



February 4, 2016

Ms. Donna Nickerson, Secretary  
Delaware Public Service Commission  
861 Silver Lake Boulevard  
Cannon Building, Suite 100  
Dover, Delaware 19904

RE: In the Matter of the Application of Chesapeake Utilities Corporation to Establish  
a Valuation Process and Pricing Structure of Propane Community Gas System  
Acquisitions

Dear Ms. Nickerson:

Enclosed for filing is Chesapeake Utilities Corporation's ("Chesapeake") application requesting approval of the following items relating to the acquisition of a propane community gas system ("CGS") located within Chesapeake's Delaware Division territory and subsequent conversion of the CGS to regulated natural gas service: (a) a comprehensive and transparent CGS valuation process, (b) the proper accounting treatment to be used for ratemaking purposes, and (c) a natural gas pricing structure for CGS customers who convert to natural gas.

The basis and reasons for the above proposals are discussed and explained in the attached application. Also enclosed is the Delaware Public Service Commission's "Filing Cover Sheet" along with the application fee of \$100.00.

Should you have any questions with regard to this submission, please contact me at 302.736.7635.

Sincerely,

A handwritten signature in blue ink, appearing to read "Will O'Brien", is written over a light blue horizontal line.

William O'Brien  
Associate General Counsel

Enclosures

CC: William A. Denman, Esquire  
David Bonar, Public Advocate  
Jason Smith, Public Utilities Analyst

For PSC Use Only:

Docket No. \_\_\_\_\_

Filing Date: \_\_\_\_\_

Reviewer: \_\_\_\_\_

Given to: \_\_\_\_\_

**DELAWARE PUBLIC SERVICE COMMISSION  
FILING COVER SHEET**

1. NAME OF APPLICANT: Chesapeake Utilities Corporation
2. TYPE OF FILING:           RATE CHANGE                   \_\_\_  
                                  FUEL ADJUSTMENT               \_\_\_  
                                  ADMINISTRATIVE               \_\_\_  
                                  CPCN                               \_\_\_  
                                  NEW SERVICE OFFERING       \_\_\_  
                                  OTHER                            X

IF A TELECOMMUNICATIONS FILING, WHAT TYPE OF SERVICE IS IMPACTED?  
(PLEASE CHECK)

BASIC \_\_\_           COMPETITIVE \_\_\_           DISCRETIONARY

3. PROPOSED EFFECTIVE DATE: n/a

IS EXPEDITED TREATMENT REQUESTED?                                   YES \_\_\_   NO X

4. SHORT SYNOPSIS OF FILING: Chesapeake Utilities Corporation requests approval to establish a valuation process and pricing structure for propane community gas system acquisitions.

5. DOES THIS FILING RELATE TO PENDING DOCKETS?                   YES \_\_\_   NO X

IF SO, PLEASE LIST DOCKET(S) NO(S):

6. IS PUBLIC NOTICE REQUIRED?   YES \_\_\_   NO X

IF YES, PLEASE ATTACH COPY OF PROPOSED PUBLIC NOTICE.

7. APPLICANT'S CONTACT PERSON:                   (NAME)           William O'Brien  
  (TITLE)           Associate General Counsel  
  (TELE. NO.)     302.736.7635  
  (EMAIL)           bobrien@chpk.com

8. DID YOU PROVIDE A COMPLETE COPY OF THE FILING TO THE PUBLIC ADVOCATE?

YES X   NO \_\_\_   IF SO, WHEN? February 4, 2016

9. FILING FEE ENCLOSED:                           \$100.00  
  (AMOUNT)

NOTE: House Bill 681, enacted into law 7/13/98, authorizes the Commission to recover the cost of time spent by in-house staff to process all filings initiated after the date of enactment. You may be required to reimburse the Commission for staff time.

