportunities for significant short-term discounts. Finally, interconnections with more than one pipeline will increase system reliability for end-users.

Q. **DO OPPORTUNITIES EXIST FOR FEASIBLE SYSTEM EXPANSIONS INTO NEW SERVICE AREAS THAT ARE NOT RELATED TO THE CONSTRUCTION OF NEW INTERSTATE PIPELINE FACILITIES?**

A. Yes. In recent years the Company has actively looked for opportunities to serve customers in close proximity to the existing FGT transmission pipeline. In 1998, the Company extended natural gas service to two industrial businesses in Gadsden County (Fernlea Nursery and Quincy Farms). This system expansion is an excellent example of the Company's efforts to identify large volume propane or fuel oil accounts that can be feasibly served from the existing interstate pipeline. Both customers have been on-line for almost two years. The actual construction cost to serve these facilities was on budget, and the first year sales volumes and revenues were slightly above initial projections. Similar opportunities exist throughout the State. The Champions Gate development currently under construction in western Osceola County is another example of the Company's effort to expand gas service to new areas. Champions' Gate is a mixed-use development adjacent to Interstate 4, close to the Disney World complex. The projected build-out calls for 4,136 residences, 1,636 hotel rooms, 426,000 square feet of retail space and three golf courses. The Company was able to secure a contract to serve the Champions Gate development even though this general geographic area is currently unserved by natural gas. Gas service to the first units is scheduled to begin in late fall 2000. The State of Florida's *Energy* Direct program is also offering new service opportunities to LDCs. The Florida Department of Management Services (DMS) administers a program to lower the fuel costs of facilities eligible to participate in the State's natural gas term contract purchasing program. *Energy* Direct is a mechanism for aggregating the gas loads of participating facilities to provide transportation service. The DMS negotiates gas supply arrangements and coordinates capacity requirements to the benefit of those customers in the *Energy* Direct buying pool. The program focuses on shifting existing natural gas facilities from sales service to lower cost transportation, the conversion of non-gas facilities to natural gas, and encouraging gas use in new construction. *Energy* Direct has successfully converted a number of correctional institutions to gas. Frequently these prisons are in rural areas with no natural gas service. In many cases the facility is willing to pay a portion of the capital cost to ensure the project is feasible. Extending natural gas to the prison, or other state facility, may offer the LDC an opportunity to provide gas service to a near-by community.

Q. ARE THERE SPECIFIC EXAMPLES WHERE THIS OPPORTUNITY EXISTS?

A. In a recent territorial exchange with Peoples Gas System as approved by Order No. PSC-99-2228-PAA-GU, the Company acquired the facilities necessary to serve Lancaster Correctional Institution in Gilchrist County, and the North Florida Reception Center in Union County. These correctional institutions participate in the Energy Direct program. Both are relatively close to small rural communities (Trenton and Lake Butler, respectively) that have expressed an interest in natural gas service.

In north Florida, the Company is extending gas mains to the Holmes Correctional Institution, close to the city of Bonifay. As mentioned above, the gas loads for the Desoto Correctional Institution facility and the G. Pierce Wood Hospital will help in assessing the feasibility of serving the town of Arcadia. At this time, the Company has not made a final determination on serving any of the above communities. If these extensions prove feasible, the Company's long-term capital spending plan anticipates extending service to these communities in 2002-2003 or beyond.

Q. ARE THERE OTHER EFFORTS UNDERWAY TO DIVERSIFY THE COMPANY REVENUE SOURCES?

Although the Company has focused its efforts to grow the regulated, natural gas segment of its business over the last several years, it is also involved in some unregulated activities. These activities are designed to supplement and enhance the main natural gas operations of the Company by providing additional services that customers of the Company desire. Builders, commercial customers and residential homeowners want to have a convenient source for installation of customer-owned piping needed for natural gas service. Commercial and residential customers want a trusted and well-trained source for appliance and equipment repairs and maintenance. The Company has recognized that it has the trained professionals needed to fulfill these needs and expectations of its customers at an unregulated market price. In addition, large use customers (over the current threshold of 200,000 therms per year) eligible to transport natural gas on the Company's system, want an experienced and knowledgeable marketer to help take full advantage of open market gas purchasing opportunities. The Company has its own marketing affiliate, PESCO, to fulfill this need. Further, the Company is beginning its propane start-up activities in Citrus and Polk Counties that are anticipated to be operational before the end of the year 2000. Other propane opportunities are currently being evaluated.

Projected Capital Expenditures and Expenses

Q. WHAT ARE THE PROJECTED CAPITAL EXPENDITURES FOR 2000 AND 2001?

The Company has an approved capital budget for the year 2000 of $5,756,126 and has projected its capital budget for 2001 at $5,261,064. Included in each of these two years capital budgets are various projects that would connect State and industrial projects around the state. It is important for the Company to identify and include in its budgeting process projects such as these so that the Company can identify the potential future capital requirements. This allows the Company adequate time to attract the necessary external capital at favorable interest rates. Several of these projects remain uncertain at this time; therefore, the Company has removed these projects from the projections made in this case. The capital dollars removed in the years 2000 and 2001 relating to these uncertain projects are $1,558,937 and $2,193,616, respectively.

The capital expenditure projection for 2000 reflected in the MFRs totals $4,197,189, and includes $3,558,871 for revenue-producing facilities, including approximately $1.5 million for the construction of the facilities in Citrus County; $248,125 for replacement of mains and services and improvement of the distribution system; and $390,193 for replacement of vehicles and equipment and for improvements to structures.

Capital expenditure projections for 2001, as reflected in the MFRs, total $3,067,448, and includes $2,294,448 for revenue-producing facilities, including approximately $1 million for the continued construction of facilities in Citrus County; $420,000 for replacement of mains and services and improvement of the distribution system; and $353,000 for replacement of vehicles and equipment and for improvements to structures.

Q. ARE ALL PROJECTS IN THE CAPITAL PROJECTIONS FOR NEW DISTRIBUTION FACILITES?

A. No, there are several road-widening related main relocation projects contained in the capital budgets. The Company is authorized by federal, state and local transportation agencies to place its distribution facilities within the public rights-of-way at no charge. However, if it is a road right-of-way, then the Company is fully responsible for all of its incurred costs to relocate its facilities due to any road widening. For example, if the road is being widened from two lanes to four lanes, the Company's distribution facilities located within the right-of-way may need to be moved so that they are not underneath the road but rather adjacent to the road. This is typically required for safety reasons and for ease of access should the distribution facilities require maintenance. The original distribution main is typically removed and replaced with a new section of distribution main and tied back into unaffected sections of the distribution system; hence, the capitalization of the new facilities.

The areas the Company serves are continuing to experience rapid growth that places a significant burden on the transportation infrastructure. As a result, several projects are already in progress and are expected to be completed by the end of the projected test year. These projects include the Cypress Garden Boulevard road-widening project through Winter Haven, requiring a capital expenditure from the Company of $100,000; the State Road 17 rerouting project through the middle of Winter Haven, estimated to cost $125,000; and a portion of the US 27 widening project from Interstate 4 south to Lake Wales, estimated at $350,000. Recently completed road projects have impacted the Company's ability to earn a reasonable return, including the Interstate 4 widening from four to six lanes through Plant City, that required the Company to invest $122,000 in 1995 through 1997 for removing and replacing the distribution main. Additionally, the State Road 540 project, which is widening the road from 2 to 4 lanes at the southwestern entrance corridor to Winter Haven, is nearly complete, at a projected total cost of $253,000 (about $200,000 of the total was incurred in 1999, the remainder will be expended in 2000).

Q. HOW ARE THE PROJECTED TEST YEAR EXPENSES DERIVED?

The projected test year expenses are derived by using the adjusted, historical test year expenses as a basis and then applying the appropriate trending factors (inflation only, payroll only, customer growth times inflation and specifically known changes only). The Company has modified the traditional approach of utilizing the customer growth factor by lowering the actual customer growth included in the projected revenues to a more appropriate level. The Company has a relatively small customer base (approximately 10,000 customers) and is projecting aggressive growth of nearly 10% per year through the projected test year. This growth in customers leads to an unusually high increase in projected expenses, if not modified. The Company has, therefore, lowered the customer growth factors for expense projection purposes to a more reasonable level of 5% per year. The Benchmark Variance (MFR Schedule C-34) demonstrates that overall actual expenses from the last case to the current historic base year have not grown as fast as the benchmark would indicate. The Company has managed its expense well over the last decade and believes that its expenses will not grow as fast as the traditional trending of certain expenses by customer growth times inflation would indicate. Therefore, the Company has lowered the customer growth factor as detailed above. The Company has not changed any corresponding revenue projections, however.

