

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

IN THE MATTER OF THE APPLICATION)
OF CHESAPEAKE UTILITIES CORPORATION)
FOR A GENERAL INCREASE IN ITS NATURAL) PSC DOCKET NO. 15-1734
GAS RATES AND FOR APPROVAL OF CERTAIN)
OTHER CHANGES TO ITS NATURAL GAS)
TARIFF (FILED DECEMBER 21, 2015))

ORDER NO. 8982

AND NOW, this 20th day of December, 2016.

WHEREAS, the Commission having received and considered the Report and Recommendations of the Hearing Examiner ("Report") issued in the above-captioned docket, which was submitted after a duly-noticed public evidentiary hearing; and

WHEREAS, the Hearing Examiner recommends that the proposed Settlement Agreement, which is endorsed by the Company, Commission Staff, the Division of the Public Advocate, the Delaware Association of Alternative Energy Providers and the Federal Executive Agencies ("FEA"), and which is not opposed by Delmarva Power & Light Company, and which is attached to the Hearing Examiner's Report as "Exhibit 1", be adopted by the Commission; and

WHEREAS, the Commission finds, for the reasons identified by the Hearing Examiner in his Report, that the Proposed Settlement results in just and reasonable rates and is in the public interest as required by 26 Del. C. § 512(c);

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

1. That, the Report and Recommendations of the Hearing

Examiner, appended to the original hereof as "Attachment A," are hereby adopted.

2. That the Proposed Settlement Agreement, attached to the Hearing Examiner's Report as Exhibit "1", is accepted as a resolution of this matter which is in the public interest as required by 26 *Del. C.* § 512(c).

3. That, consistent with the Proposed Settlement, the revised Tariffs and Rate Design attached as composite Exhibit "A" to the Proposed Settlement, and the revised rates and rate structure set forth therein, are approved and shall govern the gas services offered by Chesapeake Utilities Corporation as described below.

4. That, consistent with the Settlement, the rates contained in the Settlement adopted herein shall be implemented as follows:

- (a) The rates shall become effective for services rendered by the utility on and after January 1, 2017;
- (b) Until December 31, 2016, the interim rates previously approved shall continue to apply for services to customers, but such continued interim rates shall be subject to the refund obligation for interim rates set forth in Ordering Paragraph 5 below and 26 *Del. C.* § 306(b)&(c).

5. That Chesapeake Utilities Corporation, the Division of the Public Advocate, Commission Staff, and the FEA shall confer to determine the amount of any refund amounts that might be due and how

such refunds (or refund credits) are to be made. The Company will refund amounts collected through Interim Rates in excess of the \$2,250,000 revenue requirement agreed to in the Settlement Agreement. Refunds will be made based on each class's proportionate share of revenues collected through the Interim Rate increase. The Company shall submit a Refund Plan within thirty (30) days of the date of this Order.

6. 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:

Secretary

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

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FINDINGS AND RECOMMENDATION OF THE HEARING EXAMINER

DATED: December 5, 2016

MARK LAWRENCE
SENIOR HEARING EXAMINER

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FINDINGS OF FACT AND RECOMMENDATION OF THE HEARING EXAMINER

Mark Lawrence, having been appointed to act as the Hearing Examiner in this matter by PSC Order No. 8848 (January 19, 2016), submits the following Report to the Delaware Public Service Commission (the "Commission").

I. SUMMARY

Chesapeake Utilities Corporation ("Chesapeake"), Commission Staff ("Staff"), the Division of the Public Advocate ("DPA"), and Intervenors, the Delaware Association of Alternative Energy Providers ("DAAEP") and the Federal Executive Agencies ("FEA"), (together, "the Settling Parties") request the Commission to adopt a Settlement Agreement agreed to by those parties, and not opposed by Intervenor Delmarva Power & Light Company ("Delmarva"). According to the Settling Parties, the Settlement Agreement would allow the natural gas utility a reasonable increase in its base rates, permit it to restructure its residential customer charge, permit deferred accounting treatment of certain expenses relating to a new Customer Information System subject to certain conditions, and resolve other issues surrounding the

Company's services and operations. I recommend that the Commission adopt the Proposed Settlement, including its proposed rates and terms, as a resolution of this case since it is "in the public interest."