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF )  
CHESAPEAKE UTILITIES CORPORATION )  
TO ESTABLISH A VALUATION PROCESS ) P.S.C. DOCKET NO. 16-  
AND PRICING STRUCTURE FOR PROPANE )  
COMMUNITY GAS SYSTEM ACQUISITIONS )

CERTIFICATE OF SERVICE

I, William O'Brien, do hereby certify that on February 4, 2016, a copy of the attached CHESAPEAKE UTILITIES CORPORATION application was issued to the following persons in the manner indicated:

**VIA ELECTRONIC DELIVERY**

DAVID BONAR, PUBLIC ADVOCATE  
DIVISION OF THE PUBLIC ADVOCATE  
JOHN G. TOWNSEND BUILDING  
401 FEDERAL ST, STE 3 (SOS)  
DOVER, DE 19904

**VIA ELECTRONIC DELIVERY**

WILLIAM A. DENMAN, ESQUIRE  
PARKOWSKI, GUERKE AND SWAYZE P.A.  
116 WEST WATER STREET  
P. O. BOX 598  
DOVER, DELAWARE 19903

**VIA ELECTRONIC DELIVERY**

JASON R. SMITH  
DELAWARE PUBLIC SERVICE COMMISSION  
861 SILVER LAKE BLVD  
CANNON BUILDING, SUITE 100  
DOVER, DELAWARE 19904



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William O'Brien  
Associate General Counsel

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

**IN THE MATTER OF THE APPLICATION OF )  
CHESAPEAKE UTILITIES CORPORATION )  
TO ESTABLISH A VALUATION PROCESS ) P.S.C. DOCKET NO. 16-  
AND PRICING STRUCTURE FOR PROPANE )  
COMMUNITY GAS SYSTEM ACQUISITIONS )  
(FILED FEBRUARY 4, 2016) )**

1. In this Application, Chesapeake Utilities Corporation (“Chesapeake” or “Company”), pursuant to its Code of Conduct<sup>1</sup> and 26 Del. C. § 102(3), requests Commission approval of the following items relating to the acquisition of a propane community gas system (“CGS”) located within Chesapeake’s Delaware Division territory and subsequent conversion of the CGS to regulated natural gas service: (i) a comprehensive and transparent CGS valuation process, (ii) the proper accounting treatment to be used for ratemaking purposes, and (iii) a natural gas pricing structure for CGS customers who convert to natural gas service. Approval of this Application will expedite conversions to natural gas service, reduce energy costs for consumers, and benefit the environment.

2. Applicant is Chesapeake Utilities Corporation, 909 Silver Lake Boulevard, Dover, Delaware 19904. All communications should be addressed to the Applicant at the following address, Attention: William F. O’Brien, Associate General Counsel, 909 Silver Lake Boulevard, Dover, Delaware 19904 or at the following email address:

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<sup>1</sup> See PSC Order No. 5828 dated Nov. 6, 2001, in Docket No. 00-523, approving the Company’s Code of Conduct.

bobrien@chpk.com. The respective phone number and fax number are 302.736.7635 and 302.734.6750.

3. Counsel for the Applicant is William A. Denman, Esquire, Parkowski, Guerke & Swayze P.A., 116 West Water Street, P.O. Box 598, Dover, Delaware 19903. Correspondence and other communications concerning this application should be directed to counsel at the foregoing address, or at the following e-mail address: wdenman@pgslegal.com. The respective phone number and fax number are 302.678.3262 and 302.678.9415.

4. To date, several homeowners' associations ("HOAs") whose communities utilize CGSs have requested natural gas service from Chesapeake. However, one of the uncertainties in evaluating such a request is whether the Delaware Public Service Commission ("Commission") will allow the Company to include the purchase price of the CGS in the Company's rate base in its next rate case.<sup>2</sup> Approval of a comprehensive and transparent valuation process, accounting process and pricing structure for CGS acquisitions, therefore, would remove these uncertainties, facilitate the Company's prompt evaluation of such requests, and enable the Company to move forward with the acquisition and conversion of these systems to natural gas services.<sup>3</sup> Chesapeake estimates that there are over 10,000 customers served by propane CGSs that are potential natural gas customers; compared to the Company's current customer count of approximately 47,000. Not only is that a large number of Delawareans that could benefit from natural gas under this proposal but the Company's existing customers would benefit from the new

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<sup>2</sup> A typical propane CGS consists of a centralized tank (or tanks) that serve the residents of a subdivision through a piped system, which includes mains under the roads, and service lines and meters at each residence.

