BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF CHESAPEAKE UTILITIES CORPORATION FOR APPROVAL OF NATURAL GAS EXPANSION SERVICE OFFERINGS (FILED JUNE 25, 2012)	)))))	PSC DOCKET NO. 12-292

REPORT AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATE: February 6, 2013

MARK LAWRENCE
HEARING EXAMINER

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Mark Lawrence, the duly appointed Hearing Examiner in this Docket pursuant to *26 Del. C*. §502 and *29 Del. C*. Ch. 101, by the Commission Order No. 8174 dated July 3, 2012, 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

Jeffrey R. Tietbohl, Vice President

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

BY: JAMES McC. GEDDES, ESQ., Rate Counsel

Susan B. Neidig, Senior Regulatory Policy Administrator

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

BY: REGINA A. IORII, ESQUIRE, Deputy Attorney General

Michael D. Sheehy, THE PUBLIC ADVOCATE

On behalf of Delmarva Power & Light Company ("Delmarva")

BY: PAMELA J. SCOTT, ESQUIRE

On behalf of the Caesar Rodney Institute, Center for Energy Competiveness ("CRI")

BY: DAVID T. STEVENSON, DIRECTOR

On behalf of the Delaware Association of Alternative Energy Providers, Inc. ("DAAEP")

BY: GLENN C. KENTON, ESQUIRE and TODD A. COOMES, ESQUIRE; RICHARDS, LAYTON and FINGER, P.A.

Adam Lambert, President

On behalf of Delaware's Department of Natural Resources ("DNREC")

BY: RALPH K. DURSTEIN III, ESQUIRE, Deputy Attorney General

VALERIE SATTERFIELD, ESQUIRE, Deputy Attorney General

II. BACKGROUND

A. Application

1. On June 25, 2012, the Delaware Division of Chesapeake Utilities Corporation ("Chesapeake" or "the Company") filed an Application seeking Commission approval: a) to establish and utilize an alternative rate design and rate structure to lower the amount of up-front contributions from new customers from regarding the Company's expansion into areas of eastern Sussex County (the "Infrastructure Expansion Service Rate" or "IES rate"); and b) to establish a Distribution Expansion Service ("DES") Rate for all customers which "would be utilized by Chesapeake to support the necessary resources and administrative requirements to facilitate the large number of anticipated conversions from propane, fuel oil, and electricity to natural gas."[1] (Application,¶¶7,8.)

2. According to Chesapeake's Application: the Infrastructure Expansion Service ("IES") Rate would cost residential customers either $8.00 per month or $25.00 per month depending on whether or not they are a heating customer. For a typical residential service (R-2) customer using 50 Mcf of natural gas annually who needs an approximately thirty (30) foot main extension, if Chesapeake's Application is approved, the up-front capital cost of $627 per customer of providing service to a customer in an existing development would generally be eliminated.[2] (Applic.¶7; Tietbohl, pp.18-19.)

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[1] The Exhibits attached to this Report will be referred to as, for example "Exhibit 1," using the complete word "Exhibit."

[2] As a condition of receiving service, each new customer would pay this non-refundable CIAC fee to Chesapeake to offset the acquisition, improvement or construction costs of facilities to provide service to that customer.

3. As proposed, the IES rate would be $40.00 per month for Expansion Area General Service, $125.00 per month for Expansion Area Medium Volume Service, while Large Volume Service and High Load factor Service Customers would not be charged this rate. (*Id.*)

4. Regarding the proposed the Distribution Service ("DES") rate, as shown in the graph below, this charge would cost $1.25 per month for current customer classifications (i.e., RS-1, RS-2, GS, MVS, LVS and HLFS), and the proposed expansion classifications (i.e., ERS-1, ERS-2, EGS and EMVS) would increase as follows:

Rate Schedule (Customer Class)	Current Monthly Customer Charge	Proposed Monthly Customer Charge
RS-1	$10.50	$11.75
RS-2	$13.00	$14.25
GS	$26.00	$27.25
MVS	$65.00	$66.25
LVS	$125.00	$126.25
HLFS	$75.00	$76.25
ERS-1	n/a	$19.75
ERS-2	n/a	$39.25
EGS	n/a	$67.25
EMVS	n/a	$191.25

(Applic., Public Notice,¶8.)

(Applic., Tietbohl, p.18, LL 12-22.) Currently, Chesapeake's Tariff permits either "a CIAC fee, a Customer Advance, a Letter of Credit or other financial guarantee at the Company's Discretion." (P.S.C. Del. No.4, 3rd Rev. Sheet No. 12.2, §VI, 6.3.)

5. The proposed expansion service offerings also include an optional Conversion Finance Service to provide financing for new residential and commercial customers in any Delaware county seeking to convert existing equipment and fuel piping to natural gas. If approved, the maximum amount of financing for residential customers is $1,500 and $3,000 for commercial customers. (Applic.,¶9.) Customers would have the option of "payback periods of 3, 5 or 10 years, with a return component payable to the Company at a rate equal to the Company's authorized rate of return." (*Id.*) The monthly charges would depend upon the conversion cost and selected payment option. (*Id.*) Also, Chesapeake has proposed an optional $100 Conversion Management Service fee for the Company to assist outside contractors with coordinating the conversion work for new customers in any Delaware county. (*Id*. at ¶¶¶7-9; Applic., Tietbohl, p.14, LL 7-15.)