The Company has reviewed its budget to determine expenses projected to be incurred beyond the normal trending methods. As detailed earlier in this testimony, the Company's strategic plans require additional resources and training. The year 2000 budget was prepared based on information that was known relative to the overall strategic plan. As with any valuable plan, it changes over time as newly updated information becomes available.

Q. **CAN YOU BE MORE SPECIFIC?**

A. Yes. The Company's projections in this case use the most current information available from the Company's strategic plan. Therefore, those projections contain several new, unbudgeted positions. One of the direct results of the actual and projected customer and geographical growth of the Company is that the amount of internal financial, accounting and rate information required to properly manage the expanding natural gas activities increases dramatically. Each specific distribution area and system must be accounted for separately, both for internal reporting purposes as well as for external taxing authorities, utility and franchise purposes and regulatory purposes. A Regulatory and Rates Manager position is included in the 2001 projected expenses to handle these activities. Some of the duties currently managed by the existing Finance Manager, such as the regulatory filings for the PGA, Energy Conservation, Surveillance Reports, Form 2, and others, will be assigned to the new position. Additionally, this employee will develop special contract rates for large industrial customers, perform periodic tariff review and updating activities, and perform cost studies to determine the profitability of regulated activities. The person filling this position will also manage the special rate offerings of the Company, including the Area Expansion Program, Load Enhancement Programs and the Flexible Gas Service tariff.

The Company proposes adding a Sales Representative due to the customer growth anticipated during the projected test period. The Company currently has the following positions established related to the marketing and sales area: Business Development Manager; Director of Marketing & Sales; Marketing Manager; Commercial & Industrial Sales Manager; two Sales Representatives in the Winter Haven office; a Sales Representative in the Citrus County office; and, a Project Coordinator in the Winter Haven office. The level of expenses, as adjusted, associated with these positions for the historic base year (1999) was $348,547 (see MFR Schedule C-34). The projected growth is at an unprecedented rate during the years 2000, 2001 and beyond. The Orlando and Tampa areas continue to be strong growth areas within the State and this growth is having a tremendous impact on the Hillsborough, Polk and Osceola service territories of the Company. In order to capture the benefits of this growth opportunity, an additional Sales Representative, at an additional cost of $63,000 per year beginning in 2001, is needed to handle the incremental residential growth projected in the revenues, specifically in the western Polk County and Hillsborough County territory.

Two additional new positions, a Scheduler and a Customer Service Representative, are discussed in Mr. Householder's prefiled direct testimony.

Outside Professional Services

Q. PLEASE DESCRIBE EXPENSES FOR OUTSIDE PROFESSIONAL SERVICES.

MFR Schedule C-31 lists all of the outside professional service expenses incurred by the Company during the historical base year. Most of these outside services are normal, recurring expenses, including legal and accounting services. However, three outside services warrant further discussion. First, Mr. Don Headley, a 24-year employee of the Company prior to his retirement in 1999, has been retained to continue to provide the critical industrial customer relations function that has served the Company so well over the years. It is because of the fact that the Company developed, directly through

Mr. Headley, a successful and on-going relationship with every large-use customer (over 50,000 therms annually) that the Company has been able to avoid the negative impacts of a customer bypass of the Company's distribution system. Mr. Headley, who performed this industrial relationship function while an employee, is continuing this role as a consultant, and has gathered valuable information for forecasting purposes while maintaining the personal relationships he has cultivated over the last 20+ years. This role is vitally important to the future business plans and success of the Company and therefore, projects that this relationship will continue well into the foreseeable future.

Second, Mr. David Langer has been retained by the Company to provide key community and governmental contacts for the Citrus County distribution system. Mr. Langer has assisted the Company in many ways, including the acquisition of a piece of property for the city gate station from a local developer at no cost, commitments from the two largest developers in the County to utilize natural gas in their new home construction, and facilitating the Company's understanding and functioning of the local (City and County) permitting processes. Mr. Langer's role in Citrus County will continue in the future as the Company continues to expand its natural gas distribution system beyond the initial commitment from the two largest developers. Mr. Langer's services are required to successfully manage relations with local governmental agencies in the City of Inverness, where construction is now just beginning and in the City of Crystal River, where service is now available. Mr. Langer's extensive community ties will continue to be important in ensuring the acceptance of the Company and natural gas and will result in an enhancement to the number of customers that utilize the distribution system.

The third outside professional expense that warrants discussion is the Associated Gas Distributors of Florida (AGDF). This organization of investor-owned natural gas utilities provides a key forum for the exchange of ideas, full discussion of industry related issues, monitors and participates in State legislative activities and acts as a voice for each individual member at State and Federal regulatory proceedings. The AGDF is active at the Federal Energy Regulatory Commission (FERC) when the incumbent and new interstate pipelines make various filings, including rate increases, expansions, changes to operational terms and conditions and other filings that impact, directly and indirectly, all natural gas consumers in Florida. The AGDF helps member utilities, including the Company, in closely monitoring federal regulatory activities while sharing the associated costs. If this organization did not exist or the Company did not participate in the FERC activities, then the total costs incurred by the Company to adequately monitor and participate in each applicable federal proceeding would be significantly higher than the Company's share of AGDF expenses incurred for the same purpose. Over the past ten years, there have been many significant FERC proceedings relating to the unbundling of interstate pipelines, (resulting in Orders 436, 500, 636, 636A, 636B, and 637) that have required significant participation by Florida natural gas utilities. As a member of AGDF, the Company has controlled these costs while receiving added value through the frequent discussions among members at the AGDF meetings. However, the AGDF does not always come to a consensus on every issue of importance to the Company, so for these instances, the Company retains independent counsel in these specific matters. The Company does not incur duplicative charges on any issues before FERC, through AGDF and the concurrent use of the Company's independent counsel.

Rate Case Expenses

Q. PLEASE DESCRIBE PROJECTED RATE CASE EXPENSES.

Mr. Williams identifies the total amount of projected rate case expenses in his testimony. The projected expenses for this rate case are significantly higher than previous rate cases. There are several reasons for the projection to reflect this level of expense.

The current filing seeks Commission approval of extensive tariff revisions including, unbundled transportation service, new rate classifications and schedules, and changes in flexible pricing schedules that are designed to enable the Company to succeed in a new competitive market environment. These are broader issues than those addressed in the last rate case, which was a basic case essentially designed to increase the Company's revenue requirements.

The rate case expenses projected and included in MFR Schedule C-13 reflect costs that are likely to be incurred assuming the case runs its full course, including a hearing at the Commission. If this case results in a stipulated agreement among all parties, as did its last rate case, then the Company believes it would be more appropriate to incorporate actual rate case expenses incurred in the determination of final rates.

The projected rate case expenses include several outside consultants. Mr. Householder has been retained as a Company witness, testifying on a broad array of issues, including current market conditions, enhanced marketing and sales activities associated with the growth potential in the State, competitive energy alternatives, revenue projections, cost of service and proposed permanent rate design, and the unbundling of transportation services. Mr. Householder brings a level of expertise on these issues that does not exist with current Company personnel. The estimated professional fees included in the rate case expenses for Mr. Householder total $75,000 for the cost of service and other components covered in his testimony.

Mr. Paul Moul's services include pre-filed testimony, rebuttal testimony, responding to interrogatories and data requests and appearing and testifying at a hearing on the Return on Equity components of the case. Mr. Moul's fees are estimated at $41,000.

Mr. William Pence's services are similar in nature to Mr. Moul's. Mr. Pence addresses the Company's ongoing remediation activities at its former Manufactured Gas Plant Site. Mr. Pence's fees are estimated at $20,000. The previous rate case did not include any expenses for a witness on the Manufactured Gas Plant Site.

The aforementioned issues are complex and technical and require the use of outside experts to properly assemble the necessary information, data and testimony to fulfill the Company's burden of proof obligations.