<sup>3</sup> Most CGSs in the Company's service territory serve residential communities and, therefore, this Application is framed in the context of a residential CGS. However, the Company is aware that certain CGSs serve both residential and commercial customers or only commercial customers and proposes herein to utilize the approved process for all CGS acquisitions.

customers' contribution to the Company's fixed costs, which include such items as gas supply related costs and its shared corporate costs.

5. Each potential acquisition depends, of course, on the CGS owner's independent determination to sell its system at the price Chesapeake offers under the process approved herein. The CGS owner, who is typically in the business of retail propane sales and is the propane supplier for the residents (or businesses) served by the CGS community, may not be inclined toward the requests of the HOA to sell the system. If the CGS owner declines Chesapeake's purchase offer, then Chesapeake would not be in a position to serve natural gas to the residents of the subdivision – short of constructing a duplicate piped system.<sup>4</sup>

6. Chesapeake's ability to provide natural gas service to individual residents would also depend on the residents' willingness to pay for the conversion of their gas appliances and any necessary modifications to their inside piping<sup>5</sup> and their agreement to pay any incremental pricing that may be required in lieu of an upfront, lump sum contribution. As outlined herein, the Company proposes to structure this incremental pricing as an adjustment to the otherwise applicable tariffed, monthly, fixed customer charge. Adjusting a customer charge for expansion purposes is not new, but follows the same structure the Commission approved in the Company's designated "Expansion Area" in southeastern Sussex County. (See Commission Order No. 8479, dated November 5, 2013.)

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<sup>4</sup> Duplication may not be possible, depending on the terms of either the agreement between the CGS owner and the HOA or the service agreements between the CGS owner and the residents. In addition, parallel systems carry certain pipeline safety considerations, which would need to be addressed.

<sup>5</sup> The Company plans to offer a behind-the-meter conversion service (with perhaps a financing option) to customers on an unregulated basis, and include the associated charges on the customer's natural gas bill, consistent with the Docket 12-292 settlement agreement at Paragraph 5, as adopted by the Commission in Order No. 8479, dated November 5, 2012.

7. The Company, by this Application, is requesting that the Commission approve a process by which the Company will calculate the new CGS customer charge and implement the new charge for each CGS acquisition. For each acquisition, the Company will provide to the Commission: (a) an appraisal of the CGS performed by a qualified independent appraiser, (b) an executed copy of the Purchase Agreement; (c) the Company's economic model showing the level of investment supported by the anticipated revenues from the new customers and the level of contribution required to render the acquisition economic; (d) the calculation of the new customer charge based upon the contribution required; and (e) new tariff pages listing the new charge and describing the geographic boundaries where the charge applies. Should the CGS owner only be willing to sell the system at a price above the appraised value, then the Company will determine the level of customer charge required for the purchase to be economic at that price (in addition to any other investment required to convert the CGS to natural gas). It will be the CGS residents' decision whether to pay the required customer charge. If the minimum number of CGS residents (based on the Company's economic model) agrees to pay the new charge, then the Company will make the purchase. After the acquisition is consummated, the Company would record the acquired assets on its books at the agreed upon purchase price (plus any additional investment required to convert the system from propane to natural gas) and, as long as the Company followed the process approved in this docket, the Commission would allow the full cost of the system in rate base in the Company's next rate case.

