State of Florida

Public Service Commission

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

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

DATE: August 6, 2009

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Kaproth, D. Buys, Davis, Draper)
Office of the General Counsel (Sayler)

RE: Docket No. 090125-GU – Petition for increase in rates by Florida Division of Chesapeake Utilities Corporation.

AGENDA: 08/18/09 – Regular Agenda – Decision on Interim Rates – Participation is Limited to Commissioners and Staff

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: McMurrian

CRITICAL DATES: 09/14/09 (60-Day Suspension Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\090125.RCM.DOC

Case Background

This proceeding commenced on July 14, 2009, with the filing of a petition for a permanent rate increase by Florida Division of Chesapeake Utilities Corporation (Chesapeake or Company). The Company is engaged in business as a public utility providing distribution and transportation for gas as defined in Section 366.02, Florida Statutes (F.S.), and is subject to the jurisdiction of the Commission. Chesapeake serves gas to approximately 14,500 customers in Winter Haven, Plant City, St. Cloud, Inverness, Crystal River, and other nearby communities. The Company also provides service to industrial customers in DeSoto, Gadsden, Gilchrist, Holmes, Jackson, Liberty, Suwannee, Union, and Washington Counties, and is ready to provide service, pursuant to an approved territorial agreement, to customers in portions of Pasco County.

Chesapeake requested an increase in its retail rates and charges to generate an increase in annual revenues of $2,965,398 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 7.15 percent or an 11.50 percent return on equity (range 10.50 to 12.50 percent). The Company based its request on a projected test year ending December 31, 2010. In its petition, Chesapeake stated that 2010 is the appropriate period to be utilized because it best represents expected future operations for use in analyzing the request for rate relief. Chesapeake has elected to have its petition for rate relief processed under the proposed agency action (PAA) procedures authorized by Section 366.06(4), F.S.

Chesapeake has also requested an interim rate increase in its retail rates and charges to generate an additional $417,555 in gross annual revenues.[1] This increase would allow the Company to earn an overall rate of return of 6.88 percent or a 10.50 percent return on equity, which is the minimum of the currently authorized return on equity range of 10.50 to 12.50 percent. The Company based its interim request on a historical test year ended December 31, 2008.

The Commission last granted Chesapeake a $1,251,900 rate increase by Order No. PSC-00-2263-FOF-GU.[2] In that order, the Commission found the Company's jurisdictional rate base to be $21,088,311 for the projected test year ended December 31, 2001. The allowed rate of return was found to be 8.60 percent for the year using an 11.50 percent return on equity.

This recommendation addresses the suspension of the requested permanent rate increase and the requested interim rate increase. The Commission has jurisdiction pursuant to Sections 366.06(2) and (4), and 366,071, F.S.

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[1] Chesapeake has entered into merger talks with Florida Public Utilities Company. This proposed merger will have no effect on any interim rates approved in this proceeding.
[2] Order No. PSC-00-2263-FOF-GU, issued November 28, 2000, in Docket No. 000108-GU, In re: Application for rate increase by Florida Division of Chesapeake Utilities Corporation.

Discussion of Issues

Issue 1: Should the $2,965,398 permanent base rate increase and the associated tariff revisions requested by the Florida Division of Chesapeake Utilities Corporation be suspended pending a final decision in this docket?

Recommendation: Yes. The $2,965,398 permanent base rate increase and the associated tariff revisions requested by Chesapeake should be suspended pending a final decision in this docket. (Kaproth, Draper)

Staff Analysis: Chesapeake filed its petition, testimony, and minimum filing requirements (MFR Schedule G-1) on July 14, 2009. The Company has requested a total permanent base rate increase of $2,965,398 based on a projected test year ending December 31, 2010.

Historically, especially when a projected test year has been involved, the Commission has suspended the requested permanent rate schedules in order to adequately and thoroughly examine the basis for the new rates. The suspension of the rate increase is authorized by Section 366.06(3), F.S., which provides:

> Pending a final order by the commission in any rate proceeding under this section, the commission may withhold consent to the operation of all or any portion of the new rate schedules, delivering to the utility requesting such increase, within 60 days, a reason or written statement of good cause for withholding its consent.

Because Chesapeake's requested permanent rate relief is based on a projected test year, staff recommends that the Commission suspend the requested permanent rate schedules to allow staff and any intervenors sufficient time to adequately investigate whether the request for permanent rate relief is appropriate.

Issue 2: Is Chesapeake's proposed 2008 interim test year rate base of $37,868,590 appropriate?