The Company, in the 1989 rate proceeding, did not include as significant a level of work by outside counsel in the preparation of the case. The complexities and broader scope of this case, as described above, warrant increased involvement of outside counsel in the preparation and defense of the case. The Company's legal counsel is the same individual as in the last case. His hourly rate has increased since the 1989 case by twenty percent. The projected professional fees for legal services are $97,500, again through the formal hearing process, rather than by stipulation.

Other miscellaneous expenses, which include travel expenses, Company personnel overtime expenses, and reproduction costs, are estimated at $10,000.

Total rate case expense estimated to be incurred for a full rate increase proceeding is estimated at $243,500. The Company requests a four (4) year amortization period, to mitigate the rate impact of this expense. The Commission approved two and three year amortization periods for the 1987 and 1989 rate cases, respectively. The longer amortization period results in rate case expense in the projected year of $60,875.

Allocated Expenses

Q. **MR WILLIAMS DISCUSSES THE METHODOLOGIES EMPLOYED FOR THE ACCOUNTING OF COSTS BETWEEN CHESAPEAKE UTILITIES CORPORATION (CUC) AND THE COMPANY. PLEASE ELABORATE ON THE BENEFITS THAT THE COMPANY AND ITS CUSTOMERS RECEIVE DUE TO THE AFFILIATION WITH CUC.**

A. One of the primary benefits enjoyed by the Company and its customer base is greater access to capital at more favorable interest rates than could be attained by the previous stand-alone company.

Human Resource functions, which include administering all personnel matters, the mandated drug and alcohol program and complying with administratively complex federal laws, such as the Family and Medical Leave Act (FMLA), provide significant value to the Company because only a portion of the total cost to perform these vital functions are allocated to the Company.

Another benefit from the Company's relationship with CUC is the ability to offer an impressive benefits package to its employees, thereby attracting and retaining quality, dedicated personnel. The Company only bears its proportional share of the costs necessary to administer these benefit programs (401(k) plan, health and life insurance and other employee benefits).

Additional benefits accrue to the Company from other corporate functions, including strategic planning, investor relations' activities, certain accounting functions, including internal audit and the production of mandated quarterly and annual reports, safety, and insurance administration.

The Company employs a superior level of technology and sophistication due to the central resources of the CUC's Management Information Systems (MIS) department. The Company not only is able to increase the productivity level of its employees through the use of computers and related software, but also is able to utilize state-of-the-art field technology, such as electronic flow measurement devices, that reduces the cost of providing reliable service to all of its customers. Such resources would not be as readily available to the Company on a stand-alone basis.

Because these shared resources provide necessary services to the Company at a fraction of the costs that would be incurred if it were a stand-alone company, the lower costs can be passed through to the Company's customers. As is reflected in MFR Schedule C-34, Administrative and General expenses are well below the level of expenses projected by the benchmark.

Q. PLEASE DESCRIBE HOW THE COMPANY ALLOCATES COSTS TO ITS UNREGULATED ACTIVITIES.

Through 1999, the Company's unregulated activities have been exclusively related to the installation and repair of customer-owned facilities (piping and appliances) and the gas marketing activities of Peninsula Energy Services Company (PESCO). PESCO provides existing individual transportation customers the necessary services to secure gas supply and capacity management activities on behalf of the customer. Additional PESCO services include managing the gas transportation scheduling activities, responding to operational orders of the pipeline, and managing the monthly balancing services in accordance with the interstate pipeline's tariff.

The general approach utilized by the Company in this case to allocate rate base and operating expenses to the unregulated portion of the business is consistent with what was approved in the previous rate filing. The method used by the Company to allocate rate base items to these unregulated activities is based on the proportion of direct unregulated payroll expenses to the total Company payroll expenses. Operating and maintenance expenses are directly charged to PESCO and the other unregulated activities. The historical base year expenses, as shown on MFR Schedule C-5, already reflect the direct allocation of costs; thus no additional adjustment to expenses has been made.

<u>Tariff Issues</u>

Q, PLEASE DESCRIBE HOW THE COMPANY IS PROPOSING TO COMPLY WITH THE NEWLY ADOPTED COMMISSION RULE REGARDING TRANSPORTATION SERVICES.

The FPSC recently adopted Rule 25-7.0335, F.A.C., effective April 23, 2000, which requires each local distribution company to offer the transportation of natural gas to all non-residential customers. In order to meet that objective, each gas utility must file a transportation service tariff with the FPSC by July 1, 2000. The Company's proposal to implement the new rule is filed as a part of this rate case. The Company has been working in anticipation of this requirement for over a year and believes that it will incur specific costs to comply with the rule. These costs are detailed in Mr. Householder's testimony.

The Company is fundamentally supportive of the new transportation rule and the positive impacts that it will have on the competitiveness of the non-residential market. The Company believes that ultimately the outcome of this rule will be a complete migration of non-residential customers to transportation service, resulting in savings to these customers primarily through a reduction in interstate pipeline charges. The Company welcomes participation by gas marketers and believes that a sufficient number will enter the market to produce a robust, competitive gas supply and capacity management environment. The Company believes that this type of environment will lead to innovative services that are tailored to individual customer needs at competitive prices. This in turn will encourage non-residential customers to use natural gas for more of their energy needs, helping the Company to feasibly expand and diversify its customer base.

Q. WHAT OTHER TARIFF PROVISIONS ARE PROPOSED BY THE COMPANY?

A. The Company proposes several other changes to the current Commission-approved tariff. The organization of the tariff is updated to be more user friendly. All of the pages relating to the Company's service territory are updated to incorporate changes made in our existing service territories as a result of the recently approved Territorial Agreement and to otherwise reflect the Company's growth throughout the State. Definitions and other terms and conditions are revised to incorporate recently adopted Gas Industry Standards Board (GISB) standards and to define new services being offered by the Company, such as Transportation Aggregation Service. Mr. Householder's testimony details the new Transportation options being offered by the Company and the tariff modifications being made to accommodate these choices.

The Company proposes to remove its Curtailment Plan from the tariff and file it with the Commission for administrative approval. The Company believes that the tariff is not the appropriate place for the plan to reside, but instead curtailment is an operational issue that is best handled within the context of its operation and maintenance procedures. The Company further believes that removing the plan from the tariff will make it easier to adjust the plan over time and keep the plan in step with the existing interstate pipelines' curtailment plan. Additionally, with the potential for at least one more interstate pipeline system providing an interconnection with the Company's distribution system, the Company's curtailment plan will need to be flexible enough to accommodate more than one set of interstate pipeline rules. By removing the curtailment plan from its tariff now, the Company will be prepared to administratively modify it without incurring the costs associated with a formal filing to this Commission to update its curtailment plan.

The Company proposes to modify its Maximum Allowable Construction Cost (MACC) calculation that is used to determine if the Company can feasibly extend its distribution facilities. The maximum capital investment that the Company can currently make is five times the estimated annual non-fuel revenues to be derived from the new facilities. The Company proposes to change this from five to six times the estimated annual non-fuel revenues. This change will support the Company's strategic objective of diversifying its customer base, since having the MACC calculated with a multiplier of six times annual non-fuel revenues will facilitate continued expansion of the existing distribution system. Encouraging system expansions that diversify the customer base reduces existing business risks of the Company and spreads the fixed costs of the system to a larger number of customers. Thus, by enhancing the MACC, existing customers benefit from the growth of the system.

Other minor changes are being made to clean up outdated or minor items within the tariff.

Manufactured Gas Plant Site

Q. PLEASE DISCUSS THE CURRENT STATUS OF THE MANUFACTURED GAS PLANT SITE ACTIVITIES.

A. The Company continues to be involved with a longstanding environmental issue at a former manufactured gas plant site in Winter Haven. As is more fully described in Mr. William Pence's prefiled direct testimony, the Company is working with the Florida Department of Environmental Protection (FDEP) to remediate the site.

The Commission has long been supportive of the Company's efforts in that regard, authorizing recovery of cleanup costs. By Order 18202, issued on September 25, 1987, the Commission allowed recovery of certain costs in the Company's 1987 application for new depreciation rates. By Order No. PSC-93-0025-FOF-GU, issued on January 5, 1993, the Commission authorized amortization of such expenses at an annual rate of $71,114. By Order No. PSC-93-0520-FOF-GU, issued on April 6, 1993, the Commission ratified this authorization, while also allowing the Company to partially offset the expenses with 1991 overearnings, including accrued interest. In addition, by Order No. PSC-95-0160-FOF-GU, issued on February 6, 1995, the Commission permitted the Company to retroactively resume its $71,114 annual accrual to its environmental cleanup of the site, and allowed the Company to offset 1994 excess earnings against costs incurred in 1995. Similarly, the Commission allowed the Company to offset 1995 overearnings, by Order No. PSC-97-0136-FOF-GU, issued on February 10, 1997.

