

State of Florida



Public Service Commission
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DATE: OCTOBER 24, 2002

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

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

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

AGENDA: NOVEMBER 5, 2002 - REGULAR AGENDA - TARIFF FILING -
INTERESTED PERSONS MAY PARTICIPATE

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

SPECIAL INSTRUCTIONS: NONE

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

CASE BACKGROUND

On March 28, 2002, Chesapeake Utilities Corporation filed its Petition for Authority to Convert All Remaining Sales Customers to Transportation Service and to Exit Merchant Function. This recommendation addresses the Petition.

The number of Chesapeake's non-residential sales customers has decreased substantially in the past few years due to restructuring of the gas industry. As these customers started buying gas on the open market, Chesapeake's transportation volumes increased and its sales volumes decreased. Prior to 2000, transportation service to non-residential customers comprised 70% of the Company's total system throughput, and it now comprises 96% of that throughput.

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The remaining sales customers include 663 non-residential customers, all of whom are in the low usage rate classifications, and 9,587 residential customers. The non-residential customers account for 2.5% of the total system throughput and the residential customers account for 1.5% of the total system throughput. These customers require a small and seasonally variable volume of gas, factors that make the cost of the gas expensive.

Chesapeake believes gas marketers can sell gas to its remaining sales customers less expensively than Chesapeake can. Chesapeake has concluded that the only cost effective approach available to it is to completely exit the merchant function, and require all remaining sales customers to convert to transportation service. Chesapeake's Petition is for a new tariff which allows a gradual transition from sales service to transportation service for the remaining sales customers.

Customer meetings were held on June 25, 2002, in Winter Haven and St. Cloud, and on June 26, 2002, in Plant City and Crystal River.

Jurisdiction over this matter is vested in the Commission by several provisions of Chapter 366, Florida Statutes, including Sections 366.03 and 366.04, Florida Statutes.

DISCUSSION OF ISSUES

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

RECOMMENDATION: Yes. The Commission should approve Chesapeake's petition, effective November 5, 2002, the date of the Commission vote in this matter. (MAKIN, BULECZA-BANKS)

STAFF ANALYSIS: The staff analysis consists of two sections. The first section addresses the provisions of the proposed tariff and

the second addresses the Commission's authority to approve the tariff.

I. Provisions of the Proposed Tariff

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

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

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

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

The implementation of Phase One would be for a two-year period where all remaining residential and non-residential sales customers would receive gas supply service through one qualified Pool Manager, selected by the Company through a Request for Proposals (RFP) process. The TTS agreement between the Company and the

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selected Pool Manager would be structured to provide customers the opportunity to select between two pricing options: a monthly indexed price, similar to the current PGA pricing mechanism, or a fixed price option that enables customers to mitigate the potential price volatility of the monthly indexed price.

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

Staff recommends that the report should be submitted no later than 90 days from the conclusion of Phase One. If the tariff becomes effective on November 5, 2002, the report would be due no later than 90 days after November 5, 2004.

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

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

would be authorized to directly solicit any and all customers for gas supply services.

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

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

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

For the residential and small commercial customers transitioning from sales to transportation service, the Company would maintain the customer service function, maintain customer account transaction records, and provide gas supply billing and collections indefinitely. Customers would continue to receive one monthly bill, and the Pool Managers' charges would appear in lieu of the Company's purchased gas adjustment. The Company would follow a prescribed hierarchy in applying customer payments. All

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payments would first be applied to any taxes and fees imposed by government; second, to Pool Managers' charges for gas supply; and third, to the Company's regulated transportation charges. Customers currently taking service under the transportation tariff (primarily large commercial and industrial customers) would have the option of getting billed directly from the marketer serving them or through Chesapeake

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

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

As the Company prepares to exit the merchant function, participation in the purchased gas cost recovery proceedings will no longer be necessary. The Company filed its final true-up for the calendar year 2001 in the PGA docket in May 2002, indicating an over-recovery. Projected filings are due in September 2002, to determine the PGA cap for the year 2003. However, upon the activation of service by the Phase One TTS Pool Manager, there would cease to be any need for the Company to have an active PGA mechanism. Whatever over or under-recovery may have accrued at that time will be reviewed by the Commission for appropriate

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disposition by the Company. Chesapeake proposes to address that matter in a subsequent filing within ninety days of the termination of its gas sales merchant function. Based on the most recent data, it appears that the company will be in an over-recovery state for the period ended August 31, 2002.

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

II. Commission's Jurisdiction

Chesapeake cites Rule 25-7.0335, Florida Administrative Code, as the Commission's authority for approving the Petition. The rule requires that each local distribution company (LDC) "offer" the transportation of natural gas to all non-residential customers. The rule further provides that each LDC "may offer" the transportation of natural gas to residential customers when it is cost effective to do so.

While the Commission has ample statutory authority to approve the Petition, staff believes that the request in the Petition falls outside the scope of the rule. The rule requires that LDC's "offer" transportation service to non-residential customers and that LDC's "may offer" such service to residential customers. The rule does not allow LDC's to require that any customer switch to transportation service. Chesapeake's proposed TTS tariff requires customers to switch from sales to transportation service and so the rule is inapplicable.

Staff believes that Sections 366.04(1), 366.03, and 366.041, Florida Statutes, grant the Commission authority to approve the tariff. Section 366.04(1) confers the broadest grant of authority in that it grants "jurisdiction to regulate and supervise each public utility with respect to its rates and service." The TTS tariff affects rates and service and therefore falls within the purview of Section 366.04(1).

Section 366.03, Florida Statutes, grants the Commission authority to set the terms upon which "reasonably sufficient, adequate and efficient service" will be provided. Section 366.041, Florida Statutes, authorizes the Commission, when fixing rates and charges, to consider the "efficiency, sufficiency and adequacy of . . . services rendered; the cost of providing such service and the

value of the service to the public; the ability of the utility to improve such service. . . ." Chesapeake's Petition addresses these factors directly. Chesapeake cannot sell gas at competitive prices to its small pool of customers. Its cost is too high. Chesapeake believes the only way to improve the situation is to transition its customers out of sales service onto transportation service. This is information which the Commission may consider when deciding whether to approve the Petition.

In addition, staff believes that the Legislature expects the Commission to consider restructuring of the gas market when making decisions. The recommendation for proposing Rule 25-7.0335, Florida Administrative Code, explains that the Legislature laid the groundwork for unbundling of the gas industry in Florida when it amended Section 366.02(1), Florida Statutes. See Staff Recommendation in Docket No. 960725-GU, filed on February 3, 2000. That amendment exempts from the Commission's jurisdiction "any entity selling or arranging for sales of natural gas which neither owns nor operates natural gas transmission or distribution facilities within the state."

III. Conclusion

Based on the Company's petition, Staff believes that Chesapeake's proposal to convert all remaining sales customers to transportation service and to exit the merchant function is appropriate and reasonable, and should be approved. The tariff should become effective on November 5, 2002.

ISSUE 2: Should this docket be closed?

RECOMMENDATION: Yes. If no protest is filed within 21 days of the issuance of the Order by a person whose substantial interests are affected, the docket should be closed upon the issuance of a Consummating Order. If a valid protest is filed, the tariff should remain in effect pending resolution of the protest, with any charges held subject to refund pending resolution of the protest.
(STERN)

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