6. Finally, the Application includes proposed a tariff change which "would allow Chesapeake to evaluate the economics of service installations and main extensions to new and existing residential developments based on an Internal Rate of Return Model, as opposed to the existing six times net-revenue test" which currently requires that the total estimated capital expenditure for a service installation cannot exceed 6 times the estimated amount of net revenue.[3] Chesapeake also sought a tariff change which would prohibit charging customers for (a) a service installation of less than seventy-five (75) feet from an existing distribution main; and (b) any distribution main

[3] Chesapeake also seeks to eliminate the current tariff requirement that, to be included in the six times net-revenue test, the customer must have signed an application for service and are able to convert to natural gas within ninety (90) days. (Tietbohl,p.27, LL 19-21.)

extension of less than one hundred (100) feet.(*Id.* at ¶10; Tietbohl, p.27 LL 16-17 & *Id.* at ¶11; Tietbohl,p.27 LL 16-17, *respectively*.)

7. In its Application, the Company states that it recently "executed three new franchise agreements with the following towns or cities in southeastern Sussex County: 1) Town of Lewes; 2) Town of Frankford; and 3) Town of Selbyville." (Tietbohl, p.8 LL 19-22.) According to the Application, "Chesapeake has received an unprecedented amount of interest from southeastern Sussex County residents and developers as nearly fifty (50) residential subdivisions have expressed some level of interest in receiving natural gas service."[4] (*Id.* at p.9, LL 9-12.)

8. Although none of these three (3) Franchise Agreements were filed of record, the pre-filed testimony of Chesapeake's Vice President Jeffrey R. Tietbohl attached to the Application discusses portions of Chesapeake's Franchise Agreement with the Town of Lewes. According to that Franchise Agreement, Chesapeake is required to offer residential service to 25% of Lewes' residents within 5 years, 60% within 10 years, and 100% of the residents must be offered service within 15 years. (*Id.* at p.9, LL 16-21.) The Company's Application does not state whether Chesapeake's Franchise Agreements with the Town of Frankford or the Town of Selbyville contain "phase-in" periods for residential service. The Application also does not describe where

[4] 44 homeowners of the Bay Breeze Estates residential development, the Hawkseye Property Owners Association, and Nick Hammonds, Principal of Sussex County Developer Jack Lingo Asset Management LLC, also filed letters with the Commission supporting the Company's proposed expansion of natural gas service in Sussex County. Maybe Chesapeake is aware of an "unprecedented amount of interest" from customers who want to convert to natural gas, but the filings with the Commission to date do not reflect it.

Chesapeake is currently providing non-residential service i.e commercial industrial, etc. in or near Lewes, Frankford or Selbyville.

B. Procedural History

9. By PSC Order No. 8174 (July 3, 2012), the Commission suspended the proposed September 1, 2012 effective date of the Company's proposed new rates, service offerings and tariff revisions, pending further investigation, public proceedings and a final Order. (¶¶1,2.) The Commission also ordered that notice of the Company's Application and the proposed rate changes be published in Delaware newspapers as required by law. (¶3.)

10. In PSC Order No. 8174, the Commission appointed me as the Hearing Examiner with "the authority to deny Chesapeake's request for an effective date of September 1, 2012 [for the proposed new rates, service offerings and tariff revisions] if that date will not allow for the development of a full and complete record and subsequent Commission action." (¶4.) However, the September 1, 2012 deadline expired without Chesapeake pursuing that the proposed new rates, service offerings and tariff revisions become effective on an interim or temporary basis.

11. On July 3, 2012, pursuant to its statutory right, the Division of Public Advocate ("DPA") intervened as a party in this docket. (*See* 29 *Del. C.* ¶8716(g).) Thereafter, I permitted the following four (4) entities to intervene: the Delaware Association of Alternative Energy Providers ("DAAEP"),[5] Delmarva Power & Light

[5] PSC Order No. 8210 (Aug. 22, 2012). Despite Chesapeake's vigorous objection, I permitted DAAEP to intervene. "DAAEP's members share a similar interest in the distribution and sale of alternative energy supplies and services to

Company,[6] The Caesar Rodney Institute,[7] and Delaware's Department of Natural Resources ("DNREC").[8]

12. The parties decided not to enter into the formal Procedural Schedule I proposed to them. Between themselves, the parties then engaged in informal discovery, conducted workshops on October 15, 2012 and December 10, 2012, and exchanged confidential "position papers" detailing their respective positions. Except for the pre-filed testimony of Chesapeake's Vice President Jeffery R. Tietbohl filed along with the Company's Application in June, 2012, no other pre-filed testimony was filed. The parties chose not to establish an evidentiary record. Due to the filing of the Public Advocate's Motion to Close Docket, I have not held a Public Comment Session or an evidentiary hearing.