Exhibit No. TAG-3 summarizes the annual accruals and overearnings applied, as authorized by the Commission, and the annual amounts expended on the remediation of the MGP site.

As of December 31, 1999, the balance of the reserve for the MGP site remediation is $504,710. As discussed in Mr. Pence's testimony, between $745,000 to $1,440,000 is currently projected to fully comply with future cleanup requirements.

Given the uncertainty over the final scope of the remediation that will be required by FDEP, the Company believes that the most reasonable course of action in the current rate case is for the Commission to authorize the continued collection of $71,114 annually through the Company's rates to fund the ongoing clean-up efforts.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

SUPPLEMENTAL DIRECT TESTIMONY
OF
THOMAS A. GEOFFROY
FLORIDA DIVISION OF
CHESAPEAKE UTILITIES CORPORATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Thomas A. Geoffroy and my business address is P.O. Box 960, Winter Haven, Florida 33882.

Q. WHAT IS YOUR POSITION WITH THE COMPANY?

A. I am the Assistant Vice President of the Florida Division of Chesapeake Utilities Corporation.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. The purpose of my supplemental testimony is to correct an error made by the Company in its original Minimum Filing Requirements (MFR's) filed with the Commission on May 15, 2000 that has been assigned Docket No. 000108-GU.

Q. WHAT IS THE NATURE OF THE ERROR?

A. The Company made an erroneous adjustment on Schedule G-2 page 1 of 31 (Bates-stamped page 205) in an amount of ($217,321) for interest synchronization. The Company should not have made any adjustment in the Projected Test Year for interest synchronization.

Q. PLEASE EXPLAIN WHAT "INTEREST SYNCHRONIZATION" IS?

A. It is my understanding that Interest Synchronization is a regulatory adjustment that is made when (i) the Company's actual amount of interest expense deducted from regulated earnings to determine income tax expense is different than (ii) the amount of interest expense derived from the utility's adjusted capital structure. The Company, as required, reconciles its capital structure with rate base by making the appropriate adjustments to equalize these two items. Each component of the capital structure has an associated cost. For all debt components (long-term debt, short-term debt, customer deposits, flex-rate liability, etc.), a calculation is made, taking the 13-month average for each debt item and multiplying it by its cost rate. The result is the amount of interest expense applicable to the regulated portion of the company. The difference in the two said amounts of interest expense times the applicable State and Federal Income Tax rates equals the adjustment amount for Interest Synchronization.

The amount of interest deducted from earnings could be different from the amount of interest calculated from the capital structure because of innumerable reasons, a few of which are:

1) The total interest expense of the company may include interest on debt used to finance non-utility activities;
2) A projected test year is used and additional plant is projected, resulting in an increased rate base and increased investor sources of funds in the capital structure;
3) The embedded historic cost of debt is not reflective of the most recent debt cost or the projected debt cost that will be in effect when rates are in effect; and,

4) The company has plans to retire/obtain new debt.

Q. WHY IS IT INAPPROPRIATE FOR THE UTILITY TO MAKE AN ADJUSTMENT TO THE PROJECTED TEST YEAR FOR INTEREST SYNCHRONIZATION?

A. The Company, as is reflected on Schedule G-2, page 30 of 31 (Bates-stamped page 236), used the amount of interest expense derived from the utility's adjusted capital structure in the calculation of income taxes; therefore, no interest synchronization adjustment is required.

Q. WHY DID THE COMPANY MAKE THE ORIGINAL ADJUSTMENT FOR INTEREST SYNCHRONIZATION?

A. The Company last filed for a general rate increase in 1989. Since that time, the entire Florida Division staff responsible for filing rate cases is different than the staff from the previous case and has limited experience with the concept of interest synchronization. The current staff responsible for preparing the current rate case noted that an interest synchronization adjustment was made in the 1989 case and believed that they understood the rationale behind the adjustment. It appeared that in the 1989 case the amount of interest shown on Schedule G-2, page 30 of 31 (Bates-stamped page 131), times the applicable State and Federal income tax rates was, within a reasonable, minor difference, equal to the amount of interest synchronization adjustment shown on Schedule G-2, page 1 of 31 (Bates-stamped page 102). The current staff simply duplicated what it thought was the appropriate methodology for calculating the interest synchronization adjustment.

The Company first became aware of the error during the discovery process when the Commission Staff inquired into this specific adjustment and it became apparent that the adjustment, as reflected in the MFRs, was inappropriate.

Q. WHAT IMPACT DOES THE CORRECTION OF THE INTEREST SYNCHRONIZATION ADJUSTMENT HAVE ON THE REVENUE DIFFICIENCY?

A. The removal of the interest synchronization adjustment from Schedule G-2, page 1 of 31 (Bates-stamped page 205), would reduce the achieved Net Operating Income (NOI) by $217,321, thus increasing the revenue deficiency by $364,752, using the Company-filed multiplier of 1.6784 or $350,191, using a multiplier of 1.6114 as used by the Commission in setting interim rates.

Q. IS THE COMPANY PROPOSING TO INCREASE THE AMOUNT OF ITS OVERALL PROPOSED ANNUAL REVENUE INCREASE BY $350,191?

A. No. The Company is only proposing that the Commission consider this correction to the extent that the Commission determines that the original $1,826,569 amount should in fact be reduced. Then, and only then, would the Company request that the Commission allow an increase in the revenue deficiency due to the correction of the interest synchronization adjustment up to a maximum of the original request of $1,826,569.

Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?

A. Yes, it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF JAMES A. WILLIAMS

ON BEHALF OF THE FLORIDA DIVISION

OF CHESAPEAKE UTILITIES CORPORATION

DOCKET NO. 000108-GU

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

A. My name is James A. Williams, and I am the Finance Manager for the Florida Division of Chesapeake Utilities Corporation (the Company). My business address is 1015 Sixth Street, Winter Haven, Florida 33882-0960.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES AS FINANCE MANAGER?

A. As Finance Manager, I am responsible for the accounting and record keeping for all regulated and unregulated activities of the Company. I supervise the accounting staff and provide reports on the financial activities for the Company. I also prepare or supervise the preparation of reports to the Florida Public Service Commission (FPSC) and other agencies.

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL AND RELEVANT PROFESSIONAL BACKGROUND.

A. I have a Bachelors Degree from West Virginia University in Parks and Recreation with additional hours in Accounting, Business Law, and Management. I received my CPA certificate in West Virginia in 1982, though it is not currently active. I have been employed by the Company since April 1999. Prior to joining the Company I was employed for nearly two years by CC Pace Resources, an energy consulting firm based in Fairfax, Virginia, as Director of Energy Services. I was employed with the City of Leesburg as Finance Director for nine years, from 1987 through 1996, working on both natural gas and electric utility financial matters.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FPSC?

A. No.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY.

A. I will sponsor certain schedules of historical and projected data presented in the MFRs, as listed on the attached Exhibit JAW-1. These schedules were all prepared under my direction, supervision, and control.

Q. HOW DID YOU DERIVE THE HISTORICAL DATA?

A. All data related to the historical base year are taken from the books and records of the Company, located in Winter

Haven, Florida, except that data relating to settlements of corporate costs and cost of capital were provided by the Dover, Delaware offices of Chesapeake Utilities Corporation. These records are kept according to the recognized accounting practices and provisions of the Uniform System of Accounts as prescribed by the FPSC.

Q. PLEASE DESCRIBE HOW THE HISTORIC YEAR RATE BASE WAS CALCULATED.

A. For the historic base year, a 13 month average rate base was calculated for the period ended December 31, 1999. The historic base year also corresponds to the Company's fiscal year. MFR Schedule B-2 shows the calculation of historic base year rate base. Net plant is defined as the sum of 1) plant in service, less common plant allocated, 2) acquisition adjustments; and, 3) construction work in progress (CWIP), less accumulated depreciation, and amortization. Net plant during the historic year was $17,782,347. An allowance for working capital, after adjustments, in the amount of $498,227, was then added to net plant to calculate total rate base. As shown on MFR Schedule B-2, the total 13 month average rate base for the Company, after adjustments, was $18,280,574.

