

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

IN THE MATTER OF THE APPLICATION OF)
CHESAPEAKE UTILITIES CORPORATION FOR)
APPROVAL OF A CHANGE IN ITS GAS SALES) PSC DOCKET NO. 08-269F
SERVICE RATES ("GSR") TO BE EFFECTIVE)
NOVEMBER 1, 2008 (FILED SEPTEMBER 2,)
2008 AND AMENDED JANUARY 8, 2009))

ORDER NO. 7607

AND NOW, this 7th day of July, 2009;

WHEREAS, the Commission has received and considered the Findings and Recommendations of the Hearing Examiner issued in the above-captioned docket, which was submitted after duly-noticed public evidentiary hearings, and which is attached to the original hereof as Attachment "A";

AND WHEREAS, the Hearing Examiner recommends that the Gas Sales Service Rates ("GSR") proposed by Chesapeake Utilities Corporation in its September 2, 2008 application and January 8, 2009 Supplemental Application be approved as just and reasonable for service rendered on and after November 1, 2008;

AND WHEREAS, the Hearing Examiner recommends that the Proposed Settlement Agreement dated June 11, 2009, which is endorsed by all the parties, and which is attached to the original hereof as Attachment "B", be approved as reasonable and in the public interest.

**NOW, THEREFORE, IT IS HEREBY ORDERED BY THE AFFIRMATIVE
VOTE OF NOT FEWER THAN THREE COMMISSIONERS:**

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the Findings and Recommendations of the Hearing Examiner, appended to the original hereof as Attachment "A".

2. That the Commission approves the Proposed Settlement, appended to the original hereof as Attachment "B", and Chesapeake Utilities Corporation's proposed GSR rates provided in Paragraph 3 below.

3. That Chesapeake Utilities Corporation's proposed rates per Ccf are approved as just and reasonable rates effective as set forth below:

<u>Service Classification</u>	<u>Effective 11/01/08 (Interim)</u>	<u>Effective 02/01/09 (Suppl Appl.)</u>
RS-1, RS-2, GS MVS, LVS	\$1.466	\$1.243
GLR, GLO	\$1.231	\$1.013
HLFS	\$1.391	\$1.172
Firm Balancing Rate (LVS) (unchanged)	\$0.060	\$0.060
Firm Balancing Rate (HLFS) (unchanged)	\$0.019	\$0.019
Firm Balancing Rate (ITS) (unchanged)	\$0.004	\$0.004

4. That the Commission reserves the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

Chair

Commissioner

Commissioner

Commissioner

Commissioner

ATTEST:

Acting Secretary

A T T A C H M E N T "A"

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF)
CHESAPEAKE UTILITIES CORPORATION FOR)
APPROVAL OF A CHANGE IN ITS GAS SALES) PSC DOCKET NO. 08-269F
SERVICE RATES ("GSR") TO BE EFFECTIVE)
NOVEMBER 1, 2008 (FILED SEPTEMBER 2,)
2008 AND AMENDED JANUARY 8, 2009))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: JUNE 30, 2009

MARK LAWRENCE
HEARING EXAMINER

TABLE OF CONTENTS

	<u>PAGE</u>
I. APPEARANCES	1
II. BACKGROUND	2
A. Initial Application	2
B. Supplemental Application	3
C. Public Comment Sessions	5
D. Evidentiary Hearings	5
III. SUMMARY OF THE EVIDENCE	6
A. Chesapeake Utilities Corporation's Testimony	6
B. Public Service Commission's Staff Testimony	17
C. Division of Public Advocate's Testimony	22
D. Chesapeake Utilities Corporation's Rebuttal Testimony	23
E. The Proposed Settlement	41
IV. DISCUSSION	50
V. RECOMMENDATIONS	52

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

IN THE MATTER OF THE APPLICATION OF)
CHESAPEAKE UTILITIES CORPORATION FOR)
APPROVAL OF A CHANGE IN ITS GAS SALES) PSC DOCKET NO. 08-269F
SERVICE RATES ("GSR") TO BE EFFECTIVE)
NOVEMBER 1, 2008 (FILED SEPTEMBER 2,)
2008 AND AMENDED JANUARY 8, 2009))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

Mark Lawrence, duly appointed Hearing Examiner in this Docket, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, Chesapeake Utilities Corporation Delaware Division ("Chesapeake" or "Company"):

Parkowski, Guerke & Swayze, P.A.,
BY: WILLIAM A. DENMAN, ESQUIRE
Jennifer A. Clausius, Manager of Pricing and Regulation
Michael D. Cassel, Regulatory Analyst III

On behalf of the Public Service Commission Staff ("Staff"):

Murphy & Landon
BY: FRANCIS J. MURPHY, ESQUIRE
Susan B. Neidig, Public Utilities Analyst III
Richard W. Lelash, Staff Consultant

On behalf of the Division of the Public Advocate ("DPA"):

G. ARTHUR PADMORE, PUBLIC ADVOCATE
MICHAEL SHEEHY, DEPUTY DIRECTOR, PUBLIC ADVOCATE
KENT WALKER, ESQUIRE, DEPUTY ATTORNEY GENERAL
Andrea C. Crane, The Columbia Group, DPA Consultant

II. BACKGROUND

A. INITIAL APPLICATION

1. On September 2, 2008, Chesapeake applied to the Delaware Public Service Commission ("Commission") for approval of changes to its Gas Sales Service Rates ("GSR") to become effective for gas service provided from November 1, 2008 through October 31, 2009. (Exh. 3.) The proposed rates, as compared to the rates in effect since November 1, 2007, are as follows (per Ccf):

<u>Service Classification</u>	<u>Proposed Rate Effective 11/1/08</u>	<u>Approved Rate Effective 08/1/08</u>
RS-1, RS-2, GS, MVS, LVS	\$1.466	\$1.217
GLR, GLO	\$1.231	\$1.001
HLFS	\$1.391	\$1.166
		<u>Approved Rate Effective 11/01/2007</u>
Firm Balancing Rate (LVS)	\$0.060	\$0.049
Firm Balancing Rate (HLFS) (decrease)	\$0.019	\$0.022
Firm Balancing Rate (ITS) (decrease)	\$0.004	\$0.005

According to Chesapeake, under the proposed rates, residential heating customers in service classification RS-2, using 110 Ccf of gas in a winter month, would experience an increase of \$19.00 (or 10%) in

monthly gas billings over the rate in effect on or after November 1, 2007.

2. Pursuant to 26 Del. C. §§ 304 and 306, the Commission, in Order No. 7446 (Sept. 16, 2008), permitted the proposed rate changes to go into effect on November 1, 2008, on a temporary basis subject to refund, pending full evidentiary hearings. The Commission designated a Hearing Examiner to conduct the hearings and report to the Commission proposed findings and recommendations based on the evidence presented.

3. Chesapeake's Tariff No. 42 requires Chesapeake to file an "out-of-cycle" GSR application any time the Company's current estimate of the over-collection of gas costs exceeds four and one half percent (4.5%) of the projected firm cost of gas for the over/under collection period.

B. SUPPLEMENTAL APPLICATION

4. On January 8, 2009, Chesapeake filed a Supplemental Application (Exh. 4) seeking Commission approval of decreases to the Company's GSR rates because the projected over-collection exceeded the 4.5% threshold contained in Chesapeake's Tariff Sheet 42. The Company indicated that the primary reason for the change in rates is that the variable (commodity) costs were anticipated to decrease by approximately \$9.8 million as compared to the Company's original filing. The decrease reflected the changes that had taken place in the natural gas market and the associated decrease in commodity prices after the Company filed its original application in September 2008.

(Clausius, Exh. 6, p.3.) The supplemental rates, compared to the temporary rates which provisionally went into effect on November 1, 2008, are as follows (per Ccf)

	Effective	Effective
<u>Service Classification</u>	<u>11/1/08 (temporary)</u>	<u>2/1/09 (Supp. Appl.)</u>
RS-1, RS-2, GS, MVS, LVS	\$1.466	\$1.243
GLR, GLO	\$1.231	\$1.013
HLFS	\$1.391	\$1.172
Firm Balancing Rate (LVS) (unchanged)	\$0.060	\$0.060
Firm Balancing Rate (HLFS) (unchanged)	\$0.019	\$0.019
Firm Balancing Rate (ITS) (unchanged)	\$0.004	\$0.004

5. According to Chesapeake, under the proposed supplemental rates, a residential heating customer in service classification RS-2 using 110 Ccf of gas in a winter month would experience a decrease of \$25.00 per month or a 12% decrease over the interim rates which provisionally went into effect on November 1, 2008. The change in the GSR resulted in a decrease of approximately \$27 or 12% of the bill for a residential heating (RS-2) customer using 120 Ccf in a winter heating month. The Company projected an over-collection balance of 4.5% of projected gas costs, thereby triggering its Tariff. The Company filed its Supplemental Application relating to the Company's November 1, 2008 through October 31, 2009 filing. The Company also

sought a waiver of the sixty (60) day notice requirement of 26 Del. C. § 304(a) allowing an abbreviated notice period so that new rates could become effective with bills rendered on or after February 1, 2009. (Exh. 4, Supp. App.)

6. Pursuant to 26 *Del. C.* §§ 304 and 306, and Tariff Sheet No. 42, the Commission, in Order No. 7521 (Jan. 29, 2009), permitted the proposed supplemental rate changes described above to go into effect on February 1, 2009, on a temporary basis subject to true-up and refund, pending full evidentiary hearings. By that same Order, the Commission also granted the requested waiver.

C. PUBLIC COMMENT SESSIONS

7. A duly noticed¹ Public Comment Session on the original application was held on Wednesday, January 21, 2009, at 7:00 p.m. No member of the public attended the session. One (1) member of the public filed a written comment which was addressed by the Company. (Tr. 96.) A duly-noticed public comment session for the Supplemental Application and an evidentiary hearing were commenced on May 28, 2009 to consider the Original and Supplemental Applications. No member of the public attended the comment session/evidentiary hearing.

¹The Affidavits of Publication of notice of the January 21, 2009 Public Comment Session from the *Delaware State News* and *The News Journal* newspapers are included in the record as Exhibit "1." (Exhibits will be hereinafter cited as "Exh. __" and references to the hearing transcript will be cited as "Tr. __.") The Affidavits of Publication of notices of the May 28, 2009 Evidentiary Hearing and the June 11, 2009 Evidentiary Hearing from the *Delaware State News* and *The News Journal* newspapers, are included in the record as Exhibit "2."