II. APPEARANCES

On behalf of Chesapeake Utilities Corporation:

Brian M. Quinn, Esq., Venable LLP

William O'Brien, Esq., Associate General Counsel

On behalf of the Commission Staff:

Brenda R. Mayrack, Esq., Deputy Attorney General,
Department of Justice

On behalf of the Division of the Public Advocate:

Regina A. Iorii, Esq., Deputy Attorney General, Department
of Justice

On behalf of the Intervenor, Delaware Association of Alternative
Energy Providers:

Richards, Layton & Finger
Todd A. Coomes, Esq.

On behalf of the Intervenor, Delmarva Power & Light Company:

Pamela J. Scott, Esq., Assistant General Counsel

On behalf of the Intervenor, Federal Executive Agencies:

Captain Natalie A. Cepak, Esq. (argued)

Thomas A. Jernigan, Esq., Counsel for FEA

III. PROCEDURAL HISTORY

1. On December 21, 2015, Chesapeake filed an Application seeking Commission approval to increase its base natural gas rates and to make other proposed changes to its Tariff.

(Exh. 1)¹ The rates proposed by the Company were designed to produce an increase in its annual revenues of approximately \$4,741,823, or a 9.96% increase over the Company's existing revenues based upon a Test Year ending June 30, 2015 and a Test Period ending March 31, 2016. (*Id.* at ¶4.)

2. If Chesapeake's Application was granted, an average Chesapeake residential heating customer would see an increase during the winter of \$13.36 per month, or a 10.68% increase based upon an average use of 120 Ccfs² per winter month. An average non-heating customer residential heating customer would experience an increase of \$5.41 per month, or a 15.17% increase based upon an average use of 18 Ccfs per month. (*Id.* at ¶4.) Chesapeake has approximately 47,000 natural gas customers in Delaware. (*Id.* at ¶1.)

3. In addition to the proposed rate changes, the Company's Application also proposed a number of new Service Offerings including:

a) Multi-Family Housing Program - Chesapeake would provide a per-unit financial contribution to offset the costs associated with new gas piping and venting to builders that select natural gas for "multi-family

¹ Exhibits admitted into evidence at the Evidentiary Hearing will be referred to as "Exh.," with page numbers where necessary, i.e., Exh. 1, p.2. The Settlement Agreement is attached as "Exhibit "1"" with the word Exhibit not being abbreviated. Testimony from the transcript of the Evidentiary Hearing will be referred to, for example, "Tr.-26," meaning the testimony appears at page 26.

² "Ccf" equals the volume of 100 cubic feet of natural gas.

housing," meaning four (4) individually metered apartments and condominium units per building.

- b) Natural Gas Compression Service - Pursuant to a negotiated contract, Chesapeake would construct, own and maintain compression facilities (for example industrial natural gas fueling stations, compressors, gas dryers or storage vessels) for commercial customers that require enhanced pressure for their operations.
- c) Municipal Natural Gas Infrastructure Expansion Program - Chesapeake would offer municipalities or incorporated towns an advance to fund the construction of natural gas infrastructure, which must be paid back within six (6) years of installation. After six (6) years, the municipality or town would be responsible for the difference if the amount advanced by the Company exceeds six (6) times the expected delivery service revenues from the project. The Company also sought to establish a regulatory asset for the carrying costs related to the advance.
- d) Temporary Gas Storage Tank Program - This program would allow the Company to provide a customer with propane or temporary Compressed Natural Gas ("CNG") service until the customer can be connected to a new natural gas main under construction. Utilizing the economic test contained in the Company's Line

Extension Tariff, the Company would be permitted to proceed with a project if the anticipated revenues exceed the equipment cost, for example the cost of storage tanks and equipment conversion.