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO RATE BASE.

A. The adjustments to rate base can be separated into two types: (1) adjustments required by the FPSC in the Company's most recent rate case in 1989 and (2) additional adjustments made by the Company. Adjustments required by the FPSC in the 1989 rate case (Order No. 23166) include eliminating 1) an acquisition adjustment in the amount of $546,776 from plant , and the related $461,266 of accumulated depreciation, 2) an adjustment in the amount of $23,702 for the second story of an existing office building from plant and the related $7,407 from accumulated depreciation, and 3) an adjustment of $5,143 from accumulated depreciation for Franchise and Consent. In addition, the Company has made an adjustment removing common plant allocated to unregulated activities for $87,326 and the related accumulated depreciation in the amount of $38,988, as shown in Schedules B-5 and B-11.

Q. WHAT ARE THE APPROPRIATE DEPRECIATION RATES FOR THE HISTORIC BASE YEAR AND THE PROJECTED TEST YEAR?

A. In Docket No. 970428-GU, by Order No. PSC-98-0379-FOF-GU, issued March 9, 1998, the Company's present depreciation rates were approved by the FPSC. These approved rates have been implemented and are the rates used for both the Historic Base Year and the Projected Test Year.

Q. **WHAT WAS THE METHODOLOGY USED TO DETERMINE COMMON PLANT ALLOCATED TO UNREGULATED ACTIVITIES?**

A. Common Plant allocations were based on the ratio of unregulated activities payroll, $133,777, to total payroll of $1,845,720 during the historic base year. This ratio was used because it accurately represents the proportion of time the Company's furniture, vehicles, and equipment were used for unregulated purposes. This percentage was then applied to Plant accounts 391-Office Furniture & Equipment, 392 - Autos and Trucks, and 397– Computer Equipment, as well as the related accumulated depreciation accounts. For additional discussion on the allocation of Common Plant, please refer to the direct testimony of Mr. Geoffroy.

Q. **PLEASE EXPLAIN THE ADJUSTMENTS TO WORKING CAPITAL.**

A. Three types of adjustments were made to working capital, consistent with those required by the FPSC in the Company's last rate case. These are 1) cost of capital adjustments, 2) non-utility adjustments, and 3) other adjustments.

Cost of capital adjustments include eliminating a) Receivables From Associated Companies in the amount of $5,052,965, b) Customer Deposits in the amount of $627,767, c) Refunds of Customer Deposits in the amount of $1,231, d) Accumulated Deferred Income Taxes in the amount of $1,370,750, and e) Deferred Investment Tax Credits in the amount of $346,024.

The non-utility adjustment eliminates Accounts Receivable-Service in the amount of $93,388.

Other adjustments include eliminating a) Accounts Receivable-Area Expansion Program in the amount of $470,142, b) Miscellaneous Deferred Debits in the amount of $120,404, c) Conservation in the amount of $83,886, d) Miscellaneous Current Liabilities in the amount of $478,598, and e) Customer Advances For Construction in the amount of $196,399.

Unrecovered Gas Costs in the amount of $10,549, Accrued Interest in the amount of $99,611, Health Insurance Reserve in the amount of $44,290, and Self Insurance Reserve in the amount of $130,205 were adjustments increasing Working Capital. The amounts of

Health Insurance Reserve and Self-Insurance Reserve were determined using CUC's year-end balance at December 31, 1999, multiplied by the Company's percentage of net plant to the total net plant of CUC. The balances for Health Insurance Reserve and Self-Insurance Reserve are only recorded at year-end to reflect the Florida Division's share of total company Reserves.

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO NET OPERATING INCOME AS IDENTIFIED ON MFR SCHEDULE C-2.

A. There are two types of adjustments to Net Operating Income: adjustments consistent with the Company's last rate case and other adjustments made by the Company. Adjustments consistent with the last rate case include eliminating customer installation revenues in the amount of $430,745, and unregulated housepiping revenues in the amount of $307,265. Expenses related to customer installations and housepiping, including payroll and materials in the amount of $361,270, were also eliminated. Civic and charitable expenses in the amount of $25,877, memberships and dues in the amount of $2,304, and advertising in the amount of $18,330 were eliminated as determined in the last rate case. FNGA-PAC expenses for lobbying in the amount of $2,000 were also eliminated. Non-recurring consulting fees of $73,559 for market research and an ad valorem tax review were eliminated. Other depreciation expense eliminated was based on the previously mentioned adjustment to acquisition adjustments in the amount of $33,961, the 2nd story of the Company's office building in the amount of $593, and amortization of organization costs $424, as determined in the last rate case. Adjustments to income taxes in the amount of $104,028 were calculated based on the adjustments to operating revenues and expenses noted above. Other adjustments include eliminating depreciation expense for Common Plant allocated to non-regulated activities in the amount of $3,737, per Schedule C-19, and out-of-period adjustments as noted on Schedule C-15 in the amount of $11,558. For additional discussion on the allocation of common plant, please refer to the prefiled direct testimony of Mr. Geoffroy.

Q. HAS THE COMPANY PROPERLY IDENTIFIED AND EXCLUDED FROM O & M THOSE COSTS OF ITS UNREGULATED OPERATIONS?

A. Yes. Revenues and expenses associated with the Peninsula Energy Services Company (PESCO), an unregulated marketing affiliate, as well as housepiping and service functions, have been excluded from the projections for the Historic Base Year and Projected Test Year.

Q. PLEASE EXPLAIN THE OUT-OF-PERIOD ADJUSTMENTS MADE IN THIS CASE.

A. Net out-of-period Adjustments increase expenses by $11,558. Adjustments increasing expenses include $16,070 to reverse bonus accruals for 1998, $1,155 to reverse an Accounts Payable accrual for consulting fees, and a $136 expense for an electric bill.

Adjustments decreasing expenses include a $474 elimination to meter repairs and a $5,329 decrease for bonus checks from 1998.

Q. WHAT IS THE PROJECTED RATE CASE EXPENSE FOR THIS CASE AS SHOWN IN MFR SCHEDULE C-13?

A. Total rate case expenses are projected to be $243,500. The Company requests a four year amortization which will result in a projected test year rate case expense of $60,875. Additional information regarding rate case expenses can be found in the prefiled direct testimony of Mr. Geoffroy.

Q. PLEASE EXPLAIN THE SOURCE OF DATA FOR THE O & M COMPOUND MULTIPLIER CALCULATION ON MFR SCHEDULE C-37.

A. The Company's FERC Form 2's were used to determine the number of customers at year end. From June 30, 1989 through December 31,1999, customers increased by 2,530, or 36%. The CPI data was obtained from the Annual and Monthly Report from the US Bureau of Labor Statistics. The CPI increased from 124.1 on June 30, 1989 to 168.3 on December 31, 1999, for an increase of 36%.

Q. PLEASE EXPLAIN THE TRENDING FACTORS ON MFR SCHEDULE G-2, page 10.

A. A payroll trend rate of 4% was used for both the Historic Base Year + 1 and the projected test year. This payroll trend rate was based on the Company's estimated payroll growth. Customer growth was estimated for expense projection purposes at 5% for both the Historic Base Year + 1, and the Projected Test Year. Inflation was estimated at 2.5% for both the Historic Base Year + 1,and the projected test year.

The overall trend for the future will reflect outside influences, including inflation, the Company's growth rate, the marketplace for qualified personnel, and the Company's efforts to meet the challenge of the unbundled competitive market.

As a consequence of applying the trend rates that reflect our estimates of costs, coupled with recognizing the specific changes in staffing levels, the Company's projected O & M reflects an 8% increase in payroll costs from the historic base year to the projected test year. Other trended O & M costs reflect a 9% increase from the historic base year to the projected test year.

Q. PLEASE DISCUSS THE BENCHMARK VARIANCES FOR OPERATIONS & MAINTENANCE EXPENSE AS SHOWN ON MFR SCHEDULE C-34.

A. Although certain individual operating and maintenance accounts have grown at a rate faster than the benchmark would predict, overall costs are about 22% below the benchmark projections from the last rate case to the present. The two areas, Sales Expense and Distribution Operations, that have grown faster than what the benchmark would suggest are directly related to the Company's accelerated growth. The total variance for O & M Expenses is a favorable variance of $1,098,578. This total favorable variance includes individual favorable variances for Maintenance Expenses, Customer Accounts, Customer Service and Information, and Administration & General of $7,883, $81,984, $11,647, and $1,414,857, respectively, and unfavorable variances of $251,888 for Distribution Expenses and $165,905 for Sales Expenses.