D. EVIDENTIARY HEARINGS

8. At the May 28, 2009 evidentiary hearing, pursuant to the parties' request to extend promising settlement negotiations, the Hearing Examiner continued the evidentiary hearing until June 11, 2009. (Tr. 45-46.) At the June 11, 2009 hearing, the parties submitted a proposed Settlement Agreement ("Proposed Settlement"), which, if approved by the Commission, would resolve all issues in the case, except for one (1) issue which arose late in this docket. (Exh. 11; Tr. 86.) The remaining issue relates to capacity releases made by Chesapeake to an affiliate of Chesapeake, Peninsula Energy Services Group ("PESCO") (Tr. 95). This issue will be addressed in "Phase II" of this docket and will be resolved at the September 2, 2009 evidentiary hearing. I have considered all of the record evidence, including the Proposed Settlement, and based thereon, I submit for the Commission's consideration these Findings and Recommendations.

III. SUMMARY OF THE EVIDENCE

A. CHESAPEAKE'S TESTIMONY REGARDING INITIAL AND SUPPLEMENTAL APPLICATIONS

1. Initial Application

9. Michael D. Cassel, Senior Regulatory Analyst for Chesapeake, submitted pre-filed direct testimony dated September 2, 2008, explaining the basis for the changes requested in the Company's original application. (Exh. 12.) Mr. Cassel described the calculations of the three (3) proposed GSR rates and discussed the Company's gas supply and transportation service offerings. According

to Mr. Cassel, the proposed GSR rates were developed in accordance with the approved gas cost recovery mechanism prescribed by the Company's natural gas tariff. (Id. at 6.) Mr. Cassel testified that the proposed increase in GSR rates reflected anticipated increases in commodity gas costs since the last filing. The variable cost increases "are primarily due to the projected cost of flowing commodity gas." (Id. at 5.) Moreover, there are also increases in fixed costs, which are mainly attributable to increased daily firm transportation entitlements regarding the Eastern Shore Natural Gas Company ("ESNG") pipeline and the Transcontinental Gas Pipeline Corporation ("Transco"). (Id.) Lastly, Mr. Cassel's testimony also addressed the impact of the GSR charges on a typical residential heating customer. (Id. at 17.)

10. The pre-filed testimony of Jennifer A. Clausius, the Company's Manager of Pricing and Regulation, further explained the reasons for the proposed increases in GSR rates and decrease in the firm balancing rates. (Exh. 5, pp. 9-10, 17-18.) The calculation of the firm balancing rates is explained on pages 20-23 of Exhibit 5, Ms. Clausius' testimony regarding the Original Application. Ms. Clausius explained that the primary reason for the decrease in the firm balancing rate for transportation customers served under Rate Schedule LVS is a reduction in the annual load factor for the class from 32.56% in the last filing to 27.52% as shown on Schedule J of the current filing. (Id. at 17.) The primary reason for the decrease of the firm balancing service rate under Rate Schedule HLFS is an

increase in the annual load factor for this class from 51.51% to 53.69%. (Id.) The primary reason for the proposed decrease for the balancing rate for interruptible customers ("ITS"), who are being charged \$0.005 per Ccf, is the Company agreed to later update this rate in PSC Docket No. 07-186. (Id. at 17-18.)

11. Ms. Clausius also explained that the Company was required to perform an annual internal audit of the Company's margin sharing revenues in accordance with the Settlement Agreement in PSC Docket No. 95-73, Phase II. (Id. at 5.) According to Ms. Clausius, the Company's audit analysis would later be made available to the Commission Staff for review on a confidential basis in this GSR proceeding. (Id.)

12. As a result of Commission Order No. 7024 and the Settlement Agreement (Sept. 19, 2006) in PSC Docket No. 05-315F, the Company agreed to: a) provide the gas procurement rates charged by other area utilities; b) update the Commission as to the steps the Company is taking to mitigate the effect of rising gas costs on its customers; and c) update the Commission regarding the Company's Asset management procurement process. (Id. at 6.)

13. As a result of Commission Order No. 7228 (July 24, 2007), in PSC Docket No. 06-287F, the Company agreed to submit: (a) an Annual Report of its hedging activities, including results; (b) specify the amount of capacity charges for delivery points in eastern Sussex County, Delaware which the Company is seeking to recover in its GSR charges; and (c) regarding the settlement of the Company's GSR filing

for rates effective November 1, 2007, the Company agreed to credit the GSR in the amount of \$275,000 representing certain capacity charges paid by the Company for Eastern Shore capacity at delivery points in eastern Sussex County, Delaware, which the Company seeks to now recover. (Id. at 6-7.)

14. As a result of a Settlement Agreement in PSC Docket No. 07-246F, the Company has agreed to credit the GSR for 100% of the revenues received by the Company for any capacity released to serve former off-system sales customers. (Id. at 7, LL 18-22.) This projected credit is included on Schedule I. (Id.) The Company has also agreed to identify and quantify any future claims for cost recovery associated with any pre-certification costs related to the Eastern Shore E3 project. (Id. at 7-8.) The Company has not included any costs associated with this project in its current filing. (Id. at 8.)

15. As a result of Commission Order No. 7360 (Feb. 5, 2008), in PSC Docket No. 07-299, approving the Company's last Environmental Rider filing, the Commission directed the Company to terminate its Environmental Rider rate at the end of the current recovery year (November 30, 2008) and include any remaining balance in its next GSR application, to be filed on September 1, 2008. (Id.) As part of this GSR application, the Company has included an under refund of \$13,511

of July 31, 2008. This under refund is shown as a reduction to the fixed gas costs on Schedule B.² (Id.)

16. As a result of a Settlement Agreement in PSC Docket No. 07-186, the Company's most recent base rate proceeding, the Company has included the following in this filing: (a) the Company's current Residential Service Rate Schedule will be separated into two (2) different rate schedules - RS-1 and RS-2; (b) the Company will no longer be offering a Gas Cooling or a Seasonal Firm Service Rate Schedule; (c) existing interruptible sales customers with a minimum annual usage of at least 10,000 Mcf have been moved to the ITS Rate Schedule and are assumed to be transporting in this filing. Existing interruptible sales customers with a minimum annual usage of less than 10,000 Mcf have been moved to the appropriate firm rate schedule; (d) eighty percent (80%) of the margins from upstream capacity release credits have been shared among the RS-1, RS-2, GS, MVS, and LVS Rate Schedules as shown on Schedule A.2; and (5) the Company has updated the Interruptible Balancing Service Rate as shown on Schedule J. (Id. at 8-9.)

17. In the Settlement Agreement reached with the Commission Staff, the DPA, and the Company in Phase II of PSC Docket No. 95-73 and again in Phase II of PSC Docket No. 01-307, shared margins are defined as "any margins that the Company receives as a result of interruptible sales, capacity release, or off-system sales." (Id. at

²Order No. 7360 also required the Company to include any remaining balance which occurs in the months of August, September, October, and November, 2008 in its GSR under- or over-collection balance.

11.) As a result of PSC Docket No. 07-186, any margins received from interruptible transportation customers are retained by the Company and not shared with the eligible customers. (Id.) Eighty percent (80%) of the margins from upstream capacity release credits and eighty percent (80%) of any off system sales margins will be credited to the GSR. (Id.) As shown on Schedule A.2, the shared margin levels were used in the calculation of the \$0.040 per Ccf margin sharing rate, proposed to be effective November 1, 2008. (Id. at 11-12.) The majority of the \$0.040 per Ccf margin sharing rate is a result of an under refund from the previous determination period. (Id. at 12.) The Company did not include a projection of any off system sales margins in this determination period. However, if the Company does make any off system sales, eighty percent (80%) of the margins will be credited to the ratepayers according to the margin sharing mechanism. (Id.)

18. As stated in prior GSR filings, although the Settlement Agreement in PSC Docket No. 95-73, Phase II directed the Company to include margins from capacity release in the shared margin pool, the Company believes crediting 100% of the capacity released for the Delaware Division's firm transportation customers to the firm sales customers is appropriate "due to the ESNG market for this capacity." (Id. at 12.) The Company has estimated this capacity release value to be \$1,076,873 for the twelve-month period ending October 2009 as calculated on Schedule I and shown as a reduction to fixed demand costs on Schedule B. (Id. at 12-13.) The total peak day firm

entitlements on ESNG are projected to be 61,637 Dts per day for this determination period of which 4,934 Dts per day of Daily Contract Quantity entitlements are projected to be released to firm transportation customers, or approximately eight percent (8%) of the Delaware Division's peak day capacity on ESNG. (Id. at 13.)

19. The Company has not included in its projections any new large firm commercial or industrial customers switching from sales service to transportation service during the determination period. (Id.) This filing includes projections for gas to be transported on the Company's distribution system for those customers who are currently receiving transportation service or will be in the near future based on the Company's current eligibility requirements. (Id.) There are thirty (30) firm commercial/industrial customers and six (6) interruptible commercial/industrial customers who will be transporting their own gas on the Delaware Division's distribution system. (Id.) The Company has estimated the firm commercial/industrial transportation volumes to be approximately 724,000 and the interruptible commercial/industrial transportation volumes to be approximately 446,000 Mcf during this period. (Id. at 13-14.)

20. The steps the Company has taken to mitigate the effect of rising gas costs on its customers are as follows: (a) the Company included messages on its customers' bills during the months of June, July, and August 2008 encouraging customers to sign up for the Company's budget billing program, which provides for the same monthly payments from September through May; (b) the Company included a

message about budget billing on its fall bill insert sent with its August 2008 bills; and (c) the Company continues to promote conservation by including conservation tips: (i) on its customers' bills sent as part of its customer guides sent each winter to each residential customer prior to every winter; and (ii) including such tips on a pamphlet available in its Dover office. (Id. at 14.)

21. A comparison of the residential GSR rates charged by Chesapeake over the past twelve-month period to the rates charged by other utilities in the area is included on Schedule K. (Id. at 15.) The Company believes in this analysis that it is important to take into consideration not just the actual rate charged per Ccf, but the frequency of the rate change and the average consumption per customer over which the rate is calculated as well. (Id.) Therefore, the Company has included an average rate per Ccf for those utilities whose rates change more frequently than once a year.³ (Id.)

22. Chesapeake's firm transportation balancing rates are calculated in accordance with the methodology approved in PSC Docket No. 95-73, Phase II, by Order No. 4400, based on Chesapeake's annual purchased gas costs, and its balancing rates are updated on an annual basis at the time of its annual GSR rate application. (Id. at 16.) Chesapeake agreed to update its interruptible balancing rate as a result of a settlement agreement in PSC Docket No. 07-186. (Id.) The relationship between the GSR charges and the transportation balancing rates exist because the gas costs being presented in this GSR filing

³The average rate per Ccf is calculated based on the consumption of the Company's typical RS-2 customer using 700 Ccf per year.

are the same gas costs that are used to calculate the transportation balancing rates. (Id.)