III. PUBLIC ADVOCATE'S MOTION TO CLOSE DOCKET & RESPONSES FROM OTHER PARTIES

13. On January 4, 2013, Public Advocate Michael Sheehy, an Intervener, filed a Motion to Close Docket. The Motion is attached as Exhibit "1". The Motion states the Public Advocate does not support the Company's Application "although [the Public Advocate's] support for expansion of natural gas infrastructure into un-served and underserved portions of Delaware continues." (p.3,¶10.) According to the Public Advocate, "… to proceed further with this docket without the benefit of the expense and revenue data obtained thorough a normal

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their customers for use in heating and other residential and commercial uses." (*Id.*at §6.)"Chesapeake has an unregulated propane subsidiary, Sharp Propane, which competes with all of DAAEP's members." (*Id.*)

[6] PSC Order No. 8205 (Aug. 24, 2012).

[7] PSC Order No. 8213 (Sept. 6, 2012).

[8] PSC Order No. 8206 (Aug. 15, 2012).

rate case proceeding would be a waste of this Commission's time and resources, as well as those of the intervening parties." (*Id.*)

14. The Public Advocate's Motion to Close Docket argues as follows:

> "The Public Advocate wants to make clear that he does not oppose the expansion of natural gas service into areas that do not currently have natural gas service. But the Public Advocate contends that the Company's application for expansion rates is deficient in three respects: (1) the Company has never attempted to implement *any* proposed expansion under its tariffed "Experimental Area Expansion Program" [which required the Company to establish one, 18 month program for one geographical area, so that true expansion costs could be monitored]; (2) it constitutes single-issue ratemaking [which considers changes in isolation thereby risking overpayment of revenue to a utility], to which the Public Advocate is adamantly opposed; and (3) under the proposed DES [Distribution Expansion Service]rate, current customers would subsidize the expansion of natural gas service to future customers.
>
> The Public Advocate continues his strong opposition to such subsidies. The Public Advocate respectfully submits that these deficiencies justify the Commission to order that this proposed expansion plan be considered in the context of a full rate case where all of the Company's revenues and costs can be examined to determine the most economic and efficient way to further the goal of extending natural gas service in Delaware."
>
> (p.4,¶10.)

I will address the merits of the Public Advocate's Motion in the Discussion section of this Report. However, I will now discuss the other parties' Responses to the Public Advocate's Motion to Close Docket.

15. **CRI's Response.** On January 7, 2013, I required all parties to respond to the Public Advocate's Motion to Close Docket on or before January 23, 2013. On January 7, 2013, without offering any additional argument, Intervener The Caesar Rodney Institute ("CRI") joined with the Public Advocate in seeking to close this docket.

16. **Staff's Response.** Like the Public Advocate, in its Response, Staff "supports expanded natural gas service, but opposes customers subsidizing the cost of such expansion."(¶5.) Staff's Response is attached as Exhibit "2". Staff argues that it "cannot support rates that are not cost based or favor one class of customers over another." (¶7.) However, Staff "does not object to having Chesapeake's entire customer base support such expansions of service."(¶6.)

17. Staff also responded that, despite extensive negotiations and the resulting settlement agreement from Chesapeake's 2007 rate base case, "according to the Company, it has never used the Experimental Area Expansion Program,… and the six times revenue test for main extensions-the Company now believes to be "not sufficient going forward." (¶6, *quoting* Tietbohl testimony, Applic., p.27.)

18. While noting that it is unlikely the parties will resolve "the fundamental issues underlying the filing," Staff Response's concluded that "it is up to the Company to decide which direction it wants to go — withdrawal of the Application or push forward with formal hearings."(Exhibit "2";¶8.)

19. **DNREC's Response.** DNREC strongly opposes closing this docket. In its Response attached as Exhibit "3," DNREC argued as follows:

> DNREC's policy interest in this docket was summarized in the position paper filed November 30, 2012:
>
> > "Expanding access to natural gas infrastructure to underserved areas of the state in the most cost-effective manner has the potential to advance strategic environmental and economic priorities because of the fuel's greater efficiency, lower cost, and lower emission profile when compared to many other fuel alternatives."
>
> This is a matter of administration policy, most recently articulated last week by Governor Jack Markell in his State of the State speech delivered January 17, 2013.
>
> > "Second, we need to expand natural gas infrastructure across our state. Too many in Delaware are paying too much for energy because they are too far from a pipeline to bring them affordable natural gas. The energy savings from fuel switching are substantial and can cover the costs of new infrastructure. To help businesses and residents save money, we are working with both Delmarva and Chesapeake to make it easier for businesses to switch to cheaper and cleaner energy."