Recommendation: Yes. Chesapeake's proposed 2008 interim test year rate base of $37,868,590 is appropriate. (Kaproth)

Staff Analysis: On MFR Schedule F-4, The proposed interim test year rate base of $37,868,590 is the thirteen-month average amount for the period ended December 31, 2008. Staff has reviewed the rate base adjustments made in the current interim filing for consistency with the findings made in the Company's last rate case order. Based on staff's review, it appears that Chesapeake has made the applicable and appropriate adjustments that are consistent with the previous rate case. Therefore, staff recommends that $37,868,590 is the appropriate amount of rate base for the 2008 interim test year. The calculation is shown on Attachment A.

It should be noted that 2008 is also the historical base year that was used to develop the 2010 projected test year for the requested permanent base rate increase. The 2008 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

Issue 3: Are Chesapeake's proposed return on equity of 10.50 percent and its overall cost of capital of 6.88 percent appropriate for purposes of determining interim rates?

Recommendation: Yes. Chesapeake's proposed return on equity of 10.50 percent and its overall cost of capital of 6.88 percent for purposes of determining interim rates are appropriate. (Davis, D. Buys)

Staff Analysis: Pursuant to Section 366.071(2)(a), F.S., the appropriate return on equity (ROE) for purposes of determining an interim rate increase is the minimum of the Company's currently authorized ROE range. Chesapeake's currently authorized ROE is 11.50 percent with a range of plus or minus 100 basis points. The Commission set the return and range in Order No. PSC-00-2263-FOF-GU. For its interim request, Chesapeake used an ROE of 10.50 percent. Staff agrees that the resulting overall cost of capital is appropriate for calculating interim rates. Attachment B details the calculation of the Company's overall cost of capital.

Issue 4: Is Chesapeake's proposed 2008 interim test year net operating income of $2,346,483 appropriate?

Recommendation: Yes. Chesapeake's proposed 2008 interim test year net operating income of $2,346,483 is appropriate. (Kaproth)

Staff Analysis: On MFR Schedule F-4, the proposed interim test year net operating income of $2,346,483 is the twelve month amount for the year ended December 31, 2008. Staff has reviewed the net operating income adjustments made in the current interim filing for consistency with the findings made in the Company's last rate case. Based on staff's preliminary review, it appears that Chesapeake has made the applicable and appropriate adjustments that are consistent with the previous rate case. Therefore, staff recommends that $2,346,483 is the appropriate 2008 interim test year net operating income.

It should be noted that 2008 is also the historical base year that was used to develop the 2010 projected test year for the requested permanent base rate increase. The 2008 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

Issue 5: Is Chesapeake's proposed net operating income multiplier of 1.6114 appropriate?

Recommendation: Yes. The appropriate net operating income multiplier for interim rate purposes is 1.6114. (Kaproth)

Staff Analysis: On MFR Schedule F-6, the Company calculated a net operating income multiplier of 1.6114 using a 34.0 percent federal income tax rate and a 5.5 percent state income tax rate. Additionally, the Company applied a 0.50 percent factor for regulatory assessment fees. Staff has reviewed the Company's calculation of the net operating income multiplier and is not proposing any adjustments. Therefore, staff recommends that 1.6114 is the appropriate net operating income multiplier. The calculation is shown below.

Line	Description	
1	Revenue Requirement	100.000%
2	Gross Receipts Tax	0.000%
3	Regulatory Assessment Fee	(0.500)%
4	Bad Debt Rate	(0.000)%
5	Net Before Income Taxes	99.500%
6	Combined State/Federal Income Tax @ 37.63 %	(37.442)%
7	Revenue Expansion Factor	62.058%
8	Net Operating Income Multiplier (100%/Line 7)	1.6114

Issue 6: Should Chesapeake's requested interim rate increase of $417,555 and percentage increase factor of 4.08 percent be granted?

Recommendation: Yes. Chesapeake's requested interim rate increase of $417,555 and percentage increase factor of 4.08 percent should be granted. (Kaproth, Draper)

Staff Analysis: On MFR Schedule F-7, Chesapeake's requested interim rate relief of $417,555 for the historical test year ended December 31, 2008. This would allow the Company to earn an overall rate of return of 6.88 percent and the minimum of the range of return on equity of 10.50 percent. After a determination of the permanent rate increase has been made, the interim rate increase will be reviewed to determine if any portion should be refunded to the ratepayers.

The calculation of the $417,555 of interim rate relief and the percentage increase factor is shown below.