- e) CNG Service - Chesapeake would make available natural gas service to owners or operators of CNG facilities or to CNG transportation providers that compress and/or transport CNG to third parties.
- f) Poultry House Transportation Program - This offering would allow poultry companies to aggregate usage from their poultry houses for purposes of meeting the minimum consumption eligibility requirement of 30,000 Ccf for the Transportation Service Rate.
- g) Revenue Normalization Adjustment ("RNA") - Chesapeake also proposes a RNA for residential and smaller commercial customers. Chesapeake sought that "each quarter, the Company [would] implement an adjustment to rates of the customer classes subject to the RNA's [true-up] to collect or return differences between the actual margin per customer collected and the per-customer margin approved in this proceeding."
(Application, Exh. 1, ¶7; Mierzwa, Exh. 25, pp.33, 40-43; Breakie, Exh. 12, pp. 1-19.)

- 4. Chesapeake also proposed a tariff amendment changing its curtailment policy as to the rate Chesapeake pays a customer if Chesapeake diverts customer-owned gas for higher priority

customers.³ (Exh. 1, Sheet 3, Red-lined Tariff) The Company's Application also seeks to extend the customer bill payment due date for all rate classes from ten (10) days to twenty (20) days. (Exh. 6, Third Rev. Sheet 24, §13.4, Red-lined Tariff) Chesapeake also seeks to revise its tariff to replace the interest rate on customer deposits held more than ninety (90) days from 6% per annum to a Treasury-yield calculation. (Exh. 6, Third Rev. Sheet No. 23, §13.2(b), Red-lined Tariff)

5. Finally, the Company also sought Commission approval of deferred accounting treatment for expenses relating to the implementation of new technologies, including a new billing system since the current system is over twenty (20) years old, as well as expenses associated with the Company's pension, deferred compensation, and other post-retirement benefits. (Exh. 1, ¶ 7, 8; Dewey, Exh. 14, p.7.)

6. As will be explained later in Article IV, Section G herein which addresses the testimony at the evidentiary hearing, the parties agreed upon some variations of the Company's proposed Service Offerings, and the Company subsequently withdrew some of its proposed Service Offerings.

7. Chesapeake's Application asserted that a significant portion of its proposed rate increase is due to replacing

³Sheet No. 2 of Chesapeake's Tariff defines the Company's curtailment rules and regulations. In the event that the Company determines that there is insufficient gas supply to meet the demands of customers on its distribution system, the Company has the discretion to curtail service to customers based upon an established priority system beginning with residences, hotels, hospitals, the police and "other institutions essential to the public welfare."

unprotected bare steel pipe and cast iron pipe totaling approximately \$11.3 million with pipe which increases reliability by less corrosion and leaks. (Exh. 1, ¶3; Redd, Exh. 21, pp. 4-5.) According to the Company, it has also experienced a decline in consumption on a per-customer basis over the past eight (8) years, which has led to decreased volumes upon which fixed costs can be allocated.⁴ (Exh. 1, ¶3).

8. By PSC Order No. 8848 (January 19, 2016), the Commission suspended the proposed effective date of the Company's proposed new rates and numerous tariff revisions pending further investigation, public comment, an evidentiary hearing, and a final decision by the Commission. Thereafter, pursuant to 26 *Del. C.* §306(c), Chesapeake requested that the Commission implement the Company's proposed interim rate increase of \$2,500,000 in additional revenues based on the Company's current rate schedules, with such adjustments subject to refund. (Exh. 1, Application ¶¶ 5, 10) The Commission ordered that those interim rates would become effective on February 19, 2016. (PSC Order No. 8848, §3)

9. The Commission also granted Chesapeake's request for a waiver of the requirements of 6 *Del. C.* §306(b), which requires a public utility to file a bond with a surety in an amount approved by the Commission. Instead, the Commission required that the Company abide by any Commission refund order. (*Id.* at §4.)