23. Chesapeake is proposing an increase in the firm balancing rate for transportation customers served under Rate Schedule "LVS" from \$0.049 per Ccf to \$0.060 per Ccf to be effective for service rendered on and after November 1, 2008. (Id. at 17.) The primary reason for the increase in the firm balancing rate for transportation customers served under Rate Schedule "LVS" which is being proposed is a reduction in the annual load factor for the class from 32.56% in the last filing to 27.52% as shown on Schedule J of this filing. (Id.) The primary reason for the decrease in the firm balancing rate for transportation customers served under Rate Schedule "HLFS" which is being proposed is an increase in the annual load factor for the class from 51.51% in the last filing to 53.69% as shown on Schedule J. (Id.) The Company is proposing a decrease in the firm balancing rate for transportation customers served under Rate Schedule "HLFS" from \$0.022 per Ccf to \$0.019 per Ccf to be effective for service rendered on and after November 1, 2008. (Id.) The Company is also proposing a decrease in the interruptible balancing rate for transportation customers served under Rate Schedule "ITS" from \$0.005 per Ccf to \$0.004 per Ccf to be effective for service rendered on and after November 1, 2008. (Id.) The primary reason for the change in the interruptible balancing rate for transportation customers served under Rate Schedule "ITS" which is being proposed is a result of the

settlement agreement in PSC Docket No. 07-186, whereby the Company agreed to update the balancing rate in this GSR application.⁴

24. Marie E. Kozel, Senior Procurement Analyst for Chesapeake, submitted pre-filed direct testimony dated September 2, 2008. (Exh. 9.) Ms. Kozel's testimony provided background support for the GSR initial application calculation. (Id. at 3-5.) Ms. Kozel's testimony also addressed the Company's gas supply procurement activities. (Id. at 5-7.)

2. Supplemental Application

25. Ms. Clausius also submitted pre-filed, Supplemental testimony in support of the proposed GSR rates proposed in the Company's Supplemental Application to be effective February 1, 2009. (Clausius, Exh. 6 (1/8/09), p. 3.) The Company stated that the primary reason for the decrease in rates is that the variable (commodity) costs were anticipated to decrease by approximately \$9.8m as compared to the Company's original filing. (Id.) The decrease reflected the changes that had taken place in the natural gas market and the associated decrease in commodity prices after the Company filed its original application in September, 2008. (Id.) Ms. Clausius explained that the Company's over-collection level will be

⁴Schedule J, page 1 of Exhibit 4 of the Company's Application shows the Delaware Division's gas supply resources being used in developing the balancing service rates along with the purchased gas costs associated with these gas supply resources. All of these resources provide firm deliveries that vary in daily entitlements and duration. The Company also plans on using the propane peak shaving facilities as a gas supply resource in its balancing services. The Delaware Division currently has 12,048 Dt of propane peak shaving capacity available on a peak day to supplement its current pipeline entitlements.

approximately 16.51% for the twelve-month over-under-collection period ending October 31, 2009. (Id. at 3-4.) The proposed supplemental rates were calculated in accordance with the Company's approved GSR tariff. (Id. at 4.)

26. Michael D. Cassel's also submitted pre-filed, Supplemental testimony dated January 8, 2009. (Exh. 13.) Regarding the Company's Supplemental application, Mr. Cassel described the calculation of the three (3) proposed GSR rates. (Id. at 3-9.) Mr. Cassel's testimony also addressed the impact on a typical residential heating customer. (Id. at 10.) During the winter heating season, a customer using 110 Ccf per month will experience a decrease of approximately 12% or \$25 per winter month. (Id.) A customer using 120 Ccf per month will experience a decrease of approximately 12% or \$27 per winter month. (Id.)

27. Marie E. Kozel also submitted pre-filed, Supplemental testimony dated January 8, 2009. (Exh. 10.) Regarding the Company's Supplemental Application, Ms. Kozel discussed the Company's gas supply and procurement activities. (Id. at 2.) Ms. Kozel explained that the Company has purchased some requirements from third-party suppliers pursuant to short-term agreements and has also used its Asset Manager for base load and spot purchases to meet projected daily demand requirements. (Id.) Most of the Company's gas supply costs during the winter months are based on fixed prices which are set prior to the beginning of each winter delivery month to minimize volatility. (Id. at 3.) The daily spot purchases referenced above are susceptible to

the daily market volatility; however, they are essential due to the varying nature of the Company's demand requirements. (Id.) The Company's use of the daily spot market is more prevalent during the summer months when the demand is more predictable. (Id.) During the winter season of 2008-09, the Company met the requirements through: (a) supply purchases through its Asset Manager with the supply provided from the Company's contracted storage; (b) "no requirements" contracts with several natural gas suppliers; and (c) as of January 1, 2009, the Company permanently acquired an additional 67 dekatherms of capacity on both the Transcontinental Gas Pipe Line, LLC and Eastern Shore Natural Gas Pipeline. (Id. at 4.)

28. In order to improve the reliability of supply and to mitigate the impact of winter price fluctuations, the Company's supply includes gas which is stored during the months of April through October primarily intended for use during the November through March period. (Id. at 5.) By November 2008, the Company had secured a fixed price for a significant portion of its winter gas supply through hedging. (Id.) Chesapeake's procurement program insures that its storage capacity will be fully operational in time for the winter season. (Id.) The Company purchases a portion of its requirements from third party suppliers pursuant to short-term agreements and uses its Asset Manager for base load and spot purchases to meet projected daily demand requirements. (Id.) Lastly, Ms. Kozel testified that the Company uses a commodity procurement plan which enables the Company to obtain a weighted average fixed price for up to seventy

percent (70%) of the forecasted flowing natural gas requirements based on the most current GSR filing. (Id. at 6.) At least fifty percent (50%) of natural gas supply is procured in one-twelfth (1/12) increments over the twelve (12) months proceeding the month in which the gas is to be delivered. (Id.) Recent commodity prices have been "attractively low" and, as such, the Company modified the current procurement plan to increase the procurement quantity from the target of 50% for this determination period. (Id.)

B. STAFF'S TESTIMONY

29. Susan B. Neidig, Public Utilities Analyst III, submitted pre-filed direct testimony on behalf of Staff dated March 3, 2009. (Exh. 16.) On behalf of Staff, Ms Neidig concluded that:

"Staff has reviewed the Company's application and support schedules and documentation and recommends that the Commission approve the GSR and firm balancing rates requested by the Company. Staff finds that the rates are just and reasonable and are in the public interest."

30. Commission Staff witness Richard W. LeLash, a Financial and Regulatory Consultant, submitted pre-filed testimony dated April 2, 2009. (Exh. 17.) Mr. LeLash, a Financial and Regulatory Consultant, stated his recommendations on pages 8 through 11 of his testimony, as follows:

(a) In developing its demand requirements, the Company should be required to fully justify its

increases to its design regression for two (2) standard errors of the dependent variable. Unless it can be shown that this is standard practice in the gas industry, the additional supply requirements should be omitted.

- (b) The Commission should clarify its procedures concerning the modification of capacity related margin sharing. The Company has historically taken the position that margin sharing can only be addressed in base rate proceedings. However, given FERC's recent Order 712 and ongoing changes in the Company's levels of capacity, it is logical that capacity margin sharing should be subject to review and potential modification within the annual GSR proceedings. This is all the more relevant since the Settlement allows for modification of the sharing framework at the end of the initial Determination Period, which will be at the end of the current GSR period.
- (c) In Docket No. 07-186, the Settlement provided for 80% of margins to be credited to the GSR for the initial Determination Period. That determination period should end as of October 31, 2009. As of that date, it is recommended that the asset manager margins credited to the GSR be increased

from 80% to 100%. Mr. LeLash also recommended deferral of the \$275,000 of capacity costs for capacity with delivery points in eastern Sussex County be deferred until the next base rate proceeding.

- (d) The Company should also be required to utilize a more recent load period for its forecasting. While the Company's comprehensive Gas Supply Plan can still be done every two (2) years, the Company's design day demand requirements should be determined annually. According to Mr. LeLash, these latter requirements must be based on the most recent prior winter's data.
- (e) In this proceeding the Commission should reaffirm the need for a comprehensive evaluation of LPG options. A filing which addresses the Company's LPG should be submitted prior to the Company's next GSR filing and it should address the Company's historical utilization of LPG and the economics of LPG expansion vs. alternative delivered peaking supply. Such an evaluation is all the more necessary given the Company's lack of adequate upstream capacity and the apparent cancellation of the E3 Project.

- (f) The Company's prospective asset management agreement has not yet been finalized, but the Company states a signed agreement will be submitted prior to March 31, 2009.⁵ [After Mr. LeLash's testimony was filed, the Company submitted the signed Agreement to the Commission and the parties; Clausius Rebuttal, Exh. 7, pp. 10-11.]
- (g) Based on the Company's history, it is unclear whether the Company is fully utilizing its storage capacity. To a considerable degree, its storage operation is probably affected by its asset management agreement. However, in looking at the monthly storage inventory levels, it is unclear whether some of the balances are virtual rather than physical in nature.
- (h) It is recommended that the Company and the Commission consider further refinements to the

⁵The Settlement Agreement in PSC Docket No. 07-246F, which was approved by the Commission on October 7, 2008, included the following provision:

"The Company will explore extending its relationship with its current Asset Manager and make a good faith effort to obtain information from its current Asset Manager on the actual margins achieved by its Asset Manager in optimizing Chesapeake's capacity resources. If after obtaining the aforesaid information from its current Asset Manager the Company is unable to reach an agreement with its current Asset Manager that is acceptable to the Company, or if the current Asset Manager does not provide information on the actual margins achieved, the Company will conduct competitive bidding and issue a Request for Proposal ("RFP") for a new [Asset Management Agreement] no later than October 1, 2008."

hedging program in order to address severe gas price volatility. Such refinements could include extending the hedging period from ___ (redacted) to 18 months and allowing the Company to alter its prorated purchasing by reducing or eliminating hedging during months of above normal prices and increasing hedge levels during months with below normal pricing. Another potential refinement could be to utilize a true dollar cost averaging methodology for hedge positions taken by the Company.

C. DIVISION OF PUBLIC ADVOCATE'S TESTIMONY

31. Public Advocate Witness Andrea Crane of The Columbia Group submitted pre-filed testimony dated March 13, 2009. (See Exh. 15.) On pages 5 through 7 her testimony, DPA Witness Crane, who specializes in utility regulation and regulatory policy, stated her recommendations, as follows:

- (a) The Company has not complied with the terms of the Settlement Agreement in Docket No. 07-246F regarding its Asset Management Agreement.
- (b) Given the provisions of the proposed Asset Management Agreement, ratepayers should receive 100% of capacity release revenues received from the Asset Manager for release of upstream capacity.