(http://govenor.delaware.gov/speeches/2013stateofthestate/2013_sots_address.shtml)

20. In addition to its public policy concerns, DNREC refuted the Public Advocate's three (3) reasons for closing this docket as follows: a) the Company's not attempting to implement the Experimental Area Expansion Program "is not sufficient reason for precluding full consideration of alternative rate structures;" b) "… the Commission is authorized to conduct limited single issue rate proceedings;" and c) customer subsidies is an issue which can be addressed in this docket,

and is not a sufficient reason to close the docket. (p.2.) DNREC concluded that "DNREC is willing to remain at the table as long as there is a meaningful opportunity to fully consider the economic and environmental benefits of promoting fuel switching from dirtier and more expensive fuels to cleaner and less expensive natural gas." (*Id.*)

21. **DAAEP's Response.** DAAEP responded that Chesapeake "could continue with the Application, amend it or withdraw it." (¶9.) (Exhibit "4") DAAEP strongly argued that the Commission should require Chesapeake to implement the Experimental Area Expansion Program. (¶4.)After noting that propane costs have substantially decreased since the filing of the Application, DAAEP stated that its main concerns in this docket remain:

> "i) Chesapeake's standards for expanding natural gas service, and the potential for Chesapeake extensions based upon either overly optimistic or "reverse engineered" projections, and ii) current rate payers effectively subsidizing Chesapeake extensions."
>
> "Importantly, it has become clear based upon the information that has come to light in the workshops regarding the application and the changed circumstances since its filing, that the originally-stated economic benefits for the Chesapeake Application were overstated." (¶¶6,7.)
>
> Furthermore, as the workshops proceeded, it became clear that there is no "typical" or "average" resident of southeastern Sussex County in connection with energy use and no "average savings." Rather there are two "typical" or "average" users: full time residents and seasonal homeowners, who generally are not heating customers and whose consumption is well below 50 Mcf per year. Preliminary information in connection with the workshop suggests that perhaps between 60% and 70% of the residents in

> southeastern Sussex County may be seasonal homeowners for whom savings from natural gas are likely to be minimal or even negative." (¶8.)

22. **Delmarva Power's Response** In its January 23, 2013 filing, Intervener Delmarva Power "took no position on the Public Advocate's Motion to Close Docket…." Additionally, Delmarva Power's filing states that "Delmarva Power has never taken any position one way or the other concerning Chesapeake's application…." I will now discuss the Company's Response to the Public Advocate's Motion to Close Docket.

IV. COMPANY'S RESPONSE TO PUBLIC ADVOCATE'S MOTION TO CLOSE DOCKET

23. Chesapeake's Response to the Public Advocate's Motion to Close Docket is attached hereto as Exhibit "5". In its Response, in addition to the Commission allowing this Docket to proceed, Chesapeake seeks that the Commission approve the proposed Infrastructure Expansion Rate ("IES") on an interim basis. (¶¶14,15.). The Company seeks that the interim IES rate be allowed to remain in effect for "an appropriate time period for review of these rates that will facilitate the objective or goal of expansion of natural gas service in the defined expansion areas in Sussex County." (¶15.) Before addressing the Company's interim IES rate request, however, I want to first discuss the Company's Response as to the three (3) reasons why the Public Advocate argues that this Docket should be closed.

24. As to the Experimental Area Expansion Program ("AEP"), Chesapeake argues that: a) the Company can demonstrate to the Commission that the AEP is not a solution for economically making natural gas available to eastern Sussex County residents and businesses; and b) Chesapeake allegedly demonstrated this to the

parties using an illustration of an existing subdivision and other data, which showed that the resulting AEP rate is "significantly higher" than the proposed IES rate. (¶13 & fn.2.)

25. As to the Public Advocate's aversion to single-issue ratemaking, Chesapeake argues that "limited issue rate proceedings are specifically authorized by statute, 26 *Del. C.* §304(b). According to Chesapeake, "given the goal of Chesapeake's application, the numerous requests being received from consumers for natural gas service, and the parties' general support of that goal (making natural gas available to more residents of Sussex County), a limited issue rate proceeding is more preferable to a general rate case. The Commission's "recent" approved rate of returns has no bearing on the present application as the Company is not seeking a change in its authorized rate of return as part of its application." (¶4, *emphasis in original*.)

26. As to the Public Advocate's argument that the Company's proposed subsidies require the Commission to close this docket, Chesapeake argues that:

> "the majority of [the Company's] proposals are not based upon historical embedded cost of service because historical costs are not relevant when making investment decisions related to expanding its natural gas system. What is relevant is the marginal capital expenditure, the marginal operating expense and the marginal revenue generated by the expansion." (¶3.) Under the Company's existing line extension policy, the Company cannot extend its lines unless the *projected* revenues from the new customers will be sufficient to recover the Company's *projected* expenses plus a return on its investment. The appropriate revenue and expense analysis differs from that of the traditional rate case analysis in that the focus is on the *projected* revenues

> and expenses for an extension of service to new customers and developments. It is necessary therefore to evaluate the proposed IES rate based on projected expenses and revenues rather than on actual test period data, which is what is used to adjust base rates in an existing service territory in a base rate case. The dollar amount for the IES rate will determine how much farther (and quicker) the Company can extend its lines compared to what the Company otherwise could do under its existing base rates. As acknowledged by the Company, if, after an appropriate time period, the IES rate needs to be modified or adjusted based on the actual operating experience achieved, then the rates can be adjusted accordingly." (¶7.)

27. Chesapeake also claims that it will use the same model for residential customers, allegedly permitted by tariff, which has allowed Chesapeake "to extend its mainline facilities to larger commercial and industrial customers in Sussex County in a manner that does not require any customer subsidies." (*Id.*) Chesapeake's commercial and industrial sales using and not using its model could have been disclosed to myself and the Commission on a redacted basis but were not.