⁴ Notice of the Company's Application was published in the News Journal and Delaware State News on February 1, 2016. (Exh. 8)

10. Pursuant to its statutory right, the DPA intervened in this Docket. Delmarva intervened without objection from any party. (PSC Order No. 8857, March 1, 2016) Finally, the FEA, representing the interests of Dover Air Force Base, also intervened without objection from any party. (PSC Order No. 8882 (April 20, 2016))
11. The DAAEP, which represents a number of propane companies, sought and was granted intervention by the Commission. DAAEP's intervention was primarily to address the Company's new service proposals relating to the Company's main extension policies, including the parameters of its expansion of services into Kent and Sussex Counties. (PSC Order No. 8878 (May 17, 2016) (approving Hearing Examiner's Recommendation by 4-1 vote to allow DAAEP to intervene without conditions)) In the proposed Settlement, the Company has reserved its right to appeal the Commission's decision allowing DAAEP to intervene in this case.⁵ (Exhibit 1, Settle. Agree., ¶39.)
12. I held three (3) public comment sessions on the Company's Application in the Commission's office in Dover on May 17, 2016, at the Middletown High School on May 18, and at the Millsboro Am Vets-2 facility on May 19. No member of the public appeared at the Dover or Middletown evening sessions. One (1)

⁵ Due to the substantial increase in the number of objections as to approved or not approved interventions in various dockets by utilities, Staff, the DPA and Interveners, I recommend that the Commission open a Regulatory Docket to review its intervention requirements adopted in 1999. (See 26 Del. Admin. C. § 1001, Rule 2.9.) E.g., PSC Order 8658 (Oct. 14, 2015)(in Exelon/Delmarva Power Merger Docket, Intervenor's written discovery halted due to vexatious and overly burdensome discovery requests); PSC Docket 13-250 (in DPL Billing Transparency Docket, DPA's intervention objections filed Aug. 5, 2013).

customer spoke in Millsboro. That customer later submitted a written comment primarily arguing that: a) his Customer Charge is excessive when compared to his minimal natural gas use; b) it is unfair that, because he resides in the "Expansion Area," his Customer Charge is higher than other areas served by the Company;⁶ and c) in light of ample natural gas supply nationwide, the customer believes that the Company's price for natural gas is simply too expensive.⁷

13. On July 13, 2016, the Company filed a petition seeking to implement an additional interim rate increase in the amount of \$2,241,823, as permitted by 26 *Del. C.* §306(b). On July 26, 2016, the Commission issued Order No. 8921 granting the Company's request to place its entire requested revenue increase into effect, on an interim basis and subject to refund, effective August 1, 2016. On August 1, 2016, the Company placed into effect the total approved interim increase of \$4,741,823, which included the interim rates amount of \$2,500,000 previously placed into effect on February 19, 2016. (PSC Order 8921, July 26, 2016)

⁶ By PSC Order No. 8479 (November 5, 2013), the Commission permitted the Company to establish an "Expansion Area" whose customers would be charged a higher Customer Charge than customers in other areas:

"10. [I]n the Expansion Area, the Company will charge an Infrastructure Expansion Service ("IES") Rate to all new Residential, General Service, and Medium Volume Service customers. Revenues collected through the IES Rates will be utilized by Chesapeake to enable Chesapeake to extend its natural gas distribution system in the Expansion Area. Unless provided for further order of the Commission, the IES Rates will remain in place for a period of time to ensure an appropriate level of rate and cost recovery related to the distribution system infrastructure established in the Expansion Area." (Attach. A, p 10)

⁷ The Notice of Public Comment Sessions was published in the *Delaware State News*, *Cape Gazette*, and *News Journal* on April 23, 22 and 21, 2016, respectively. (Exh. 9)