- (c) The Commission should initiate a review of the Company's Gas Hedging Plan once the Company's hedging results for the Second Quarter, 2009 are available.
- (d) The Company's request to recover \$275,000 in past capacity costs from ratepayers should be denied.
- (e) The Company's shareholders should be at risk for costs relating to additional capacity which the Company may acquire from ESNG relating to the eastern Sussex County expansion project.
- (f) The Commission should continue to monitor costs from the Company's affiliate, ESNG, for reasonableness.
- (g) The Company should clearly identify and quantify any future claims for recovery of costs relating to the Eastern Shore Energylink Expansion ("E3") project.
- (h) The Commission should continue to require Chesapeake to impute capacity release revenues for the ESNG capacity assigned to former off-system sales customers at levels which will compensate ratepayers for the loss of the off-system sales margins.
- (i) The Commission should approve the GSR rates proposed by the Company, subject to true-up for

the period November 1, 2008 through October 31, 2009 in the Company's next GSR proceeding.

D. CHESAPEAKE'S REBUTTAL TESTIMONY

32. Michael D. Cassel submitted pre-filed Rebuttal testimony dated April 24, 2009. (Exh. 14.) The purpose of Mr. Cassel's rebuttal testimony was to respond to certain recommendations made by Division of the Public Advocate ("DPA") Witness Andrea C. Crane. (Id. at 2.) As to Ms. Crane's testimony that the Company's GSR rates continue to be high relative to the rates charged by Delmarva Power and Light Company ("DPL") and by other natural gas utilities in the area, Mr. Cassel responded that "[i]t is neither reasonable nor appropriate to compare the Company's gas cost rates with the rates of other utilities selected by Ms. Crane." (Id. at 3-4.) In the chart on Page 12 of her testimony, Ms. Crane provides the rates for thirteen (13) companies from New Jersey and Pennsylvania. (Id. at 4; Crane, Exh. 15.) According to the Company, Ms. Crane uses data for comparison purposes from the Pennsylvania Office of Consumer Advocate's ("OCA") website. (Id. at 4.) Of the rates provided for these nine (9) companies, the only company which Chesapeake is able to tie to an approved rate from the Pennsylvania Public Utility Commission's ("PUC") website was that of the Dominion Peoples Utility - and that rate was effective in October, 2003. (Id. at 4-5.) The Company was unable to find the remaining rates on the Pennsylvania PUC's website as approved rates. (Id. at 4.)

33. As to New Jersey utilities, Mr. Cassel testified that the comparison of the Company's rates to the rates charged by four (4) utilities is unfair because of the dates of the comparison Ms. Crane uses. (Id. at 3-4.) The New Jersey rates Ms. Crane uses for Elizabethtown and New Jersey Natural Gas became effective in October 2008, a full month after the Company filed its application. (Id. at 4.) The rate for Public Service Gas & Electric became effective in March 2009 - six (6) months after Chesapeake filed its application. (Id.) The rate comparison used for South Jersey Gas became effective in December, 2008, three (3) months after Chesapeake filed its Initial Application in this docket. (Id.)

34. According to Mr. Cassel, since DPL's customers have a greater consumption per customer on average than Chesapeake's customers, this causes the amount of fixed costs per unit to be less. [Id. at 5-6; The Company also supported its position in its confidential response to DPA-Data Request 64.] According to Mr. Cassel, Ms. Crane's comparison is also not appropriate because DPL is located in a more northerly position on the Delmarva Peninsula than Chesapeake. (Id. at 6.) DPL has direct interconnects with interstate pipelines such as Transcontinental Gas Pipe Line Company and Columbia Gas Transmission Company, whereas all of Chesapeake's natural gas supply flows through an additional interstate pipeline, Eastern Shore Natural Gas, to get to Chesapeake's distribution system on the

Delmarva Peninsula. Both of these factors tend to have an upward effect on Chesapeake GSR rates.⁶ (Id. at 6, LL 5-11)

35. Ms. Crane recommended that the Commission require Chesapeake to forecast sales using a thirty (30) year average for normal weather. (Crane, Exh. 15, pp. 17-18.) However, Mr. Cassel's testimony was that it has been the Company's practice, since at least 1995, to use a 10-year normalization for weather in forecasting sales. (Id. at 8.) The Company believes that a ten-year normalization most accurately reflects the "norm" in its service territory. (Id.) Ms. Crane recommends on page 18 (Lines 8-13) of her testimony that the Company should change to a 30-year standard to be in line with both DPL and the National Oceanic and Atmospheric Association ("NOAA"). Mr. Cassel of Chesapeake instead argued that, since Chesapeake's service territory is located south of DPL's territory, "[w]hat might be best for DPL's customers may not necessarily be best for Chesapeake's customers." (Cassel, Exh. 14, p. 7, LL 22-23.)

36. The Company re-forecasted its sales with a 30-year normal and found no material impact on the GSR rate being requested. (Id. at 7-8.) This is confirmed by Ms. Crane on page 20 (Lines 9-13) of her testimony where she states that her proposed change would not have a significant impact in this case. (Crane, Exh. 15.) Ms. Crane is not

⁶Mr. Cassel also noted that Staff Witness LeLash's testimony stated "[t]he Company receives its gas supply from just one interstate pipeline. While it accesses other pipeline natural gas, ultimately all of its gas must flow through the Eastern Shore Natural Gas system. This physical reality limits diversification and adds an additional element to its total GSR cost. (LeLash, Exh. 17, p.5, LL 10-13.) Also, DPA's Witness Crane likewise stated in her testimony that Chesapeake "is a fast growing utility and its pipeline interconnect options are limited due to its geographic location." (Crane, Exh. 15, p. 28, LL 11-12.)

recommending any quantitative adjustment at this time. (Exh. 15, p.20, LL 12-13) According to the Company, the GSR mechanism is "a pass-through of actual costs through a true-up provision, the resultant impact is merely a timing issue." (Cassel, Exh. 14, p. 8, LL 5-7) Ultimately, the impact of the weather normalization, whether 10, or 30 years, will flow into the GSR rates by way of the over/under collection balance. (Id.) Ms. Crane recommended that the Commission utilize the weather normalization standard adopted by NOAA. (Crane, Exh. 15, pp. 19-20) The Company does not agree with this argument because it suggests that to "game the system" a party would have to be changing methodologies periodically to gain an advantage. (Cassel, Exh. 14, p. 8, LL 17-19) The Company has made no such changes in its methodologies in at least the last fourteen (14) years. (Id. at LL 19-21) Finally, the Company believes that weather normalization issues are better addressed in base rate cases. (Id. at 8-9.)

37. Jennifer Clausius submitted Rebuttal Testimony dated April 24, 2009. (Exh. 7.) Ms. Clausius first addressed the issue of the Company's Asset Management Agreement. (Id. at 8.) Both DPA Witness Crane and Commission Staff Witness LeLash had made comments regarding the Company's compliance with the settlement terms in the prior GSR proceeding (i.e. PSC Docket No. 07-246F) in this regard. (Id. at 9.) DPA Witness Crane had stated that: (a) the Company did not comply with the terms of the settlement agreement because it did not enter into a new agreement with the current asset manager, nor did it issue an RFP for a new Agreement by October 1, 2008; and (b) if the

Company's new Asset Management Agreement involves a fixed payment, there is no need to provide an incentive for the Company to maximize these capacity release revenues through a margin sharing mechanism. (Id.) Therefore, the ratepayers should receive 100% of the benefit of any capacity release revenues. Staff Witness LeLash had stated that: (a) the parties have had no input into the Asset Management Agreement's provisions or whether or not the agreement is sufficiently beneficial to avoid competitive bidding; and (b) given the current market environment, it is unnecessary and unreasonable to provide the Company with an additional incentive and that the Company should no longer e permitted to retain 100% of any asset manager margins. (Id.)

38. According to Ms. Clausius, the Company complied with the terms of the prior settlement agreement with respect to its Asset Management Agreement. (Id. at 9-10.) The Company entered into a twelve-month extension with its Asset Manager in March, 2008. (Id. at 10.) Subsequently, the Company agreed in the Settlement of PSC Docket No. 07-246F that "the Company would first explore extending its current relationship and, if unsuccessful, would bid for a new asset manager contract." (Id. at p. 10, LL 24-27) "The Company was able to extend its relationship with its current Asset Manager and finalize a new agreement. In doing so, the Company complied with the Settlement Agreement." (Id at pp. 10-11.)

39. According to Ms. Clausius, the Company prepared to issue an RFP for a new Asset Manager in Fall, 2008. (Id. at 11.) Also, on September 17, 2008, the Company requested its current Asset Manager to

provide detail on historical actual margins received by the Asset Manager for use of Chesapeake's resources. (Id.) In exchange for the receipt of this information, the Company offered the Asset Manager the opportunity to submit a proposal for Chesapeake's consideration prior to an RFP being issued. (Id.) The Settlement Agreement required Chesapeake to issue an RFP by October 1, 2008 if it was unable to reach an agreement outside of bidding or did not receive the requested historical information. (Id.) The Company's Asset Manager is based in Houston, Texas, which was hit by a hurricane in September 2008. (Id.) Consequently, on September 23, 2008, the Company requested additional time from Staff and DPA before the Company would otherwise be required to issue an RFP. (See Company's Response to DPA's Data Request 65.) An extension to October 20, 2008 was agreed to by the Commission Staff and the DPA. (Id.) The Company received the historical margin information and a proposal from its Asset Manager on October 6, 2008. (Id.; See Company's Response to DPA Data Request 67.) The Company was able to use this information to negotiate more favorable terms for a new agreement. (Id.)

40. On October 20, 2008, the Company and Staff had a telephone conference on the progress being made and the information being received. (Id.; See Company's Response to DPA-67.) The Company also notified the Commission Staff during this telephone conference of the level of fixed cost recovery that the Company could achieve through a new agreement. (Id. at 12.) Specifically, the Company discussed a fixed payment as opposed to a market sharing mechanism for a new Asset

Management Agreement. (See Company's Response to DPA Data Request 69.) All indications to Chesapeake were that the terms were acceptable. Between October, 2008 and March, 2009, the parties negotiated the specific language of the Agreement, not the Asset Manager's Compensation. (See Company's Response to DPA Data Request 71.) In March 2009, the Company completed negotiations on the language of the new agreement which resulted in a new three-year agreement with its current Asset Manager with terms consistent with those discussed with the parties prior to the actual signing of the agreement. (Id. at 12.) The Company considers the terms of the Agreement to be "favorable," although its reasons are confidential. (See Company's Response to DPA Data Request 73.)

41. According to Ms. Clausius, the Company has in good faith taken every step required to comply with the Settlement in PSC Docket No. 07-246F. (Id.) The Company has taken into consideration the suggestions from the parties in negotiating a new, three (3) year Asset Management Agreement consummated in March, 2009. (Id. at 12, LL 8-11) The Company also had a telephone conference with the Commission Staff prior to agreeing to the specific terms of the agreement. (Id.) The language in the prior settlement agreement required the Company to issue an RFP if the Company was unable to reach an agreement with its current Asset Manager that "is acceptable to the Company." (Id. at 13.)