28. In its Application, Chesapeake argues that, regardless of new rates be implemented, the Company is also requesting approval to provide two (2) new services: a Conversion Financing Service and a Conversion Management Service. The optional Conversion Finance Service will provide financing for new residential and commercial customers in any Delaware county seeking to convert existing equipment and fuel piping to natural gas. If approved, the maximum amount of financing for residential customers is $1,500 and $3,000 for commercial customers. (Applic.,¶9.) Customers would have the option of "payback

periods of 3, 5 or 10 years, with a return component payable to the Company at a rate equal to the Company's authorized rate of return." (*Id.*) The monthly charges would depend upon the conversion cost and selected payment option. (*Id.*) Moreover, Chesapeake has proposed an optional $100 Conversion Management Service fee for the Company to assist outside contractors with coordinating the conversion work for new customers in any Delaware county. (*Id.* at ¶¶¶7-9; Applic., Tietbohl, p.14, LL 7-15.)

29. Chesapeake has also proposed a tariff amendment to change the economic test used by Chesapeake to evaluate the economics of extending service to existing developments by using the Internal Rate of Return based model presently used for new developments, rather than the six times net-revenue test. (Exhibit 4,¶5.) Chesapeake has also proposed eliminating the current tariff provisions that prohibit charging for service installations within 75 feet of an existing distribution main, or for mainline extensions of less than 100 feet. (*Id.*)

30. Finally, Chesapeake seeks that the Commission approve the proposed Infrastructure Expansion Rate ("IES") on an interim basis. (¶¶14,15.). The Company seeks that the interim IES rate be allowed to remain in effect for "an appropriate time period for review of these rates that will facilitate the objective or goal of expansion of natural gas service in the defined expansion areas in Sussex County." (¶15.)

31. Chesapeake's Response to the Public Advocate's Motion to Close Docket concludes that "[t]he DPA, in its motion, provides no

basis for dismissing, without evidentiary hearings, Chesapeake’s request to implement these new service offerings and tariff amendments. There is no reason to require the Company to file a rate case.” Before discussing the merits of the parties’ respective positions, however, I will briefly discuss the Commission’s jurisdiction over this docket and give some background about Chesapeake’s operation.

V. DISCUSSION OF JURISDICTION & COMPANY BACKGROUND

A. Jurisdiction

32. According to 21 *Del. C.* §201(a), since Chesapeake is a regulated public utility and the Company has proposed new rates and services, the Commission has jurisdiction over this docket. This statute provides, in pertinent part, that the “[t]he Commission shall have exclusive original supervision and regulation of all public utilities and also over their rates, property rights, equipment, facilities … so far as may be necessary for the purpose of carrying out the provisions of this title. Such regulation shall include the regulation of rates ….”

33. Moreover, Section 201(d) provides that the Commission “may … alter in whole or in part, its supervision and regulation over some or all of a utility’s … services … to the extent necessary to promote and sustain adequate service at just and reasonable rates where the Commission determines that alternatives to supervision and regulation including the competitive provision of such products and services are in the public interest.” 26 *Del. C.* §201(d)(1). “Alternatives include, but are not limited to, incentive regulation … categorization of

services for the purpose of pricing … ranges of authorized returns … and different returns for different services."[9]

B. Company Background & 2007 Base Rate Commission Docket

34. By way of background, Chesapeake serves approximately 41,430 customers in all 3 Delaware counties, of which 91.6% are residential customers. (PSC Order No. 8168 (July 17, 2012, HE's Report, p.17,¶42.) In this docket, Chesapeake's non-residential i.e commercial, industrial, etc. have not been disclosed on a redacted basis to me or to the Commission.

35. Regarding Chesapeake's plans to expand into eastern Sussex County, in Gas Sales Service dockets in recent years, the Public Advocate's Consultant Andrea Crane has repeatedly questioned whether or not the Company's forecasts of residential and commercial customer growth for the eastern Sussex County area have been "overly optimistic." (*E.g., Id.* at ¶45.)

36. The Public Advocate's Motion to Close Docket argues that "Chesapeake has declining per customer usage." (Exhibit 1, ¶16.) Although the Company rapidly grew at the rate of 8.7% per year between 2002 and 2008, overall demand has since considerably slowed, primarily due to the recession.[10] However, natural gas prices have recently

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[9] Chesapeake argues that 26 *Del. C.* §201(d)(1) "authorizes the Commission to alter traditional rate regulation when it serves the public interest." (Exhibit 5, pp. 6-7.) Although it is not necessary to determine the statute's effect now, I note that both the United States Supreme Court and Delaware courts have addressed this issue. *E.g.,* FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944); Chesapeake Utils. Corp. v. Delaware Pub. Serv. Comm'n, 705 A.2d 1059 (Del. Super. Ct. 1997)('The primary purpose of ratemaking is to fix rates sufficient to give the utility a fair return upon the present value of the property dedicated to public use.")

[10] During this time period, the national average for industry growth was only 2-3%.(PSC Order No. 8168 (July 17, 2012, HE's Report, p.17, ¶42, fn 14.)

remained relatively low, with production increasing a staggering 10% between 2008 and 2011. (U.S. Energy Administration Report, 2012.)