Jurisdictional Adjusted Rate Base	$37,868,590
Overall Rate of Return Requested	x 6.88%
Jurisdictional Net Operating Income Requested	$2,605,610
Jurisdictional Adjusted Net Operating Income	(2,346,483)
Income Deficiency/(Excess)	$259,127
Net Operating Income Multiplier	x 1.6114
Interim Revenue Increase/(Decrease)	$417,555
Base Rate Revenues	-:- 10,242,330
Percentage Increase Factor	4.08%

<u>Issue 7</u>: How should the interim revenue increase for Chesapeake be distributed among the rate classes?

<u>Recommendation</u>: Any interim revenue increase approved should be applied evenly across the board to all rate classes based on their base rate revenues, as required by Rule 25-7.040, F.A.C., and should be recovered on a cents-per-therm basis. The interim rates should be made effective for all meter readings made on or after 30 days from the date of the vote approving any interim increase. The Company should give notice to customers of the interim increase commencing with the first bill for service that reflects the increase. (Draper)

<u>Staff Analysis</u>: As shown on Attachments C and D, staff has determined the cents-per-therm increases to be applied to each rate class based on staff's recommended interim increase of $417,555. The increases were calculated using the methodology contained in Rule 25-7.040, F.A.C., which requires that any increase be applied evenly across the board to all rate classes based on their base rate revenues. A residential customer using 20 therms taking service under the FTS-1 rate will see the bill increase from $23.81 to $24.79 or by $0.98. The bills do not include the cost of gas, as Chesapeake does not purchase gas for its customers. Rather, customers purchase gas from gas marketers, or shippers. Staff also notes the Chesapeake classifies its customers based on annual therm usage, and does not distinguish between residential and commercial customers.

In Order No. PSC-07-0427-TRF-GU,[3] Chesapeake received approval for a fixed charge rate design alternative to the existing FTS-A, FTS-B, FTS-1, FTS-2, and FTS-3 rate schedules. Those rate schedules are applicable to customers using 10,000 therms or less annually. Customers who opt to take service under the fixed rate design pay a fixed monthly transportation charge and no variable per-therm usage charge. The optional fixed rates are elected by customers during an annual open enrollment period. Chesapeake states that customers selecting that option expect that the fixed rates will not change for a period of one year. Therefore, Chesapeake is proposing to retain the current fixed rate and make no interim rate adjustment for these customers. Chesapeake states that it will absorb the resulting revenue shortfall and thus the general body of ratepayers is not impacted by that decision.

The interim rates should be made effective for all meter readings made on or after 30 days from the date of the Commission vote approving any interim increase. Chesapeake should be required to give appropriate notice to customers commencing with the first bill for service that reflects the approved interim increase that explains the nature, purpose, and effect of the increase. A copy of the notice should be submitted to staff for approval prior to distribution to the customers.

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[3] Order No. PSC-07-0427-TRF-GU, issued May 15, 2007, Docket No. 060675-GU, <u>In re: Petition for authority to implement phase two of experimental transitional transportation service pilot program and for approval of new tariff to reflect transportation service environment, by Florida Division of Chesapeake Utilities Corporation</u>.

Issue 8: What is the appropriate security to guarantee the amount collected subject to refund?

Recommendation: The appropriate security to guarantee the funds collected subject to refund is a corporate undertaking contingent upon receipt of the written guarantee by Chesapeake Utilities Corporation. (D. Buys, Davis)

Staff Analysis: Chesapeake requested that all funds collected subject to refund during the interim period be secured by a corporate undertaking. The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. The Company is an operating division of Chesapeake Utilities Corporation (Chesapeake Corp.).

Staff reviewed the financial statements included in the 2006, 2007, and 2008 Form 10-K Annual Reports Chesapeake Corp. filed with the Securities and Exchange Commission to determine if Chesapeake can support a corporate undertaking in the amount of $174,000. For 2006, 2007, and 2008, Chesapeake Corp. has maintained net working capital in excess of $22 million and an interest coverage ratio greater than 4.0 times. Chesapeake Corp.'s average equity ratio over the three-year period has been stable at an average of 50.7 percent. Chesapeake Corp.'s net income has increased in each of the previous three years and the average net income over the three-year period is seventy-two times the requested interim amount. Based on the analysis of Chesapeake Corp.'s financial condition, staff recommends that the Company can support a corporate undertaking in the amount of $174,000 contingent upon the receipt of the written guarantee by Chesapeake Corp.

This brief financial analysis is only appropriate for deciding if Chesapeake can support a corporate undertaking in the amount proposed and should not be considered a finding regarding staff's position on other issues in this proceeding.

Issue 9: Should this docket be closed?

Recommendation: No, this docket should remain open to process the Company's revenue increase request. (Sayler)

Staff Analysis: This docket should remain open pending the Commission's final resolution of the Company's rate increase.