14. The Company, Staff, the DPA, DAAEP and the FEA filed pre-filed written direct testimonies. On December 21, 2015, the Company submitted the following thirteen (13) pre-filed Direct Testimonies: (a) Direct Testimony of Ronald J. Amen (Exh. 11); b) Direct Testimony of Shane Breakie (Exh. 12); c) Direct Testimony of Autumn Chalabala (Exh. 13); d) Direct Testimony of Matthew Dewey (Exh. 14); e) Direct Testimony of Lisa Elder (Exh. 15); f) Direct Testimony of Matthew Everngam (Exh. 16); g) Direct Testimony of Sarah Hardy (Exh. 17); h) Direct Testimony of Kathryn G. McVay (Exh. 18); (i) Direct Testimony of James Moore (Exh. 19); (j) Direct Testimony of Paul R. Moul (Exh. 20); k) Direct Testimony of Christopher Redd (Exh. 21); l) Direct Testimony of John Taylor (Exh. 22); and m) Direct Testimony of Jeffrey Weiss. (Exh. 23)
15. On June 1, 2016, the Company filed updated financial information for the twelve (12) month period ending March 31, 2016, the end of the Company's Test Period. (Exh. 42)
16. On August 2, 3 and 4, 2016, Staff conducted an audit at the Company's headquarters, including a tour of certain distribution facilities. (Exhibit 1, Settle. Agree., ¶10.)
17. On August 24, 2016, Staff filed the following five (5) pre-filed testimonies: a) Direct Testimony of Lisa B. Driggins; (Exh. 24); b) Direct Testimony of Jerome D. Mierzwa (Exh. 25); c) Direct Testimony of Lafayette K. Morgan, Jr. (Exh. 26); d) Direct Testimony of David C. Parcell (Exh. 27); and e) Direct Testimony of Jason R. Smith (Exh. 28).

18. On August 24, 2016, the DPA filed the following two (2) pre-filed Direct Testimonies: a) Direct Testimony of Michael Gorman; (Exh. 30); and b) Direct Testimony of Glenn A. Watkins. (Exh. 29)
19. On August 24, 2016, Intervenor DAAEP filed the pre-filed Direct Testimony of James F. Wilson. Intervenor FEA filed the pre-filed Direct Testimony of Amanda M. Alderson. (Exhs. 32, 31, *respectively*)
20. On September 30, 2016, the Company filed the following eight (8) pre-filed Rebuttal Testimonies: (a) Rebuttal Testimony of Ronald J. Amen (Exh. 33); (b) Rebuttal Testimony of Shane Breakie (Exh. 34); c) Rebuttal Testimony of Matthew Dewey (Exh. 35); d) Rebuttal Testimony of Matthew Everngam (Exh. 36); e) Rebuttal Testimony of Kathryn G. McVay (Exh. 38); f) Rebuttal Testimony of Paul R. Moul (Exh. 37); g) Rebuttal Testimony of John Taylor (Exh. 39); and h) Rebuttal Testimony of Jeffrey Weiss. (Exh. 40)
21. During this docket, the parties conducted substantial written and informal discovery. (Exhibit 1, Settle. Agree., ¶13)
22. On October 5, 2016, the parties attended a settlement conference. (Tr.-148)
23. I held a pre-hearing conference call with the parties on November 2, 2016. During that call, the Settling Parties notified me that they had reached an agreement as to most major

issues and they were actively attempting to resolve the remaining issues.