37. Chesapeake's efforts to expand natural gas service in Sussex County were most recently fully litigated in Docket No. 07-186, a base rate case. In PSC order No. 7434 (Sept. 2, 2008), the Commission approved a settlement agreement between the parties with a rate increase of $325,000 awarded to the Company. In the settlement agreement in Docket No. 07-186, the parties agreed to a number of matters, including the following, which are some of the requirements Chesapeake now seeks to change in this docket without filing a base rate case: the Experimental Area Expansion Program, the (revised) Main Extension Policy, and the Area Extension Program.

VI. DISCUSSION OF WHETHER TO CLOSE DOCKET & COMPANY'S REQUEST FOR INTERIM "IES" RATE

A. Early Stage of this Docket requires Docket to Proceed

38. In its Response, Chesapeake maintains that "[t]he DPA, in its motion, provides no basis for dismissing, without evidentiary hearings, Chesapeake's request to implement these new service offerings and tariff amendments. There is no reason to require the Company to file a rate case." Although they are currently less than

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Warmer weather may also be a cause of less demand. 2012 was the warmest year on record for Delaware, according to the National Climatic Data Center's December 2012 Report. (*See* www.ncdc.noaa.gov [National Temperature and Precipitation Analysis.]) Obviously, a warm year results in substantially less natural gas being used for winter heating purposes in a mid-Atlantic state like Delaware, particularly for full-time residents as opposed to seasonal residents. Finally, to save money, or to save energy, more customers may be using less natural gas.

enamored with Chesapeake's filing, Staff, DNREC, and DAAEP agree that the Company has the right to proceed with this docket.

39. This rate case has not been fully vetted yet. The parties agreed not to enter into a formal Procedural Schedule, which would have required an evidentiary hearing. Between themselves, the parties engaged in informal discovery (presumably unsworn), conducted workshops on October 15, 2012 and December 10, 2012, and exchanged confidential "position papers" detailing their respective positions.

40. Except for the pre-filed testimony of Chesapeake's Vice President Jeffery R. Tietbohl filed along with the Company's Application in June, 2012, no other pre-filed testimony was filed by any party. There is no evidentiary record yet.

41. Another reason the docket should remain open is that, regardless if the Commission approves new rates, Chesapeake clearly has the right to pursue approval of the two (2) new services it has proposed: the Conversion Financing Service and the Conversion Management Service. The optional Conversion Finance Service will provide financing for new residential and commercial customers in any Delaware county seeking to convert existing equipment and fuel piping to natural gas. If approved, the maximum amount of financing for residential customers is $1,500 and $3,000 for commercial customers. (Applic.,¶9.) Also, Chesapeake has proposed an optional $100 Conversion Management Service fee for the Company to assist outside contractors with coordinating the conversion work for new customers in any Delaware county. (*Id.* at ¶¶¶7-9; Applic., Tietbohl, p.14, LL 7-15.)

B. Public Advocate's Three Reasons For Closing Docket Adequately Refuted By Most Parties

42. DNREC succinctly refuted the Public Advocate's three (3) reasons for closing this docket as follows: a) the Company's not attempting to implement the Experimental Area Expansion Program "is not sufficient reason for precluding full consideration of alternative rate structures;" b) "… the Commission is authorized to conduct limited single issue rate proceedings;" and c) customer subsidies is an issue which can be addressed in this docket, and is not a sufficient reason to close the docket. (p.2.)

C. Delaware Law And Public Policy Dictate that the Docket Not Be Closed

1. Delaware's Energy Efficiency Resource Standards Act of 2009

43. In addition to considering the reasons above for not closing this docket, the Commission must also consider Delaware's Energy Efficiency Resource Standards Act of 2009 detailed in the Company's Application. ("the Act") The Act creates a target of *reducing* natural gas consumption by 10% in the State through efficiency and conservation by 2015. (Applic., Attachment JRT-3, §2.3.) However, the Workgroup established to implement the Act also expressly supported *expanding* natural gas service to more homes and businesses in Delaware.

44. While the Act states that each regulated utility can determine how to meet the reduction targets, the Workgroup recommended policy changes including establishing alternative and/or higher levels

of funding to supplement existing programs and creating new stricter regulations and new pricing structures designed to incentivize energy efficiency. None of these recommended policy changes have occurred, leaving the Commission in a challenging position in regulating a natural gas company like Chesapeake regarding its future expansion plans.