42. Chesapeake maintains that it has negotiated a "favorable" Asset Management Agreement which will benefit both the Company and its

ratepayers. (Id.) Under the terms of the new agreement, the Company's ratepayers will see an increase in their portion (80%) of the fixed credit of _____ per year or ___%. (redacted) (Id.) The Company is allowed to retain a portion (20%) of the capacity release credit set forth in the Asset Management Agreement. (Id.) Also, the Asset Manager has agreed to provide information as to the annual revenues received on the Company's assets. (See Company's Response to PSC-R-2.) Thus, according to Ms. Clausius, the Company had a substantial incentive to negotiate the best terms practical under the circumstances. (Id.)

43. Now that the Company has concluded its negotiations with the Asset Manager, both Commission Staff Witness LeLash and DPA Witness Crane have recommended that Chesapeake no longer be allowed to retain its 20% portion of the capacity valuation credit received through the Asset Management Agreement. (Id. at 14.) Ms. Crane stated, "if the new Asset Management Agreement also provides for a fixed capacity release payment, then ratepayers should be credited with 100% of the capacity release revenues received from the Asset Manager for release of upstream capacity. ... This recommendation should be effective April 1, 2009 when the new Asset Management Agreement takes effect." (Crane, Exh.15, p. 38, LL 7-10, 16-17.) Mr. LeLash, stated " ... based on Settlement in Docket No. 07-186F,⁷ the Company

⁷The Settlement Agreement reached in PSC Docket No. 07-186F, included the following provision:

"During the Determination Period, as defined herein, eighty percent (80%) of the margins from upstream capacity release credits and eighty percent (80%) of any off system sales

was allowed to retain 20% of the margins received from its Asset Manager until the conclusion of the initial determination period. That period began on November 1, 2008 and will end on October 31, 2009. Based upon the margins earned by the Company during the past several years, and given the level of involvement in the level of asset manager's margins, it is time to eliminate the Company's 20% share." (Lelash, Exh. 17, p.22, LL 3-8; See Company's Response to DPA Data Request 74.)

44. The Company disagreed with these recommendations for several reasons. First, the language mentioned above allows for a review of the margin sharing mechanism following the end of the first determination period. (Clausius, Exh. 7, p.15.) The language does not automatically allow for an adjustment to the margin sharing mechanism outside of a base rate proceeding. (Id.) The Company continues to maintain, as it has done in prior gas cost proceedings, that the margin sharing mechanism is a base rate issue and should only be adjusted as part of a base rate proceeding. (Id.)

45. Second, the Company noted that the parties agreed to possibly review these margins, on a prospective basis, after the

margins shall be credited to the Company's Gas Sales Service Rate Clause, with the Company retaining twenty percent (20%). The capacity release margins associated with the Company's affiliate, Eastern Shore Natural Gas, will continue to be credited 100% to the Company's Gas Sales Service Rate Clause. The parties hereto reserve the right to review these margins, on a prospective basis, after the conclusion of the initial Determination Period, subject nevertheless to any lawful adjustments that may be implemented in the context of any future regulatory proceeding, if any."

conclusion of the initial determination period. (Id. at 15-16.) The initial determination has not yet concluded. (Id.) Therefore, the recommendations made by Commission Staff Witness LeLash and DPA Witness Crane are premature at this point in time. (Id.) Moreover, Ms. Crane's recommendation of eliminating the Company's 20% share effective April 1, 2009 violates the Settlement Agreement reached in PSC Docket No. 07-186. (Id.) Finally, the Company should be given an incentive to negotiate favorable terms in any Asset Management Agreement. (Id.) Commission Staff Witness LeLash's recommendation is based on the fact that prior to the Company's most recent change to the margin sharing mechanism, the Company retained a larger portion of the Asset Manager Credit. (Id.) What Commission Staff Witness LeLash fails to recognize is that there was a level of Asset Manager credit built into the Company's base rates prior to the most recent base rate proceeding. (Id.) For that reason, the Company in effect needed to retain a higher level of margin in order to earn its approved rate of return. The amount of the Asset Manager credit built into base rates has changed as a result of the Company's most recent base rate proceeding, and the level of retained margins were decreased accordingly. (Id.) It continues to be necessary for the Company to retain a portion of the Asset Manager credit as an incentive to enter into the most beneficial Asset Management Agreements possible, and provide the Company with an opportunity to earn its approved rate of return. (Id.)

46. DPA Witness Crane's rationale for eliminating the Company's share is that the level of capacity release revenue does not depend on any actions taken by the Company (Crane, Exh. 15, p.38, LL 12-14). The Company disagreed, stating that "the level of revenue received from the Asset Manager is completely dependent upon the actions taken by the Company in negotiating the agreement." (Clausius, Exh. 7, p. 17, LL 7-9.) "DPA Witness Crane ...[believes] that if the Asset Management Agreement had been structured in a manner such that Chesapeake would receive a set percentage of capacity release revenues, margin sharing, the Company would have input into the transactions performed by the Asset Manager (AM) that result in revenues received by the AM. (Id.) This assumption is clearly untrue because FERC Order 712 contemplates that an Asset Management Agreement will include a release of pipeline and storage capacity from the utility to the Asset Manager. (Id.) Once this capacity release is completed, the capacity effectively belongs to the AM, subject to recall by the utility, with the AM then having the obligation to serve the utility. (Id.) Therefore, Chesapeake would have no influence over the transactions performed by the AM that did not involve Chesapeake. (Id.) This would be the same result, regardless of whether the Asset Management Agreement was a fixed payment or margin sharing arrangement. (Id.) The benefit to a fixed payment arrangement is that the utility is guaranteed a level of revenue regardless of any actions taken by the AM and thus shifts the risk to the AM from the Company and the ratepayer. (Id. at 18.) This

shifting of risk is another reason why the Company should be provided with an incentive to negotiate the most favorable Asset Management Agreement possible." (Id.)

47. Both Ms. Crane and Mr. LeLash made recommendations regarding capacity costs related to the Company's expansion into eastern Sussex County, Delaware. (Id. at 18.) Ms. Crane stated "while the Settlement Agreement provided the Company with an opportunity to retroactively request recovery of these costs in the current proceeding, it does not follow that such recovery was guaranteed, or even expected. It is reasonable to assume that the parties expected CUC to make a positive argument as to why such recovery was warranted. The Company made no such argument in its testimony in this case." (Id. at 18; Crane, Exh. 15, P.32, LL 12-16) Ms. Crane recommends a disallowance of the renewed claim for the \$275,000 related to capacity costs. (Id.; Crane at 32-33.) Mr. LeLash recommends deferral of the \$275,000 of costs until the next base rate proceeding. He stated: "[t]he recovery of these costs was originally addressed in Docket No. 06-287 where they were deferred until the Company's next base rate case. In that case the Company did not seek, nor was it specifically authorized, to recover the charges. However, in the base rate case in Docket No. 07-186, a mechanism was established for the future recovery of expansion related costs. Based on the establishment of such a recovery mechanism, it is recommended that these deferred costs be recovered under the mechanism set forth in the Settlement assuming that the Internal Rate of Return Model ("IRRM") conditions are met in

aggregate with the inclusion of the deferred capacity cost." (Lelash, Exh. 17, p.31, LL 14-22.)

48. According to Ms. Clausius, the Company should receive full recovery of the \$275,000 related to capacity costs in this current GSR proceeding. The Company's position is that the Delaware Supreme Court has established legal standards for the disallowance of fuel procurement costs. (Id.) The Company's position is that fuel supply costs are fully recoverable unless found to have been incurred as a result of waste, in bad faith, or out of an abuse of discretion. Delmarva Power & Light Co. v. Public Service Commission, 508 A.2d 849, (DE. 1986). (Id.) "The Commission does not have authority to invade the province of the Board of Directors of the Company on matters involving judgment and substitute its judgment for that of the Company." (Id. at 19-20) The Delaware Supreme Court held that:

"The Commission's standard of review of a public utility's expense application in an ordinary rate case hearing proceeding has never been construed as incorporating a judgmental standard of prudence, in the sense of permitting the Commission to involve itself in the business judgment of management. A public utility commission shall not dictate business practices to be followed by a utility... The Commission's broad grant of statutory authority to set rates does not extend to the review of matters involving business judgment. In reviewing the operating expenses of a public utility, the Commission may not disallow normally accepted operating expenses... unless found to have been made in a bad faith or out of an abuse of discretion." (Id. at 20.)

49. As the Company points out, the Delaware Supreme Court held that fuel procurement costs, whether sought to be allowed in a special proceeding under § 303(b) or in a general rate application under

§ 303(a), constitute operating expenses, and that the Commission must allow the recovery of such expenses which:

"were legitimately and properly incurred and which the Commission has not demonstrated ... to have resulted from waste, inefficiency, or bad faith. We further conclude that inefficiency and waste are redundant terms; and that inefficiency is an inappropriate standard with which to measure an item of expense as distinguished from service of a public utility. Therefore, we restate the controlling standard for reviewing the operating expenses of a public utility to be: abuse of discretion, bad faith, or waste."
(Id.)

50. Capacity charges are "the fixed pipeline charges that Chesapeake incurs in order to deliver natural gas to Chesapeake's distribution system." (Clausius, Exh. 7, p. 21, LL 7-8.) Natural gas flows to the Delmarva Peninsula through a series of interstate pipelines regulated by the Federal Energy Regulatory Commission ("FERC"). (Id.) "Chesapeake needs to enter into long-term contracts for the amount of capacity that it forecasts is needed in order to be able to serve its customers on a design day." (Id. at p. 21, LL 11-13.) "Pipeline capacity is essentially space on the pipeline through which gas that has been procured by the Company flows." (Id. at p.21, LL 13-14.)

51. According to the Company, "[t]hese costs have been historically collected by the Company through its gas cost recovery mechanism." (Id. at p.21, LL 17-18) They are labeled as fixed gas costs on Schedule A.1 and are outlined on Schedule C.2, Pages 1 and 2 in the Company's annual and supplemental filings. (Id. at page 21, LL 18-20) These costs are collected from all firm customers on the

Company's distribution system as these are the customers that are served by the capacity. (Clausius, Exh. 7, p. 21, LL 20-22.)

52. "The Company's Long-Term Gas Supply and Demand Strategic Plan filed on September 30, 2008 details how the Company estimates its design day demand. (Id. at 22.) Basically, the Company looks at past consumption levels on different degree days and extrapolates what demand would be on a design day. (Id.) A design day is the coldest average temperature at which the Company designs its system to serve its customers. (Id.) Chesapeake utilizes a sixty (60) degree day, or a day with an average temperature of five (5) degrees Fahrenheit, as its design day. (Id.) The Company then attempts to secure pipeline and storage capacity to be able to deliver this amount of gas. (Id.) It is important to note that pipeline capacity does not become available overnight. (Id.) There is a significant amount of planning which must be done by the pipeline and a lengthy approval process from FERC. (Id.) There is also a great deal of time needed to construct the pipeline facilities to deliver natural gas. For these reasons, utilities are required to forecast a level of design day demand for up to three or four years into the future and enter into binding precedent agreements based on these forecasts." (Id.)