24. On November 15, 2016, Chesapeake submitted the "Proposed Settlement" (Exhibit 1) agreed to by the Company, the DPA, DAAEP, FEA, and the Staff. While Delmarva Power is not a signatory to this settlement, according to the agreement, it did not oppose the Commission approving the Proposed Settlement. (Exhibit 1, Settle. Agree., Intro. ¶) The Proposed Settlement comprehensively resolves this matter, while addressing many of the multi-faceted requests made in the original Application. The terms of the Proposed Settlement document are outlined later herein.
25. With the submission of the Proposed Settlement by the Settling Parties, the focus of the case moved to whether the agreement should be accepted by the Commission as a final resolution of this matter pursuant to the settlement authority granted to it in 26 *Del. C.* §512.
26. The duly-noticed evidentiary hearing was held on November 16, 2016 at the Commission's office in Dover.⁸ The evidentiary record consists of forty-six (46) hearing exhibits, and a sixty (60) page hearing transcript.
27. At the public hearing on November 16, 2016, the Company, the DPA, Staff, DAAEP, and FEA each presented a witness to support the Commission accepting the Proposed Settlement as a

⁸The Notice of Evidentiary Hearings was published in the *Cape Gazette*, *Delaware State News* and *News Journal* on October 25, 26 and November 1, 2016, respectively. (Exh. 10)

reasonable resolution which is in the public interest. Given that no party opposed the agreement, I did not require post-hearing briefing.

IV. SUMMARY OF THE EVIDENCE

A. COMPANY'S TESTIMONY

28. For the Test Period ending March 31, 2016,⁹ the Company calculated a revenue deficiency of \$4,741,823 (later reduced to \$4,111,163), derived from a rate base of \$70,938,749 (later reduced to \$69,380,120), a proposed overall rate of return of 9.68%,¹⁰ including and a return on equity of 11.0%,¹¹ and pro-forma net income of \$3,506,163. (Exhs. 1; Exh. 2; Briefing Sheet; Amen, Exh. 11, p.12; Exh. 43)

29. As stated previously, Chesapeake's Application asserts that a significant portion of its proposed rate increase is due to replacing unprotected bare steel pipe and cast iron pipe totaling approximately \$11.3 million with pipe which increases reliability by less corrosion and leaks. (Exh. 1, ¶ 3; Redd, Exh. 21, pp. 4-5) According to the Company, it has also

⁹ The Company used a "Test Year" comprised of the twelve (12) months ending June 30, 2015 and a "Test Period" comprised of the twelve (12) months ending March 31, 2016. Neither Staff nor the DPA disagreed with the Company's selected Test Year or Test Period. (Parcell, Exh.27, pp. 3-4, Watkins, Exh. 29, p.3.) However, as discussed later herein, Staff and the DPA did not agree with some of the Company's adjustments to the Test Year and Test Period, Rate Base calculation, some Operating Expenses, the embedded cost of debt, and the Company's proposed capital structure. These differences were eventually settled by the parties by virtue of their Settlement Agreement, except as otherwise expressed therein.

¹⁰ The rate of return is defined as the Company's net operating income divided by its rate base. *E.g.*, FPC v. Hope Nat. Gas Co., 320 U.S. 591, 596-97 (1944).

¹¹ The return on equity (or "ROE") is defined as the annual rate of return which an investor expects to earn when investing in shares of a company. (Financial Accounting Institute, *Definitions Section.*)

experienced a decline in consumption on a per-customer basis over the past eight (8) years, which has led to decreased volumes upon which fixed costs can be allocated. (Exh. 1, ¶ 3).

B. STAFF'S TESTIMONY

30. For the Test Period ending March 31, 2016, Staff determined that, based on the Company's revised revenue requirement of \$4,111,163 and Staff's rate base of \$68,322,378, a revenue increase of \$1,017,019 was warranted, an overall rate of return of 7.06%, and a return on equity of 9.30%. (Morgan, Exh. 26, pp. 4-5 & Sch. LKM-1,2; Exh. 27, Parcell, pp.4, 42)