Q. PLEASE EXPLAIN THE UNFAVORABLE VARIANCE FOR DISTRIBUTION OPERATIONS.

A. The reasons that expenses for the Distribution Operations area are above the benchmark are directly related to the growth of the system and the increase in regulatory requirements brought on by the regulatory restructuring of interstate pipelines. The Company currently has sixteen city gate stations that require necessary operations and maintenance expenses to comply with FPSC rules. The open access rules implemented by the Federal Energy Regulatory Commission (FERC) have created many opportunities in the marketplace. These rules have also placed an additional burden on the Company. The Company now purchases gas from the wellhead, either directly from the producer or from a marketer, and manages significant capacity holdings on the interstate pipeline system. The Company must also perform many new functions related to scheduling, delivery and accounting for gas supply and interstate pipeline capacity. These costs were non-existent in the last case, but are reflected appropriately within this case.

Distribution Expenses have an unfavorable variance of $251,888. This unfavorable variance includes individual account variances for Accounts 870 to 881. For Account 871, Distribution and Load Dispatch, the variance is $83,407. Account 871 expenses were increased beyond the benchmark due to higher payroll and communications costs. This is to be expected, because after the start-up of Open Access in the early 1990's on the FGT Pipeline, the Florida Division must nominate and manage supply on a daily basis, while in the last rate case these were all pipeline functions.

In Account 874, Mains and Services, the variance is $54,661. The benchmark is exceeded due to increases in corrosion control costs. The Company's corrosion control efforts were minimal prior to the last rate case. Since the last rate case, the Company has devoted more resources to corrosion control. However, as you can see from MFR Schedule I-2, the Company has been cited for deficiencies related to corrosion protection of its steel distribution facilities. The expenses incurred during the historic test year reflect the Company's commitment to providing adequate levels of protection for its distribution system. Increased focus by the Company on corrosion control work has demanded an increase in labor costs as well as costs associated with the maintenance of the corrosion control system as it was put into place. An increase in the use of rectifiers, well drilling costs and the addition of corrosion control personnel have all contributed to the cost increases above the benchmark. In addition, the costs associated with the Sunshine One-Call System, which was established in 1993 by Florida Statute, are for line locations of buried facilities. The One-Call System's requirements were not in force at the time of the last rate case.

In Account 877, Meters & Regulators-City Gate, the variance is $21,682. Odorization costs account for the increase. These odorization costs are another new cost resulting from FGT's Open Access Tariff. FGT provided the odorization of natural gas at the time of the last case. The Company must now inject odorant into the natural gas at every interconnection with the interstate pipeline.

In Account 878, Meter & House Regulator Expense is $132,373 over the benchmark. This unfavorable benchmark variance for Account 878 (36%), is attributable to an increase in the number of customers which has driven the employee-related costs up as more employees' time is needed to service those customers. In addition the company now directly assigns depreciation expense and other vehicle expenses directly to the department to which the driver is assigned. In the prior rate case, the vehicle expenses were carried in a plant account for depreciation or a vehicle cost accumulation account. In Account 880, Other Expenses, the variance is $38,394 over the benchmark. In Account 880, costs relating to obtaining building permits, rights-of-way, and other City, County, and State permits, including employee-related expenses, have increased substantially as the Company has added new customers. Account 881, Rents, has increased due to renting space for operations and customer service in a new territory, Citrus County, and increased rents paid to railroads. Rents for railroad rights-of –way are increasing with no ability on the Company's part to mitigate these costs. The charges for railroad rights-of-way is a statewide issue for all utilities that utilize these corridors and crossings.

All other accounts in Distribution have a favorable variance of $98,420. Distribution Maintenance Accounts, consisting of Accounts 885 through 894, have a favorable variance of $7,883. Customer Accounts, consisting of Accounts 901 through 905, have a favorable variance of $81,984.

Customer Service & Information, consisting of Accounts 908 and 909, have a favorable variance of $11,647.

Q. PLEASE EXPLAIN THE UNFAVORABLE VARIANCE FOR SALES EXPENSE.

A. Sales Expense has an unfavorable variance of $165,905. This total variance consists of individual account variances in Accounts 912, 913 and 916. Demonstration and Sales Expense, Account 912, has an unfavorable variance of $185,309. Changes in expenses appear to be more than that attributable to growth and inflation because of our effort to increase and diversify our customer base. In 1989 our Sales Department consisted of only two people. The annual customer growth increases from 1989 through 1995 averaged only 2.09% per year. As the region began to grow rapidly, additional staffing and related expenses were needed to keep pace. Furthermore, today the Company has operations in several new areas around the State, including Citrus, Gadsden, and other counties. Since the last rate case, the Company has developed a sales staff that extends to each level of our customer base. Staffing now includes three Sales Representatives, a Commercial Specialist, a Business Development Manager, assigned the task of pursuing new industrial and start-up natural gas systems around the State, a Marketing Manager, a Director of Marketing and Sales and support personnel. The results of the current staffing level are as follows. The customer base has expanded at a rate of over 4% per year from 1996 through 1999 (compared with the national average for natural gas companies of about 2% per year). Customer growth is projected to be about 10% per year through the projected test year. Since 1996, the Company has established or is in the process of establishing natural gas operations in 7 additional counties in Florida. Further explanation of the growth and sales strategy for the Company may be found in the pre-filed direct testimony of Mr. Geoffroy.

Finally, Account 913, Advertising, and Account 916, Miscellaneous Sales Expense, have favorable variances of $18,660 and $743, respectively.

Q. **PLEASE EXPLAIN THE ACCOUNTING OF COSTS BETWEEN CHESAPEAKE UTILITIES CORPORATION (CUC) AND THE COMPANY.**

A. Expenses are settled to the Company from CUC based on various methodologies, depending on the expense. The settlements are designed to flow costs to those departments receiving the benefits of the services and products provided.

Expenses are generally settled by one of these methods: 1) direct payroll, 2) adjusted net plant, and\or 3) number of customers. The settlement methods should reflect the relative size of the individual division that benefits from the service, since most corporate services, which are provided on a centralized basis, do not vary with the volume of business.

For example, indirect corporate expenses and interest expense from CUC are settled based on the ratio of the Florida Division's adjusted net plant at the end of the prior year to CUC's net plant. The total CUC net plant for 1998 was $97,757,392. The Florida Division's adjusted net plant for 1998 was $17,406,191, or 18% of CUC's total. The percentage of these expenses allocated to the Florida Division for 1999 was therefore 18%.

Examples of how direct corporate expenses are settled are as follows. Human Resource and Safety costs are allocated based on the total number of employees in the Florida Division vs. the total number of employees with CUC. Costs are allocated for information services based on the systems and equipment they support. Internal audit costs are allocated based on the audit plan for each business unit. The costs associated with conducting the audit for each business unit are charged to that business unit. Additional comments on the benefits that the Company and it's customers receive due to the affiliation with CUC are given in the prefiled direct testimony of Mr. Geoffroy.

Q. HOW WAS INCOME TAX EXPENSE DETERMINED?

A. Total income tax expense consists of income taxes currently payable and deferred income taxes. The current portion of income tax expense, as shown on MFR Schedule G-2, page 30, for the projected test year, was calculated by simply multiplying the currently effective Federal income tax rate by the income that is currently taxable. Currently taxable income was calculated by deducting from the projected test year net operating income before taxes, the interest expense inherent in the cost of capital and adjusting for other permanent and timing differences. Deferred income tax expense was then calculated separately for timing differences that are originating and for differences that are reversing. Deferred taxes were calculated for timing differences as shown on MFR Schedule G-2, page 31.

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO HISTORIC BASE YEAR CAPITAL PER MFR SCHEDULE D-1.

A. There are two types of adjustments made to the capital accounts. First, flex rate liability in the amount of $46,880, customer deposits in the amount of $627,767, and deferred income taxes in the amount of $119,250, were adjusted out of working capital to properly reflect these costs in the capital structure of the Company. Next, common equity in the amount of $2,766,674, long term debt in the amount of $5,432,674, and short term debt in the amount of $1,805,478 were adjusted to reflect the same ratio to total capital of Chesapeake Utilities Corporation as a whole.