8. For each CGS acquisition, the Company will file its economic test for the acquisition and system conversion to demonstrate that the anticipated revenues from the CGS residents will cover the cost of the acquisition and conversion of the CGS – without any subsidization from existing ratepayers. Anticipated revenues for each CGS will be based on the Company's approved volumetric rates, with the customer charge specifically

designed for the specific CGS such that the revenues meet the Company's authorized return. If an insufficient number of CGS customers choose to apply for natural gas service and the project is therefore determined to be uneconomic, then the Company will decide whether or not to move forward with the acquisition, recognizing that the uneconomic portion of the project may not be recoverable in rates.<sup>6</sup>

9. The goal of this Application is to address on the front end the regulatory uncertainty that the Commission may disallow including in rate base all or part of the purchase price. Without pre-approval of the ratemaking treatment for CGS acquisitions, the Company will not be able to evaluate the economics of the acquisition and would not then be in a position to make the acquisition and convert the CGS to natural gas.

10. Under 26 Del. C. §102 (3), "rate base" means:

The original cost of all used and useful utility plant and assets either to the first person who committed said plant or assets to public use or, at the option of the Commission, the first recorded book cost of said plant or assets; less [accumulated depreciation and other adjustments]."

One of the regulatory uncertainties includes the possibility that the Commission would treat the acquired CGS as if it were a regulated public utility and would limit the amount included in rate base to the net book value of the purchased assets (*i.e.*; the original cost of constructing the CGS less accumulated depreciation). In the Company's view, "the first person who commit[s] said plant or assets to public use" in this situation is the Company, when it acquires the CGS, converts the system to natural gas, and charges regulated service rates as a public utility. Prior to the Company's acquisition and conversion of the CGS, the asset was not held by a regulated public utility and, therefore, the asset was not "committed to public use." Therefore, the "original cost" of the asset from the first person

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<sup>6</sup> In the event that the Company does not achieve full subscription, those residents who do not convert to natural gas would need to either install an individual propane tank or convert its gas appliances to electric. As there may be communities that do not permit individual propane tanks, the Company intends to work with the HOAs to remove any such restrictions, if possible.

who commits the asset to public use is the Company's purchase price for the CGS, which can then be included in rate base and depreciated over time.

11. Propane CGSs clearly are not "committed to public use," because their owners do not offer service generally to the public but only to specific residents located in a discrete location. In addition, their terms of service, including price, are set by private contract rather than by a PSC-approved, public tariff. Moreover, had the CGS owner been a public utility, then its depreciation rates would have been subject to Commission regulation. Unregulated propane companies typically adopt tax depreciation rates, which depreciate assets faster than the regulated depreciation rates for public utilities. A CGS's net book value at the time of a potential acquisition, therefore, would be lower than what it would have been had it been a regulated public utility. It would be unfair, therefore, to limit rate base treatment for the acquirer of a CGS to the net book value of the asset when the CGS owner had depreciated the asset faster than it would have had it been a public utility.

12. As an alternative to finding that the CGS asset is first committed to public use when a regulated public utility acquires it, Section 102(3) provides a second authorization for the Commission to approve the requested accounting treatment. This section provides that "rate base" means the original cost of assets to the first person who committed said assets to public use or, "at the option of the Commission, the first recorded book cost of said plant or assets; [less accumulated depreciation and other adjustments]." The Commission may decide, therefore, that irrespective of who first committed the CGS to public use, it will allow rate base treatment of the Company's first recorded book cost of the asset, which would be the purchase price of the CGS, less the accumulated depreciation that occurs from the acquisition forward. The Company submits that the Commission should use its discretion in this case to allow rate base treatment of the purchase price (in the manner set forth herein) because of the public interest served by

facilitating the conversion of propane systems to cleaner, less costly natural gas for those CGS communities who request natural gas service. The Company would also note that under Section 102(3)(g), the Commission is authorized to include in rate base, “any other element of property which, in the judgment of the Commission, is necessary to the effective operation of the utility.”