31. Areas of dispute between Staff and the Company involved, among other issues:

- a) Return on equity (9.30% advocated by Staff versus 11.0% sought by the Company);
- b) Staff's proposed capital structure of 50% long-term debt and 50% common equity as opposed to the Company's proposed capital structure of 39.61% long-term debt and 60.39% common equity.¹² (Exh. 27, Parcell, pp. 25-26; Moul, Exh. 20, Attachment PRM-5);
- c) Staff recommended that revenue distribution based upon its Cost of Service "Peak & Average" approach allocating revenue by distribution main investment be adopted as opposed to the Company's proposed Customer/Demand method which Staff argued allocates distribution mains to each customer partially based upon the number of customers and partially based on design day demands. (Exh. 25, Mierzwa, p.4); and
- d) Staff maintained that, based on its analysis, the proposed increase to the residential monthly customer charge was not justified. (*Id.*)

32. Staff generally did not object to the Company's proposed Service Offerings as originally proposed, provided that current

¹²Staff Consultant Parcell's testimony describes the effect of capital structure upon a utility's rate of return. (Exh. 27, p.4.)

customers did not subsidize the programs. (Exh. 25, Mierzwa, pp. 39-44.)

C. PUBLIC ADVOCATE'S TESTIMONY

33. For the Test Period ending March 31, 2016, the Public Advocate ("DPA") recommended an overall base rate revenue increase of \$282,335, based on the DPA's rate base of \$68,446,579, an overall rate of return of 6.69%, and a return on equity of 9.15%. (Watkins, Exh. 29, pp. 2, 8; Exh. 30, Gorman, pp. 2,4)

34. Areas of dispute between the Public Advocate and the Company involved, among other issues:

- a) Return on equity (9.15% advocated by DPA versus 11.0% sought by the Company);
- b) Like Staff, the DPA's proposed capital structure of 50% long-term debt and 50% common equity, as opposed to the Company's proposed capital structure of 39.61% long-term debt and 60.39% common equity. (Gorman, Exh. 30, pp. 2, 12; Moul, Exh. 20, Attachment PRM-5);
- c) Like Staff, the DPA recommended that revenue distribution be based upon its Cost of Service "Peak & Average" study allocating revenue by distribution main investment, as opposed to the Company's proposed Customer/Demand method which the DPA argued allocates distribution mains to each customer partially based upon the number of customers and partially based on design day demands. (Exh. 20, Moul, p.42.); and
- d) the DPA argued that, based on its analysis, only a minimal increase of the residential monthly customer charge for rate class RS-1 was warranted, and a decrease of the monthly customer charge for rate class RS-2 was warranted. (*Id.* at pp. 61, 71.)

35. The DPA objected to all of the Company's proposed Service Offerings as proposed, arguing that, in their current form, current customers would subsidize them; however, the DPA agreed

to the Temporary Gas Storage Program if it was limited to six (6) months. (Exh. 29, Watkins, pp. 78-84, 82)

D. DAAEP'S TESTIMONY

36. On August 24, 2016, DAAEP filed the pre-filed Direct Testimony of James F. Wilson (Exh. 32) Mr. Wilson opined as to the Company's proposed Service Offerings as follows:

"1. With regard to Offering #3 [Municipal Natural Gas Infrastructure Expansion Program], Chesapeake acknowledges that the proposed treatment of the carrying costs constitutes a subsidy. The subsidy would appear to be contrary to Commission policy and [it is] not justified that it be paid by ... Chesapeake's natural gas customers. In addition, it is unclear how a town would pay back any financial contribution that remains unrecovered after six years. As a result, and in light of uncertainty about new customer connections and usage levels, the program appears risky.

2. With regard to Offering #4 [Gas Storage Tanks], Chesapeake acknowledges that gas storage tanks are available, on a temporary or permanent basis, from multiple unregulated providers in Delaware at market rates. There does not appear to be any sound reason why Chesapeake, as a regulated utility, should be involved in providing storage tanks and to recover the case of the storage tanks through base rates could lead to a subsidy...