53. According to Ms. Clausius, in PSC Docket No. 06-287F, "the Company included (as part of the total capacity costs incurred by the Company) the cost of capacity on the Eastern Shore Natural Gas Company ("Eastern Shore") pipeline at a delivery point in eastern Sussex County, Delaware. (Id. at 23.) The Company included these costs in

the same manner in which it includes all additional capacity costs. (Clausius, Exh.7, p.23) The Company has made a concerted effort to expand natural gas service in eastern Sussex County. (Id.) This is an area of the State that had not previously had the option of choosing natural gas service. Sussex County, at the time, was considered one of the largest growth areas in the State." (Id.)

54. As a result of the \$10 to \$15 million of anticipated capital expenditure necessary on the part of Chesapeake to be able to extend its distribution system into this area, the Company made a filing in September 2005 for a separate base rate design in order to collect additional delivery service revenues from these customers. (Id.; See Company's Response to DPA Data Request 77.) This filing was strictly for a separate rate design and was not a request by the Company for permission to expand into this area. (Id.) The areas located in eastern Sussex County, Delaware have been included in the Company's service territory. (Id.) In order to expand service to additional customers, the Company must be in a position to deliver natural gas to these customers. (Id.) Therefore, the Company requested that Eastern Shore extend its transmission line into eastern Sussex County so that it could connect its distribution system to this transmission line and serve additional customers. (Id.) While the main objective of this additional capacity was to serve customers in eastern Sussex County, this capacity could also be used at any point upstream on the Eastern Shore transmission line if needed by Chesapeake. (Id.)

55. According to Ms. Clausius' direct testimony in PSC Docket No. 06-287F, DPA recommended that the capacity costs associated with capacity at delivery points in eastern Sussex County, Delaware be disallowed. (Id. at 24.) DPA Witness Crane's position in PSC Docket No. 06-287F and reiterated on Page 30, Lines 18-20 of her testimony in this proceeding, was that " ... the Sussex County expansion project had not as yet been approved by the Commission and the Company had not justified its need for this additional capacity." (Id.) The Commission Staff, in PSC Docket No. 06-287F, had recommended that this cost be deferred. Docket 06-287F was ultimately settled by stipulation. (Id.) In that settlement, the Company agreed to credit its ratepayers an amount equal to \$275,000 in PSC Docket No. 07-246F for the determination period of November 1, 2007 through October 31, 2008. (Id.) That settlement also gave the Company the right to seek full recovery from ratepayers of the \$275,000 credit in the pending GSR proceeding (PSC Docket No. 08-269). (Id.; See Footnote 11 *infra* for actual Settlement Agreement provision.)

56. According to Ms. Clausius, per the Settlement Agreement reached in PSC Docket No. 06-287F, the Company is permitted to seek recovery of the \$275,000 of costs discussed above. (Id.) Ms. Crane's suggestion that these costs should be disallowed because the Company did not present a formal argument for recovery is flawed. (Id.) According to Ms. Clausius, the \$275,000 of capacity costs were incurred in the same manner and for the same reason as any other capacity costs and should not be treated any differently. (Id.) The

justification was included in PSC Docket No. 06-287F and remains the same today. (Id. at 25.) According to Ms. Clausius, the Company at all times acted in good faith in estimating its capacity needs; "There is no evidence to suggest otherwise." (Id.) The Company's historical decision regarding the amount of capacity needed cannot be judged with the benefit of hindsight. Sussex County was considered one of the fastest growing areas in Delaware and the Company's growth rate, by national standards, was and still is strong. (Id.) In contracting for additional capacity, the Company took these growth rates into account. (Id.) While the economy has slowed and we are in the midst of one of the deepest recessions on record, the Company's actions in contracting for additional capacity should not be judged on current economic conditions. (Id.) No one disputes the fact that the Company incurred these costs. (Id.) No one disputes the fact that these costs are gas procurement costs. Without capacity, the Company cannot serve future customers who request service. (Id.)

57. According to Ms. Clausius, the recommendation made by Commission Staff Witness LeLash to continue to defer this credit until the Company's next base rate proceeding has no merit. (Id.) Mr. LeLash's recommendation is based on the language of the Settlement Agreement in the Company's base rate proceeding, PSC Docket No. 07-186, where a mechanism was established to address what capital expansion projects will be included in rate base at the time of the

Company's next base rate proceeding. (Id. at 26.)⁸ This mechanism is applicable to all capital expansion projects, not strictly those located in eastern Sussex County, Delaware. (Id.) The credit at issue in Mr. LeLash's testimony is related to natural gas pipeline capacity costs actually incurred by the Company, not capital expansion costs, and should be collected through a gas cost recovery proceeding, not a base rate proceeding. (Id.)

58. According to the Company, the \$275,000 credit was deferred, however, the Company's position is that the costs are included in the rate effective November 1, 2008 per the Settlement Agreement from PSC Docket No. 06-287F. (See Company's Answer to Data Request PSC-R-5.)

E. THE PROPOSED SETTLEMENT

59. At the June 11, 2009 hearing, the parties submitted a Proposed Settlement. (Exh. 11; attached hereto as Attachment "A".) According to the Proposed Settlement, the parties agreed to the

⁸The Settlement Agreement from PSC Docket No. 07-186, Paragraph 19 provides as follows: "The Parties agree that in the Company's next base rate proceeding all such incremental capital projects for main extensions in excess of 500 feet proposed for rate base treatment and initiated subsequent to March 31, 2007 (the "Aggregated Projects") will be evaluated in the aggregate to determine if said capital projects earned (in the aggregate) the Company's authorized rate of return over the life of the project. If, in the evaluation of the Aggregated Projects the Commission determines that the Company did not earn a return equal to or greater than the Company's authorized rate of return on the aggregate amount of investment associated with the Aggregated Projects over the life of the project, then fifty percent (50%) of the shortfall ... shall be excluded from rate base until such time that the Aggregated Projects meet or exceed the authorized rate of return over the life of the project. If, in the evaluation of the Aggregated Projects the Commission concludes that the Company has earned a return equal to or greater than the Company's authorized rate of return over the life of the project, then all of the capital investment associated with the Aggregated Projects shall be included in rate base."

following terms, which are reproduced here verbatim; although the order of the paragraphs has been changed:

- (a) The Settling Parties agree that the Company's proposed rates as set forth in the Company's Application and Supplemental Application are just and reasonable rates.⁹

- (b) At the time of Chesapeake's next GSR filing (scheduled to be filed on September 1, 2009), Chesapeake shall provide to the Settling Parties Chesapeake's proposed changes to its current gas commodity procurement plan, if any, or in the alternative, provide an explanation for retaining the current plan. The Company is currently operating under a plan agreed to by the parties and implemented in July 2007 for an initial period of two years, after which time it was agreed to by the Company, the Staff and the DPA that it would be reviewed and potentially modified if warranted.

- (c) Chesapeake will continue to notify the Settling Parties of Eastern Shore Natural Gas Company filings with the Federal Energy Regulatory Commission that could cause a change in the

⁹See Paragraph 1 (Application) and Paragraph 4 (Supplemental Application) of this Report for the rates proposed by the Company for all service classifications.

Company's GSR charges. Such notification will include a detailed summary of the filing, whether or not Chesapeake intends to intervene, and the anticipated impact of material issues on Chesapeake's firm customers. The Company agrees that prior to executing any new agreements for incremental Eastern Shore capacity, the Company will provide the Settling Parties (on a confidential basis and for informational purposes only) with an evaluation of the customer's need for such capacity. The Settling Parties shall be afforded an opportunity to comment on the Company's evaluation, provided that all such comments shall be submitted to the Company within ten (10) days after receipt of the evaluation provided by the Company. The Company has and will continue to provide the Settling Parties, on a confidential basis and for informational purposes only, notice of any agreements the Company enters into for additional pipeline capacity that could result in rate increases for the Company's customers. Notice of such agreements shall be provided by Chesapeake prior to the filing of said agreements with the Federal Energy Regulatory Commission. Regarding the ESNG E3

Project, the parties hereto acknowledge that the Company did not include any pre-certification costs associated with this project in the current GSR filing. The Company will identify and quantify any future claims for cost recovery associated with these pre-certification costs, and will provide the Settling Parties additional information regarding the ESNG E3 Project as it becomes available.

- (d) The Company will continue to include, in its future GSR applications, an update on steps taken to mitigate the effect of rising gas costs.
- (e) The Company has been and will continue to credit the GSR, on an on-going basis, for 100% of the revenues received by the Company for any capacity released on the Eastern Shore Natural Gas transmission system, including capacity released to serve former off-system sales customers. The Settling Parties disagree as to what capacity release rate should be used in order to determine the dollar amount of the credit. The Settling Parties do acknowledge that the amount of the credit may increase or decrease depending on customer activity. The Staff, DPA, and the Company intend to seek a determination in Phase

II of the current GSR proceeding on the issue of whether the Company's provision of capacity to its affiliate Peninsula Energy Services Company ("PESCO") is being provided on terms and conditions that are consistent with applicable law, rules, and/or regulations, to what extent asymmetric pricing principles would apply, if at all, for any capacity released to PESCO to serve former off-system sales customers, and whether or not asymmetric pricing principles should apply in determining the amount of the credit to the GSR for capacity released to PESCO.¹⁰

- (f) Chesapeake has been including a Schedule K as part of its annual filings which is a comparison of the Company's GSR charges with other utilities in the area. At the time the Company files its annual applications, it does not have access to the rates to be proposed by other utilities for a comparable time period. In order to better compare Chesapeake's GSR charges with those of other utilities effective at the same time, Chesapeake will no longer be including Schedule K as part of its annual GSR filing, but will submit

¹⁰The Evidentiary Hearing for Phase II of this Docket is set for September 2, 2009. This issue involving PESCO arose late in this GSR proceeding, requiring Phase II to be established so the issue could be fully developed. (Tr. 86, 91.)

this information to the Commission in the form of a compliance filing no later than sixty (60) days after Chesapeake files its GSR application.

- (g) At the time Chesapeake files its next Long-Term Demand and Supply Plan scheduled for September 2010, Chesapeake will continue to support its increases to its design regressions for two standard errors of the dependent variable, or, in the alternative, discontinue its use of two standard errors of the dependent variable for future procurement decisions. Chesapeake also agrees to utilize the most recently available winter load period for its design day demand forecasting (i.e. the most recently completed winter season) or in the alternative will provide support for any deviation from such practice should the situation warrant.
- (h) As part of the settlement agreement in Chesapeake's last GSR proceeding, PSC Docket No. 07-246F, Chesapeake agreed to supply, within six months of the Commission Order in that proceeding, an evaluation of its propane peak shaving facilities, a proposal for incentives related to the Company's lost and unaccounted for gas costs, and an analysis of replacement of

meters that were not pressure compensating. This evaluation was supplied on April 7, 2009. As part of the next GSR proceeding, Chesapeake's April 7, 2009 report will be reviewed by the parties.