45. The Act establishes energy efficiency as one of Delaware's primary energy resources. (*See* 26 *Del. C.* §1500.) The Act recognizes that energy efficiency is among the least expensive and environmentally sound ways to meet the State's growing energy demands. (*Id.)* The Act creates energy efficiency goals or "targets" to be achieved by 2015: a) reducing electric consumption by 15%; b) reducing peak electric demand by 15%; and c) reducing natural gas consumption by 10%.[11]

46. **Composition of the Workgroup**. The Act required that a Workgroup of Delaware's energy specialists "be established to complete a study and provide recommendations during the planning and implementation of this [energy efficiency] policy." (*Id.* at §1502(c).) The Workgroup was comprised of eleven (11) members, chaired by the

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[11] Title 26, Chapter 15, Sections §§ 1502(a)(1) and (2) of the Act defines its energy savings goal as follows:
"(a) It is the goal of this chapter that each affected energy provider shall achieve a minimum percentage of energy savings as follows:
(1) For each affected electric energy provider, energy savings that is equivalent to 2% of the provider's 2007 electricity consumption, and coincident peak demand reduction that is equivalent to 2% of the provider's 2007 peak demand by 2011, with both of the foregoing increasing from 2% to 15% by 2015;
(2) For each affected natural gas distribution company, energy savings that is equivalent to 1% of the company's 2007 natural gas consumption by 2011, increasing to 10% by 2015."

DNREC State Energy Coordinator, and included representatives from Delmarva Power and Light Company, the Delaware Electric Cooperative, Chesapeake Utilities Corporation, municipal electric utilities, the Public Service Commission, the Public Advocate, the Sustainable Energy Utility ("SEU"), Delaware's Weatherization Assistance Program, along with two (2) members of the public with experience representing, *respectively*, low/moderate income families and environmental issues. (Applic., Attachment JRT-3, §2.2.)

47. The Workgroup began its analysis in October, 2009 and completed its study in May, 2011. (*Id.* at §2.3.) On June 14, 2011, the "State of Delaware Energy Efficiency Resource Standards Workgroup Report" (the "Workgroup's Report") was submitted to DNREC's Secretary after a consensus vote of the participating Workgroup members. (Applic., Tietbohl, p.5 L 23 - p.6 LL 1-4.)

48. **Support for Expanded Natural Gas Service.** The Workgroup's Report expressly supports expanding natural gas service in Delaware. (Applic.,Attachment JRT-1,§1.7.) As required by the Act, the Workgroup compared natural gas service to electric, fuel oil and propane service. (*Id.*) Performing a full-fuel-cycle measurement from the fuel source to the point-of-use i.e the home, as opposed to an on-site home test only, the Workgroup found that "[t]he full-fuel-cycle energy requirement for an average home using natural gas is approximately 27% less than for a similar home using electricity, 11% less than the similar fuel oil home, and 3% less than the similar propane home." (*Id.*) The Workgroup also held that "electricity is the most efficient

when only considering the energy requirements on site at the home.” (*Id.*)

49. **Need For Delaware Legislature To Clarify Who Will Enforce EERS Savings Targets.** The Workgroup requested that the legislature clarify “who would be accountable for EERS performance results and how the State could develop enforcement mechanisms.” The Workgroup concluded that “[h]olding regulated energy providers responsible for outcomes without any ability to design and administer efficiency programs may create unintended issues.” (Applic.,Attachment JRT-1,§9.1.3.) While the Act states that each regulated utility can determine how to meet the Targets, Delaware law also requires the Sustainable Energy Utility (“SEU”) with designing and implementing energy efficiency programs in Delaware.

50. **Needed Policy Changes.** The Workgroup specifically recommended the following policy changes:

> a) Establishing alternative and/or higher levels of funding to supplement existing programs;
>
> b) Creating new stricter regulations and new pricing structures designed to incentivize energy efficiency;
>
> c) Broadening program offerings and delivery mechanisms; and
>
> d) Increasing the energy savings that could count toward energy efficiency.
>
> (Applic., Attachment JRT-1,§9.0.)

51. In conclusion, the effect of Delaware’s Energy Efficiency Resource Standards Act of 2009 in this rate case is unclear. This is because a) the Act does not specify how utilities can comply with the target reductions; b) the Act does not specify which state agency will

enforce the target reductions; and c) none of the natural gas expansion policy changes recommended by the Workgroup have been established. Without clarifying these issues, the Delaware legislature has placed the Commission in a challenging position in regulating a natural gas company like Chesapeake regarding its future expansion plans.

2. Governor Jack Markell's State of the State Speech

52. Although the Delaware legislature has sent conflicting signals about how natural gas expansion should occur, Delaware's Governor Jack Markell clearly favors expanding natural gas service in Delaware. In his State of the State Speech delivered on January 17, 2013, Governor Markell stated as follows:

> "For manufacturers and other businesses, we know the reliability and cost of energy is key. We need to expand our energy portfolio, reduce costs and improve air quality. Secretary O'Mara, working with the leadership of our major energy companies, has developed a three-part strategy to do just that.
>
> …
>
> Second, we need to expand natural gas infrastructure across our state. Too many in Delaware are paying too much for energy because they are too far from a pipeline to bring them affordable natural gas. The energy savings from fuel switching are substantial and can cover the costs of new infrastructure. To help businesses and residents save money, we are working with both Delmarva and Chesapeake to make it easier for businesses to switch to cheaper and cleaner energy. …"

Thus, Governor Markell has clearly made natural gas expansion a priority in this state.