Q. PLEASE EXPLAIN WHY FLEX RATE LIABILITY IS INCLUDED IN CAPITAL.

A. The flex rate liability is a liability created when the Company adjusts it's flexible rates above the base non-fuel interruptible rates. The Company's tariff, First Revised Sheet No. 59, allows the Company to charge above the base rate when the comparable alternative fuel is priced above the cost of natural gas. Similarly, the Company may reduce the rate in order to compete with a lower-priced alternate fuel. Our existing tariff requires that we refund 50% of all surplus revenues over the base price. Conversely, the Company may collect 50% of any shortfall from firm gas ratepayers. These over\under recoveries are booked into the flex rate liability account and a refund per therm is calculated annually and applied to the base rate for the next twelve-month period. The flex rate liability account holds customer funds similar to customer deposits and is therefore considered capital.

Q. PLEASE EXPLAIN HOW COMMON EQUITY, LONG TERM DEBT AND SHORT TERM DEBT ARE ALLOCATED TO THE COMPANY.

A. The13-month average total capital as determined from the trial balance for Chesapeake Utilities Corporation at December 31, 1999, was $104,741,463. This consisted of $35,553,982 or 33.94% long term debt, $11,816,252 or 11.28% short term debt, and $57,371,230 or 54.77% in common equity. Applying these same ratios to the Florida Division's rate base of $18,476,909, less the customer deposits of $627,767, deferred income tax of $1,370,750, deferred ITC of $346,024, and flex rate liability of $46,880 leaves a total of $15,966,238 against which the ratios are applied to calculate common equity and debt for the Florida Division.

Q. WHAT IS THE PROJECTED TEST YEAR FOR THIS RATE CASE?

A. The projected test year is the calendar year ending December 31, 2001. The adjusted projected test year data presented in this case is representative of the conditions expected during the period in which the proposed rates will be in effect, and results in matching revenues and related expenses for that period. Additional information on how test year revenues and expenses were calculated is presented in the prefiled direct testimony of Mr. Householder.

Q. WHAT IS THE APPROPRIATE ADJUSTED RATE BASE FOR THE PROJECTED TEST YEAR?

A. The appropriate adjusted rate base for the projected test year is $21,321,700, reflecting utility plant after the deduction of depreciation and amortization reserves and customer advances for construction plus the working capital allowance. This amount is shown on Schedule G-1, page 1. Additional information on capital additions for rate base for the projected test year is provided in the prefiled direct testimony of Mr. Geoffroy.

Q. WHAT IS THE APPROPRIATE AMOUNT OF OPERATING REVENUES FOR THE PROJECTED TEST YEAR?

A. The appropriate amount of operating revenue for the projected test year is $13,481,994, reflecting the gas demand forecast and the application of the projected rates as sponsored by Mr. Householder in his prefiled direct testimony and the related MFR Schedules. The calculation of the appropriate amount of operating revenue is included on MFR Schedules G-2, pages 9-11.

Q. HAVE YOU PREPARED AN EXHIBIT SHOWING THE COMPANY'S CAPITAL STRUCTURE FOR THE PROJECTED TEST YEAR?

A. Yes, The information appears on Schedule G-3, page 2.

Q. HAVE YOU PREPARED THE COMPANY'S CAPITAL STRUCTURE FOR RATEMAKING PURPOSES CONSISTENT WITH THE MANNER IN WHICH IT WAS APPROVED IN THE LAST RATE CASE?

A. Yes. The components that are included in capital are consistent with the components of capital in the last rate case. Total capital for the projected test year is $21,321,700. The adjustments made to reconcile capital to rate base are also consistent with the adjustments made in the last rate case. The adjustments for common equity, long term debt, and short term debt are calculated as described earlier in this testimony regarding adjustments to historic base year capital. Additional testimony regarding cost of equity for the projected test year is in the prefiled direct testimony of Mr. Paul Moul.

Q. WHAT DEBT TO EQUITY RATIO DID YOU EMPLOY?

A. The calculation of capital structure reflects investor sources of capital as follows: equity, 54.8%; long term debt, 33.9%; and short term debt, 11.3%. Chesapeake Utilities Corporation has an established goal of maintaining a 60% equity to 40% debt ratio.

Q. DESCRIBE THE CAPITAL STRUCTURE FOR THE PROJECTED TEST YEAR AS SHOWN ON MFR SCHEDULE G-3, PAGE 2.

A. The capital structure for the projected test year consists of common equity in the amount of $10,289,296, or 48.26%, with a cost rate of 12%; long term debt of $6,377,973, or 29.91%, with a cost rate of 7.52%; short term debt in the amount of $2,119,103, or 9.94%, with a cost rate of 6.03%; customer deposits in the amount of $789,257, or 3.70%, with a cost rate of 6.44%; flex rate liability in the amount of $46,880, or .22%, with a cost rate of 6.30%; and accumulated deferred taxes and ITC tax credits in the amount of $1,392,213 and $306,978, at 6.53% and 1.44%, respectively, with a cost rate of zero for both.

Q. WHAT IS THE APPROPRIATE COST OF CAPITAL?

A. The appropriate Cost of Capital for the projected test year is 12% for equity and 8.89% for the overall weighted Cost of Capital.

Q. WHAT IS THE APPROPRIATE REVENUE EXPANSION FACTOR FOR THE PROJECTED TEST YEAR?

A. The appropriate revenue expansion factor is 1.6784 as calculated on MFR Schedule G-4.

Q. WHAT IS THE APPROPRIATE REVENUE DEFICIENCY FOR THE PROJECTED TEST YEAR?

A. The appropriate Revenue Deficiency for the projected test year is calculated on Schedule G-5 of the MFRs. The amount is $1,826,569.

Q. PLEASE DISCUSS HOW INTERIM RATES WERE DERIVED.

A. Rate base, net operating income and cost of capital were derived by using the December 31, 1999 year end balances, or 13 -month average balances where applicable. All adjustments to rate base and NOI were consistent with interim adjustments required in the last rate case. Certain adjustments to NOI for non-regulated activities were also made as indicated on MFR Schedule F-5. The minimum of the range of the last authorized rate of return on equity of 10%, as required by Florida Statutes Sec. 366.071 (5)(b)3, was used in calculating the weighted cost of capital of 7.86% (MFR Schedule F-8). A revenue deficiency of $830,330 was calculated on MFR Schedule F-7, using the adjusted rate base of $18,514,618, the weighted cost of capital of 7.86% and an adjusted NOI of $960,540. The revenue deficiency of $830,330 was then divided by the total revenues, as calculated on MFR Schedule F-10, to determine the interim rate increase percentage of 13.01%. The total revenues of each applicable rate class was then multiplied by 13.01% to determine the revenue dollar increase per customer class. The revenue dollar increase was then divided by the therm sales by customer class to determine the revenue increase per therm. The Special Contract Customers and Large Volume Contract Customers were not included in this calculation because their rates are determined by contract rather than rate schedule, subject to approval by the FPSC on a case-by-case basis.

Q. DOES THAT COMPLETE YOUR DIRECT TESTIMONY?

A. Yes.

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

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 nondelivery 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.

SUPPLEMENTAL DIRECT TESTIMONY

OF

JEFF HOUSEHOLDER

FLORIDA DIVISION

OF

CHESAPEAKE UTILITIES CORPORATION

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

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

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. The purposes of my supplemental testimony are to update the Company's forecast of billing determinants and revenues for the Projected Test Year involving the Company's large volume industrial customers to reflect recent developments, to correct errors in the Projected Test Year forecast, and to comment on a recent Staff audit report.

Q. PLEASE DESCRIBE THE NATURE OF THE INFORMATION LEADING THE COMPANY TO PROPOSE ADJUSTMENTS TO ITS PROJECTED TEST YEAR FORECAST.

A. Within the past two weeks, the Company received notice from two industrial customers that affects the sales volumes and total customers projected in the large volume industrial customer classes. Agifos, a phosphate mining and processing facility, and SunPac International, a citrus processor, have notified the Company that they will discontinue gas service in 2000.