13. Chesapeake’s affiliate, Sharp Energy, Inc., (“Sharp”) owns and operates several CGSs in Delaware. To enable the expansion of natural gas service to Sharp-owned CGSs, the Company requests that the Commission waive the asymmetric pricing rule contained in the Company’s Code of Conduct. In short, the asymmetric pricing rule requires the Company to record an asset purchased from affiliated companies at the lower of the affiliate’s cost (*i.e.*; net book value) or the market value of the asset.”<sup>7</sup> Adherence to the asymmetric pricing rule, therefore, would have the same effect as disallowing any acquisition premium for a non-affiliated CGS acquisition, as discussed above.

14. Because the Company’s proposal provides a formal, Commission-approved process for acquiring CGSs, and customers will only switch to natural gas if they choose to pay the required customer charge, the new customers are fully informed and

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<sup>7</sup> On November 6, 2001, the Commission approved a settlement agreement that established a Code of Conduct and cost allocation manual for the Company. The following language from the settlement agreement in that case sets forth the asymmetric pricing requirement for certain types of affiliate transactions:

Pricing Principles. The Settling Parties agree that ... for transfer of assets between Regulated Activities (“Chesapeake”) and Non-Regulated Activities, (“Affiliate”) asymmetric pricing principles (*i.e.* for transfers from Chesapeake to the Affiliate, the higher of fully allocated cost or market price; for transfers from the Affiliate to Chesapeake, the lower of fully allocated cost or market price) shall apply. Asymmetric pricing principles shall also apply to the provision of services, exclusive of shared services or common support services, provided however that if the market price of such service is not reasonably ascertainable, fully allocated costs will be used.

Paragraph II(10), Settlement Agreement in Docket No. 00-523, as approved by Order No. 5828 dated Nov. 6, 2001.

protected against “over-paying” for an affiliated CGS, which is the goal of the asymmetric pricing rule.<sup>8</sup> The process described herein would provide for a waiver of the asymmetric pricing rule so long as the Company followed the approved process. In this context, application of the asymmetric pricing rule would produce the unintended consequence of denying CGS residents and businesses the opportunity for natural gas service. For these reasons, the Company also requests that the Commission waive the asymmetric pricing rule for CGSs acquired in accordance with the process approved in this docket. To demonstrate how the proposal would work if approved, the Company sets forth a hypothetical CGS acquisition in Attachment A, which is marked Confidential.

15. The Company proposes this process in order to facilitate the acquisition and conversion of propane CGSs to meet customer demand and because the conversion of propane CGSs to natural gas serves the public interest. The public interest is served because natural gas is less expensive than propane, which produces savings to the customers, which helps stimulate economic activity. In addition, according to the U.S. Energy Information Administration, burning natural gas produces fewer CO<sub>2</sub> emissions than burning propane.<sup>9</sup> Under the proposed valuation process, existing ratepayers will not subsidize CGS acquisitions and will benefit from the economies of scale achieved from the addition of customers in that the new customers will contribute to the Company’s fixed costs in both its gas supply costs and its corporate shared costs.

WHEREFORE, the Applicant prays as follows:

- A. That the Commission file this Application and schedule it for hearing;
- B. That the Commission approve (i) the proposed process for valuation of the purchase of a CGS by the Company, (ii) the accounting and ratemaking treatment for the

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<sup>8</sup> Existing customers are protected because the adjusted customer charge paid by the new customers ensures that existing customers will not subsidize the CGS acquisition.

<sup>9</sup> See U.S. Energy Information website, at <http://www.eia.gov/tools/faqs/faq.cfm?id=73&t=11>

acquisition costs, and (iii) the process for calculating the new customer charge for each acquired system.

**SIGNATURES APPEAR ON THE FOLLOWING PAGE(S)**

CHESAPEAKE UTILITIES CORPORATION

BY:   
\_\_\_\_\_  
Stephen C. Thompson  
Senior Vice President

DATED: February 4, 2016

Parkowski, Guerke & Swayze P.A.

BY:   
\_\_\_\_\_  
William A. Denman  
116 West Water Street  
Dover, DE 19903  
Attorney for Applicant

DATED: February 4, 2016

**CONFIDENTIAL**

ATTACHMENT A

Hypothetical CGS Acquisition

**(REDACTED)**