- (i) As part of its GSR filings and Supply Plans, the Company has been including general information on the nature of its storage services and providing more specific and detailed information as part of the discovery process. As part of the next GSR proceeding, Chesapeake will include the following information on Chesapeake's storage services as part of its application: (a) identification of which storages are under the control of Chesapeake as opposed to Chesapeake's Asset Manager; (b) the basis for the inventory balances reported; and (c) how Chesapeake manages the storages Chesapeake controls. Chesapeake reconciles the Company's storage balances that are controlled by its Asset Manager at the end of each winter season and has agreed to provide this information to the parties.
- (j) Chesapeake may continue to utilize ten-year average degree days for normalized weather in future GSR filings. If Chesapeake files a GSR

application using average degree days that differ from the thirty-year average, then it agrees to also calculate the impact on its proposed GSR rates had a thirty-year average been used, and will provide such information as part of the discovery process, when and if requested.

- (k) As part of the settlement agreement in the Company's last base rate proceeding, PSC Docket No. 07-186, the parties agreed to review margins subject to sharing, on a prospective basis, following the conclusion of the initial Determination Period, which will end on October 31, 2009. As such, commencing November 1, 2009, throughout the remaining term of Chesapeake's Asset Management Agreement (term ending March 31, 2012) Chesapeake will retain ten percent (10%) of the credits received from the Asset Manager, and credit the GSR rates with the remaining ninety percent (90%). Following the end of the term of the current Asset Management Agreement and in the absence of Commission approval of any change, the aforesaid margin sharing formula shall remain in effect. Also, as part of the next GSR proceeding, the Company agrees to provide (on a confidential basis) the total sales volumes,

costs, and margins by month (starting September 2008) for Interruptible Gas Transportation sales. Issues related to the margin sharing on Interruptible Gas Transportation sales in excess of \$574,869.00 (the amount imputed in Chesapeake's existing base rates) will be reviewed, addressed, and determined as part of the next GSR proceeding.

- (1) With respect to the \$275,000.00 in capacity costs that were deferred in PSC Docket 06-287F, said capacity costs shall be deferred and recovered over a seven year period, beginning in the current determination period, without the accrual of any interest.¹¹ The Company, through the

¹¹Paragraph 13 of the parties' Settlement Agreement in PSC Docket No. 07-186 provided as follows:

"13. In this docket ("Docket 06-287F"), the DPA recommended a disallowance of a portion of the Company's capacity charges, and the Staff recommended the deferral of approximately \$535,000 in capacity charges paid by the Company for capacity from Eastern Shore Natural Gas Company ("Eastern Shore") at the Company's primary delivery points in eastern Sussex County, Delaware. Of this amount, approximately \$106,000 has already been recovered in rates pursuant to PSC Docket 05-315F, and \$429,000 is being recovered in the current rates approved by the Commission on a temporary basis in Docket 06-287F. While the Company believes that the recovery of these capacity charges is warranted, with respect to the aforesaid capacity charges incurred by the Company, in its next GSR proceeding for the determination period November 1, 2007 through October 31, 2008, the Company will credit its GSR charge by an amount equal to \$275,000. The Company shall nevertheless have the right to seek recovery of the aforesaid \$275,000

discovery process has provided information on estimated vs. actual customers and sales for service provided in eastern Sussex County. The Company will file this information in its next GSR filing."

60. At the evidentiary hearing, each party presented a witness who described the reasons why adoption of the Proposed Settlement would be in the public interest. Generally, the Company's Ms. Clausius, Staff's Ms. Neidig, and DPA's Mr. Sheehy testified that settlement of this matter avoids the costs of protracted litigation, satisfies Staff's and the DPA's concerns, and improves the future information flow on these activities. (Tr. 87-88, 90-91, 93-94.)

IV. DISCUSSION

61. The Commission has jurisdiction in this matter pursuant to 26 Del. C. § 303(b).

62. Staff and the DPA have verified that Chesapeake developed the proposed GSR rates using reasonable price projections and made its calculations in conformance with its tariff. (Tr. 90.) The proposed changes in GSR rates reflect anticipated changes in commodity gas costs since the last filing. According to its tariff, Chesapeake must recover such costs (without any profit component) through its gas cost

credit from ratepayers in its GSR period for the determination period November 1, 2008 through October 31, 2009. The Staff and DPA reserve their respective rights to argue in that proceeding that all or a portion of the aforesaid capacity charges (\$535,000) incurred by the Company should not be borne by ratepayers."

recovery mechanism. Based on the Company's supporting testimony and documentation, and based upon Staff and the DPA's favorable recommendations, I find that the proposed rates are just and reasonable and in compliance with the Company's tariff. Therefore, I recommend that the Commission approve the GSR rates as proposed in the Company's original and supplemental application, for the time periods set forth in the attached proposed Order.

63. Regarding the substantive issues raised by Staff and the DPA in their testimony, the parties agreed to enter into the Proposed Settlement as a resolution of all such issues. The terms of the proposed settlement are summarized above and are, of course, delineated in the proposed Settlement document, which is attached hereto. The settlement terms, which were reached by parties representing the interests of ratepayers, Delaware residents, and the Company's shareholders, appear to be a reasonable resolution of the issues raised by Staff and the DPA. (Tr. 87-88, 90-91, 93-94.)

64. As to the parties' settlement regarding \$275,000 in capacity costs, the Company testified that the capacity costs were incurred in 2005-06 for capacity on the Eastern Shore Natural Gas Transmission System for delivery points located in Eastern Sussex County, Delaware. (Tr. 78.) The Company's position has consistently been that the Company has at all times acted in good faith in estimating its capacity needs, and the Company was entitled to recover the capacity costs according to Delaware law. (Clausius, Exh. 6, p. 24 & Exh. 7, pp. 19-20) In entering into this proposed Settlement,

Staff and DPA are allowing the \$275,000 in capacity costs to be recovered by the Company over a seven (7) year amortization period without any carrying costs. (Tr. 79.) The use of a 7 year period . . . without interest using discounted cash flow analysis, reduces the actual value of the [\$275,000 settlement amount] to just about half or 50%. (Tr. 88.) Both Staff and DPA ultimately agreed that this negotiated settlement was in the public interest. (TR. 87-88, 93-94.)

V. RECOMMENDATIONS

In summary, and for the reasons discussed above, I propose and recommend to the Commission the following:

a. That the Commission approve as just and reasonable the Company's proposed revised GSR charges as proposed by Chesapeake Utilities Corporation in its September 2, 2008 application and January 8, 2009 Supplemental Application for service rendered on and after November 1, 2008, which (on a per Ccf basis) are as follows:

<u>Service Classification</u>	<u>Effective 11/01/08 (Interim)</u>	<u>Effective 02/01/09 (Suppl. Appl.)</u>
RS-1, RS-2, GS MVS, LVS	\$1.466	\$1.243
GLR, GLO	\$1.231	\$1.013
HLFS	\$1.391	\$1.172
Firm Balancing Rate (LVS) (unchanged)	\$0.060	\$0.060
Firm Balancing Rate (HLFS) (unchanged)	\$0.019	\$0.019

Firm Balancing Rate
(ITS) (unchanged) \$0.004 \$0.004

b. That the Commission adopt as reasonable and in the public interest the Proposed Settlement Agreement, which is attached to the proposed Order in this matter. A proposed Order, which will implement the foregoing recommendations, is attached hereto as Attachment "B."

Respectfully submitted,

/s/ Mark Lawrence
Mark Lawrence,
Hearing Examiner

Dated: June 30, 2009

A T T A C H M E N T "B"

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION)
OF CHESAPEAKE UTILITIES CORPORATION)
FOR APPROVAL OF A CHANGE IN ITS GAS) PSC DOCKET NO. 08-269F
SALES SERVICE RATES ("GSR") TO BE)
EFFECTIVE NOVEMBER 1, 2008)
(FILED SEPTEMBER 2, 2008))

PROPOSED SETTLEMENT

On this 11th day of June, 2009, Chesapeake Utilities Corporation, a Delaware corporation (hereinafter "Chesapeake" or the "Company"), and the other undersigned parties (all of whom together are the "Settling Parties") hereby propose a settlement that, in the Settling Parties' view, appropriately resolves most of the issues raised in this proceeding.

I. INTRODUCTION

1. On September 2, 2009, Chesapeake filed with the Delaware Public Service Commission (the "Commission") an application (the "Application") for a change in its Gas Sales Service Rates to be effective for service rendered on and after November 1, 2008. By Commission Order dated September 16, 2008, the Commission allowed Chesapeake's proposed rates to go into effect on November 1, 2008 on a temporary basis pending full evidentiary hearings and a final decision of the Commission.

2. On January 8, 2009, Chesapeake filed with the Commission a supplemental, or "out of cycle" application, seeking Commission approval of a decrease in its proposed GSR rates, effective for bills

rendered on and after February 1, 2009. By Commission Order dated January 29, 2009, the Commission allowed Chesapeake's proposed supplemental rates to go into effect on February 1, 2009.

3. On March 13, 2009, the Delaware Public Service Commission Staff ("Staff") and the Delaware Public Advocate ("DPA") filed their respective testimonies, asserting various issues with respect to Chesapeake's applications.

4. Subsequently, on April 24, 2009, Chesapeake filed its rebuttal testimony pursuant to which Chesapeake took issue with various recommendations of the Staff and DPA regarding several cost recovery and reporting issues.

5. During the course of this proceeding, the parties have conducted substantial written discovery in the form of both informal and formal data requests.

6. The Settling Parties have conferred in an effort to resolve all cost recovery and reporting issues raised in this proceeding. The Settling Parties acknowledge that the parties differ as to the proper resolution of many of the underlying issues in this proceeding. Notwithstanding these differences, the Settling Parties have agreed to enter into this Proposed Settlement on the terms and conditions contained herein, because they believe that this Proposed Settlement will serve the interest of the public and the Company, while meeting the statutory requirement that rates be both just and reasonable. The Settling Parties agree that subject to the approval of the Hearing Examiner, that with the exception of the capacity release issue

described in paragraph 10 hereof, the terms and conditions of this Proposed Settlement will be presented to the Commission for the Commission's approval forthwith, and that the capacity release issue described in paragraph 10 hereof will be decided in Phase II of this proceeding in accordance with a procedural schedule agreed to by the Settling Parties and approved by the Hearing Examiner. The capacity release issue described in paragraph 10 arose very late in the proceeding and therefore was not addressed as part of the record evidence. As there is no record evidence for the Hearing Examiner to rely upon in rendering a decision, the Settling Parties have agreed to a Phase II proceeding in order to allow for the development of a record on this issue.