3. Pennsylvania

53. Finally, the Pennsylvania legislature will soon be addressing expanding natural gas service to un-served and under-served homeowners. This legislation can serve as a guide to this Commission. The Pennsylvania Natural Gas Expansion and Development Initiative states that it will:

> Establish funding alternatives for gathering and distribution extensions to un-served and under-served areas; and
>
> Require the Public Utility Commission to develop rules to produce an orderly system for reviewing current levels of natural gas service and to allow for the orderly expansion of natural gas service to areas not currently served;

On December 5, 2012, Pennsylvania State Senators Gene Law and Dominic Pileggi, who will soon propose the legislation, stated that its goals are:

> "in the near future we plan to introduce legislation that will facilitate the expansion, distribution and use of low-cost, energy efficient, Pennsylvania-produced natural gas. Being able to fully utilize this commodity will reduce costs and be environmentally beneficial across the Commonwealth. This legislation is designed to assist state and local governments, similar institutions, and un-served and under-served businesses and homeowners across our state in making this conversion."

D. Company's Request for Interim Infrastructure Expansion Service ("IES") Rate Should Be Denied

54. Chesapeake now seeks that the Commission approve the proposed Infrastructure Expansion Rate ("IES") on an interim basis. (¶¶14,15.). The Company seeks that the interim IES rate be allowed to

remain in effect for "an appropriate time period for review of these rates that will facilitate the objective or goal of expansion of natural gas service in the defined expansion areas in Sussex County." (¶15.)

55. Since its interim rate request was addressed by Chesapeake in its recent Response, no party has addressed this issue yet. First, the Commission should consider whether this docket is procedurally at the stage where the Commission should enact the potentially controversial IES rate for all current customers. No evidence is in the record, no Public Comment Session has occurred, and no evidentiary hearing has occurred. Although the Delaware legislature is currently in session, none of the natural gas expansion policy changes recommended by the Energy Efficiency Resource Standards Act of 2009 Workgroup have been established.

56. Even if this docket remains open, Chesapeake continues to have the Burden of Proof in this docket. The Public Advocate's credible arguments against the proposed IES rate may eventually prevail. The Company's current Return on Equity ("ROE") may be a factor in the final result.

57. If the Public Advocate's arguments eventually prevail in this docket, the Commission would have to refund the interim IES rate monies after refusing to enact the IES rate. This Commission has always performed even stricter scrutiny of an interim rate request for a proposed, new service rate, rather than a request to increase the amount of an established service rate.

58. Due to the early procedural stage of this docket, the Commission should consider encouraging the parties to agree at oral argument that the seven (7) month interim rate implementation period set forth in 26 *Del. C.* §306 shall begin as of the date of the Commission's Order on the Public Advocate's Motion to Close Docket.

59. As opposed to Chesapeake's proposed IES rate, another option available to the Commission is a one-time "system development charge" against new Chesapeake customers in existing developments. According to Chesapeake's Application, for a typical residential service (R-2) customer using 50 Mcf of natural gas annually who needs an approximately thirty (30) foot main extension, if Chesapeake's Application is approved, the up-front capital cost of $627 per customer of providing service to a customer in an existing development would generally be eliminated. (Applic.¶7; Tietbohl, pp.18-19.)

60. Chesapeake's Application seeks to avoid a system development charge for new customers in existing developments, but this Commission approved one in Regulation Docket 15 regarding water customers in new residential developments.[12] One-time system development charges against new customers and/or Developers is becoming increasingly popular, as opposed to increasing current user charges. (*Water and Wastewater Finance and Pricing*, George A. Raftelis, 3rd ed., p.80 (2005.)

[12] In Regulation Docket 15, to aid existing ratepayers, the Commission required at least $1,500 per home to be collected by each regulated water utility from Developers to more accurately recover costs incurred in servicing a new residential development.

VII. RECOMMENDATIONS

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

62. Based upon the Company's Application and its pre-filed testimony, I recommend that the Commission not close this docket. If the docket proceeds, Chesapeake continues to have the Burden of Proof pursuant to 26 *Del. C.* §307(a), which provides as follows:

In any proceeding upon the motion of the Commission, or upon complaint, or upon application of a public utility, involving any proposed or existing rate of any public utility, or any proposed change in rates, the burden of proof to show that the rate involved is just and reasonable is upon the public utility.

(emphasis supplied)

63. Chesapeake also seeks that the Commission approve the proposed Infrastructure Expansion Rate ("IES") on an interim basis. The Company seeks that the interim IES rate be allowed to remain in effect for "an appropriate time period for review of these rates that will facilitate the objective or goal of expansion of natural gas service in the defined expansion areas in Sussex County." (Exhibit 5, ¶15.)

64. I recommend that the Commission deny Chesapeake's request that the proposed Infrastructure Expansion Rate ("IES") be implemented on an interim basis. At oral argument, due to the early stage of this docket, the parties should agree that the seven (7) month rate implementation period contained in 26 *Del. C.* §306 will begin as of the date of this Order.

65. Finally, I recommend that the Commission order that the parties are required to: a) enter into a formal Procedural Schedule within seven (7) days of the date of this Order; and b) the parties must finalize this docket within seven (7) months of the date of this Order.

66. I also attached a proposed Order as Exhibit "6", which will implement the foregoing recommendations.

Respectfully Submitted

Date: February 6, 2013

____
Mark Lawrence
Hearing Examiner