Q. WHY WILL AGRIFOS DISCONTINUE GAS SERVICE?

A. Agrifos has informed the Company that it intends to permanently terminate operations. According to Agrifos, it will continue to process the phosphorus rock already mined, but has stopped all mining operations. Processing of on-hand raw materials is scheduled to be completed within 60 – 90 days, after which the entire Agrifos facility will shut down. This action is not entirely unanticipated. On Page 12 of Mr. Geoffroy's prefiled direct testimony, he alludes to the difficulties experienced by Agrifos, and notes the uncertainty surrounding its future.

Q. WHAT IS THE PROJECTED IMPACT TO THE COMPANY OF THE AGRIFOS PLANT CLOSURE?

A. Agrifos consumed 2,789,182 therms in 1999. The Projected Test Year billing determinants included in the MFRs submitted by the Company forecast an estimated 2,800,000 therms for Agrifos. Annual revenues at the proposed GS-9 rate classification were projected at $238,036.

Q. WHY WILL SUNPAC INTERNATIONAL DISCONTINUE GAS SERVICE?

A. During a meeting with Sunpac last week, the Company was notified that Sunpac intends to bypass the Company's distribution system and direct connect to FGT's pipeline. The Company's sales revenues will stop subsequent to Sunpac's current processing season, in May 2001. The Sunpac plant is located immediately adjacent to the Florida Gas Transmission (FGT) pipeline. Given Sunpac's close proximity to FGT's pipeline, its capital investment to construct interconnection facilities is relatively small.

Q. WHAT IS THE PROJECTED IMPACT TO THE COMPANY OF THE SUNPAC BYPASS?

A. Sunpac consumed 1,638,169 therms in 1999. The Projected Test Year billing determinants included in the Company's MFRs forecast an estimated 1,542,000 therms for Sunpac. Annual revenues at the proposed TS-9 rate classification were projected at $136,186.

Q. WHAT IS THE APPROPRIATE TREATMENT OF SUNPAC'S LIMITED REVENUE CONTRIBUTION IN THE FIRST FIVE MONTHS OF THE PROJECTED TEST YEAR?

A. Since this revenue is non-recurring, it should not be used for rate-making purposes. Such projected revenue should therefore be removed from the projected test year in its entirety.

Q. ARE THERE OTHER ADJUSTMENTS TO THE COMPANY'S PROJECTED TEST YEAR FORECAST THAT ARE APPROPRIATELY CONSIDERED AT THIS TIME?

A. Yes. The Company has identified two errors in its Large Volume Customer and Sales Forecast. These were communicated to Staff via the Company's response to Staff's request for Production No. 9. Velda Farms is projected for both 2000 and 2001 at 250,000 annual therms. The forecast volume should be 350,000 therms for both years. The addition of 100,000 therms for Velda Farms at the proposed TS-7 rate would increase revenues by $10,627. Mrs. Allison's Cookies was projected to consume 524,000 therms in 2001. The forecast for this account in 2001 should be 362,500 therms. The subtraction of 161,500 therms for Mrs. Alison's Cookies at the proposed TS-8 rate would decrease revenues by $15,625.

Q. **WHAT IS THE NET EFFECT THE PROPOSED FORECAST ADJUSTMENTS WILL HAVE ON THE COMPANY'S BILLING DETERMINANTS.**

A. The total customer count will decrease by two. Total therm sales will decrease by 4,280,500.

Q. **WHAT IS THE NET REVENUE EFFECT?**

A. The revenue decrease from the Agrifos plant closure and Sunpac bypass totals $374,222, as forecast for the Projected Test Year. The net revenue decrease in the Projected Test Year, resulting from the correction of the Mrs. Allison's Cookies and Velda Farms accounts totals $4,998. The total revenue decrease related to the account losses and corrections is $379,220.

Q. IS THE COMPANY PROPOSING AN ADJUSTMENT TO ITS REQUESTED REVENUE REQUIREMENT?

A. No. The Company proposes no increase in the amount of the requested $1,826,569 increase in its annual revenue requirement. The Company instead requests that the Commission consider the forecast adjustments identified above in determining the appropriate billing determinants for rate design purposes in this proceeding. Additionally, the Company seeks to have the Commission consider the revenue impacts of the forecast adjustments as an offset to any other adjustments reducing the Company's requested increase in its revenue requirement, up to the extent of the forecast-related adjustments.

Q. IS IT LIKELY THAT AGRIFOS OR SUNPAC WILL RESUME GAS SERVICE WITH THE COMPANY IN THE FUTURE?

A. No. Given the general decline in the phosphate industry in Polk County it is highly unlikely that Agrifos, or another company, will restart operations at the Agrifos plant site. As noted in Mr. Geoffroy's testimony, several phosphate plants have gone out of business or permanently stopped operations over the past few years. It is virtually certain that Sunpac will not return as a customer in the future. In my experience, once a customer bypasses a local distribution system, they never return.

Q. HOW WILL THE COMPANY RESPOND IF EITHER AGRIFOS (OR ANY SUCCESSOR AT THE AGRIFOS SITE) OR SUNPAC DO NOT ACTUALLY TERMINATE SERVICE AS ANTICIPATED, OR SUBSEQUENTLY RESUMES GAS SERVICE?

A. The Company is willing to promptly notify the Commission of any gas service requested by Agrifos (or its successors) subsequent to January 1, 2001 or by Sunpac subsequent to July 1, 2001 for a period not to exceed twenty-four months from the date of issuance of the final order in this proceeding so that the Commission may consider whether it would be appropriate to reallocate the Company's approved revenue requirement.

Q. WOULD YOU CARE TO COMMENT ON STAFF'S AUDIT REPORT DATED SEPTEMBER 13, 2000 (AUDIT CONTROL NO. 00-159-3-1) REGARDING LARGE VOLUME CUSTOMERS?

A. This staff audit report (provided to the Company at my September 21, 2000 deposition) specifically indicated that two of the Companies large industrial accounts, Agrifos and IMC Global, were, "demonstrating very abnormal gas usage characteristics compared to 1999". The status of the Agrifos account was described above. I would like to provide information on the IMC Global account. The Company has been monitoring increased gas consumption levels at the IMC Global New Wales phosphate plant during the past several months. Part of the increase was anticipated, resulting from the addition of a new drying kiln. The Company's forecast for 2000 included a net increase of over 1,000,000 therms. This increase accounted for the new kiln, but also reflected some loss of gas sales due to the projected shift of a portion of the plant's production to other facilities, as noted in Mr. Geoffroy's testimony. The Company forecast that IMC would consume 17,500,000 therms in 2000. Through seven months of the current year, IMC is on pace to burn approximately 25,000,000 therms.

Q. **WHY HAS IMC INCREASED ITS GAS CONSUMPTION AT THE NEW WALES PLANT?**

A. IMC personnel advise that the recent cost differential between natural gas and #6 fuel oil has been such that it was economically viable to convert part of the IMC Global New Wales processing facilities traditionally served by oil to gas.

Q. **DO YOU EXPECT THAT IMC'S INCREASED GAS CONSUMPTION WILL CONTINUE THROUGHOUT THE PROJECTED TEST YEAR?**

A. No. Historically, IMC has not found it economically or operationally advantageous to consume natural gas at the IMC New Wales facliity's current level. As noted above, a substantial portion of these processing facilities typically consumes fuel oil. On rare occasions the cost of fuel oil has escalated relative to natural gas to the point that IMC has converted traditional oil facilities to gas. The period of the Gulf War was the last such occurrence. Generally, the price advantage for natural gas exists for a relatively short duration. IMC increased gas usage beginning in December 1999. The price advantage for natural gas now appears to be diminishing. As the relative price points of both fuels return to their historical status, I believe it is unlikely that IMC's increased gas usage will continue through the Projected Test Year.

Q. **IS THE COMPANY PROPOSING TO ADJUST THE PROJECTED TEST YEAR FORECAST BASED ON IMC'S INCREASED CONSUMPTION IN 2000?**

A. No.

Q. **DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?**

A. Yes.

(Transcript continues in sequence in Volume 2.)

STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, KORETTA E. STANFORD, RPR, Official FPSC Commission Reporter, do hereby certify that the Hearing in Docket Number 000108-GU was heard by the Florida Public Service Commission at the time and place herein stated.

It is further certified that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript, consisting of 210 pages, Volume 1, constitutes a true transcription of my notes of said proceedings and the insertion of the prescribed prefiled testimony of the witnesses.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED this 19th DAY OF OCTOBER, 2000

Koretta E. Stanford

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