II. SETTLEMENT PROVISIONS

7. At the time of Chesapeake's next GSR filing (scheduled to be filed on September 1, 2009), Chesapeake shall provide to the Settling Parties Chesapeake's proposed changes to its current gas commodity procurement plan, if any, or in the alternative, provide an explanation for retaining the current plan. The Company is currently operating under a plan agreed to by the parties and implemented in July 2007 for an initial period of two years, after which time it was agreed to by the Company, the Staff and the DPA that it would be reviewed and potentially modified if warranted.

8. Chesapeake will continue to notify the Settling Parties of Eastern Shore Natural Gas Company filings with the Federal Energy Regulatory Commission that could cause a change in the Company's GSR

charges. Such notification will include a detailed summary of the filing, whether or not Chesapeake intends to intervene, and the anticipated impact of material issues on Chesapeake's firm customers. The Company agrees that prior to executing any new agreements for incremental Eastern Shore capacity, the Company will provide the Settling Parties (on a confidential basis and for informational purposes only) with an evaluation of the customer's need for such capacity. The Settling Parties shall be afforded an opportunity to comment on the Company's evaluation, provided that all such comments shall be submitted to the Company within ten (10) days after receipt of the evaluation provided by the Company. The Company has and will continue to provide the Settling Parties, on a confidential basis and for informational purposes only, notice of any agreements the Company enters into for additional pipeline capacity that could result in rate increases for the Company's customers. Notice of such agreements shall be provided by Chesapeake prior to the filing of said agreements with the Federal Energy Regulatory Commission. Regarding the ESNG E3 Project, the parties hereto acknowledge that the Company did not include any pre-certification costs associated with this project in the current GSR filing. The Company will identify and quantify any future claims for cost recovery associated with these pre-certification costs, and will provide the Settling Parties additional information regarding the ESNG E3 Project as it becomes available.

9. The Company will continue to include, in its future GSR applications, an update on steps taken to mitigate the effect of rising gas costs.

10. The Company has been and will continue to credit the GSR, on an on-going basis, for 100% of the revenues received by the Company for any capacity released on the Eastern Shore Natural Gas transmission system, including capacity released to serve former off-system sales customers. The Settling Parties disagree as to what capacity release rate should be used in order to determine the dollar amount of the credit. The Settling Parties do acknowledge that the amount of the credit may increase or decrease depending on customer activity. The Staff, DPA, and the Company intend to seek a determination in Phase II of the current GSR proceeding on the issue of whether the Company's provision of capacity to its affiliate Peninsula Energy Services Company ("PESCO") is being provided on terms and conditions that are consistent with applicable law, rules, and/or regulations, to what extent asymmetric pricing principles would apply, if at all, for any capacity released to PESCO to serve former off-system sales customers, and whether or not asymmetric pricing principles should apply in determining the amount of the credit to the GSR for capacity released to PESCO.

11. Chesapeake has been including a Schedule K as part of its annual filings which is a comparison of the Company's GSR charges with other utilities in the area. At the time the Company files its annual applications, it does not have access to the rates to be proposed by

other utilities for a comparable time period. In order to better compare Chesapeake's GSR charges with those of other utilities effective at the same time, Chesapeake will no longer be including Schedule K as part of its annual GSR filing, but will submit this information to the Commission in the form of a compliance filing no later than sixty (60) days after Chesapeake files its GSR application.

12. At the time Chesapeake files its next Long-Term Demand and Supply Plan scheduled for September 2010, Chesapeake will continue to support its increases to its design regressions for two standard errors of the dependent variable, or, in the alternative, discontinue its use of two standard errors of the dependent variable for future procurement decisions. Chesapeake also agrees to utilize the most recently available winter load period for its design day demand forecasting (i.e., the most recently completed winter season) or in the alternative will provide support for any deviation from such practice should the situation warrant.

13. As part of the settlement agreement in Chesapeake's last GSR proceeding, PSC Docket No. 07-246F, Chesapeake agreed to supply, within six months of the Commission Order in that proceeding, an evaluation of its propane peak shaving facilities, a proposal for incentives related to the Company's lost and unaccounted for gas costs, and an analysis of replacement of meters that were not pressure compensating. This evaluation was supplied on April 7, 2009. As part of the next GSR proceeding, Chesapeake's April 7, 2009 report will be reviewed by the parties.

14. As part of its GSR filings and Supply Plans, the Company has been including general information on the nature of its storage services and providing more specific and detailed information as part of the discovery process. As part of the next GSR proceeding, Chesapeake will include the following information on Chesapeake's storage services as part of its application: (a) identification of which storages are under the control of Chesapeake as opposed to Chesapeake's Asset Manager; (b) the basis for the inventory balances reported; and (c) how Chesapeake manages the storages Chesapeake controls. Chesapeake reconciles the Company's storage balances that are controlled by its Asset Manager at the end of each winter season and has agreed to provide this information to the parties.

15. Chesapeake may continue to utilize ten-year average degree days for normalized weather in future GSR filings. If Chesapeake files a GSR application using average degree days that differ from the thirty-year average, then it agrees to also calculate the impact on its proposed GSR rates had a thirty-year average been used, and will provide such information as part of the discovery process, when and if requested.

16. As part of the settlement agreement in the Company's last base rate proceeding, PSC Docket No. 07-186, the parties agreed to review margins subject to sharing, on a prospective basis, following the conclusion of the initial Determination Period, which will end on October 31, 2009. As such, commencing November 1, 2009, throughout the remaining term of Chesapeake's Asset Management Agreement (term

ending March 31, 2012) Chesapeake will retain ten percent (10%) of the credits received from the Asset Manager, and credit the GSR rates with the remaining ninety percent (90%). Following the end of the term of the current Asset Management Agreement and in the absence of Commission approval of any change, the aforesaid margin sharing formula shall remain in effect. Also, as part of the next GSR proceeding, the Company agrees to provide (on a confidential basis) the total sales volumes, costs, and margins by month (starting September 2008) for Interruptible Gas Transportation sales. Issues related to the margin sharing on Interruptible Gas Transportation sales in excess of \$574,869.00 (the amount imputed in Chesapeake's existing base rates) will be reviewed, addressed, and determined as part of the next GSR proceeding.

17. With respect to the \$275,000.00 in capacity costs that were deferred in PSC Docket 06-287F, said capacity costs shall be deferred and recovered over a seven year period, beginning in the current determination period, without the accrual of any interest. The Company, through the discovery process has provided information on estimated vs. actual customers and sales for service provided in eastern Sussex County. The Company will file this information in its next GSR filing.

18. The Settling Parties agree that the Company's proposed rates as set forth in the Company's Application and Supplemental Application are just and reasonable rates.

III. STANDARD PROVISIONS AND RESERVATIONS

19. The provisions of this Proposed Settlement are not severable.

20. This Proposed Settlement recommends a compromise for the purposes of settlement and shall not be regarded as a precedent with respect to any rate making or any other principle in any future case or in any existing proceeding, except that, consistent with and subject to the provisos expressly set forth below, this Proposed Settlement shall preclude any Settling Party from taking a contrary position with respect to issues specifically addressed and resolved herein in proceedings involving the review of this Proposed Settlement and any appeals related to this Proposed Settlement. No party to this Proposed Settlement necessarily agrees or disagrees with the treatment of any particular item, any procedure followed, or the resolution of any particular issue addressed in this Proposed Settlement other than as specified herein, except that each Settling Party agrees that the Proposed Settlement may be submitted to the Commission for a determination that it is in the public interest and that no Settling Party will oppose such a determination. Except as expressly set forth below, none of the Settling Parties waives any rights it may have to take any position in future proceedings regarding the issues in this proceeding, including positions contrary to positions taken herein or previously taken.

21. In the event that this Proposed Settlement does not become final, either because it is not approved by the Commission or

because it is the subject of a successful appeal and remand, each of the Settling Parties reserves its respective rights to submit additional testimony, file briefs, or otherwise take positions as it deems appropriate in its sole discretion to litigate the issues in this proceeding.

22. The Proposed Settlement will become effective upon the Commission's issuance of a final order approving this Proposed Settlement and all the settlement terms and conditions without modification. After the issuance of such final order, the terms of this Proposed Settlement shall be implemented and enforceable notwithstanding the pendency of a legal challenge to the Commission's approval of this Proposed Settlement or to actions taken by another regulatory agency or Court, unless such implementation and enforcement is stayed or enjoined by the Commission, another regulatory agency, or a Court having jurisdiction over the matter.

23. The obligations under this Proposed Settlement, if any, that apply for a specific term set forth herein shall expire automatically in accordance with the term specified, and shall require no further action for their expiration.

24. The Settling Parties may enforce this Proposed Settlement through any appropriate action before the Commission or through any other available remedy. The Settling Parties shall consider any final Commission order related to the enforcement or interpretation of this Proposed Settlement as an appealable order to the Superior Court of

the State of Delaware. This shall be in addition to any other available remedy at law or in equity.

25. If a Court grants a legal challenge to the Commission's approval of this Proposed Settlement and issues a final non-appealable order which prevents or precludes implementation of any material term of this Proposed Settlement, or if some other legal bar has the same effect, then this Proposed Settlement is voidable upon written notice by any of the Settling Parties.

26. This Proposed Settlement resolves all of the issues specifically addressed herein and precludes the Settling Parties from asserting contrary positions during subsequent litigation in this proceeding or related appeals; provided, however, that this Proposed Settlement is made without admission against or prejudice to any factual or legal positions which any of the Settling Parties may assert (a) in the event that the Commission does not issue a final order approving this Proposed Settlement without modifications; or (b) in other proceedings before the Commission or other governmental body so long as such positions do not attempt to abrogate this Proposed Settlement. This Proposed Settlement is determinative and conclusive of all of the issues addressed herein and, upon approval by the Commission, shall constitute a final adjudication as to the Settling Parties of all of the issues addressed herein.

27. This Proposed Settlement is expressly conditioned upon the Commission's approval of all of the specific terms and conditions contained herein without modification. If the Commission should fail

to grant such approval, or should modify any of the terms and conditions herein, this Proposed Settlement will terminate and be of no force and effect, unless the Settling Parties agree to waive the application of this provision. The Settling Parties will make their best efforts to support this Proposed Settlement and to secure its approval by the Commission.

28. It is expressly understood and agreed that this Proposed Settlement constitutes a negotiated resolution of the issues in this proceeding and any related court appeals.

IV. CONCLUSION

Intending to legally bind themselves and their successors and assigns, the undersigned parties have caused this Proposed Settlement to be signed by their duly authorized representatives.

Chesapeake Utilities Corporation

Dated: 6/11/09_____

By: /s/ Jeffrey R. Tietbohl_____

**Delaware Public Service Commission
Staff**

Dated: 06/11/09_____

By: /s/ Bruce H. Burcat_____

The Delaware Public Advocate

Dated: 06/11/09_____

By: /s/ Michael Sheehy_____