3. With regard to Offering #5 [Transportation for Poultry Houses], this would be a rather ad hoc revision of Delaware's retail access policies for a single industry (the poultry industry). It would seem to be a very questionable regulatory policy...

4. Offering #1 [Multi-Family Housing Program] and Offering #4 [Temporary Gas Storage Tank Program] allow Chesapeake to use the "headroom" under its economic tests to provide a contribution to a project. This increases the risk that the project may turn out to be uneconomic...

5. The 2013 Settlement contained a provision (P.9) under which, at the next base rate proceeding, the Company would bear 50% of the shortfall if the aggregated IRRM of all expansion projects fell short of the target. Such a provision provides incentives for the Company to

select wisely, control costs and build revenues, and it provides ratepayers some protection from the potential cost of uneconomic expansions"

(*Id.* at pp. 4-5.)

E. FEA'S TESTIMONY

37. On August 24, 2016 the FEA filed the pre-filed testimony of Consultant Amanda M. Alderson (Exh. 31) According to Ms. Alderson, the FEA agreed and disagreed with the Company's Application in certain respects:

"1. Chesapeake's allocated cost of service study ("ACOSS") generally follows appropriate cost of service principles in determining the allocated cost to serve Chesapeake's customer classes. I support the Company's proposed production plant cost allocation on a peak design day method. I support the Company's proposed dual classification of distribution main costs on both a customer basis and a peak design day basis. I have no adjustments or corrections to the Company's ACOSS at this time.

2. I recommend a revenue spread across rate classes that is more consistent with the Company's ACOSS results. I agree with the Company's proposed cap of 1.5x and 2.0x the system average increase, but disagree with the proposal for a 0% increase for classes deserving of a rate decrease. I propose that these classes receive a 0.5x system average decrease. I also recommend the Residential Service-2 ("RS-2") class receive a 1.5x system average increase in line with the Company's gradualism cap instead of the 1.3x increase proposed by the Company, since the Company's ACOSS supports a 1.7x increase for this class. I make no further changes to the Company's proposed revenue increase for the remaining customer classes. The results of this revenue spread are more reflective of the Company's ACOSS results, and bring rate classes closer to cost of service than does the Company's proposed revenue spread.

3. I have no objection to the Company's general rate design for any class. I recommend the rate charges for all classes be set at levels that will recover the appropriate proposed revenue by rate class that I recommend in my testimony. To that end, I have provided

proposed tariff rate charges for the LVS and HLFS classes in my testimony.

5. I oppose the Company's proposed Revenue Normalization Adjustment for the General Service ("GS") class. The Company's own data shows that the revenue margin per customer in the GS class has not frequently fallen below the authorized level....

6. I propose the Company allow for consolidated billing for customers that meet the requirements. Where a customer has multiple service accounts all served by one distribution main, the customer should not be over-billed for the cost of that main. The costs to serve these customers should be properly reflected in the tariff rates billed to them. The Company's billing rates as they stand now collect excess revenue from these customers through the First Block usage charges. A consolidated billing customer should continue to pay appropriate Customer Charges for each meter to recover the full cost of the meters and individual service laterals. ..."

F. COMPANY'S REBUTTAL TESTIMONY

38. On September 30, 2016, the Company submitted the Rebuttal Testimony of Mr. Amen, Mr. Breakie, Mr. Dewey, Mr. Everngam, Ms. McVay, Mr. Moul, Mr. Taylor and Mr. Weiss. (Exhs. 33-40, respectively).

39. Although the Company accepted several of Staff's, the DPA's, and the Intervenors' proposed expense adjustments, their respective positions continued to differ regarding, among other things:

- a) The Company's proposed capital structure, as opposed to Staff's/DPA's proposed capital structure;
- b) the Company's proposed return on equity;
- c) the Company's proposed Service Offerings;
- d) Construction Work in Progress ("CWIP"); and
- e) Cost of Service Allocations.

G. TESTIMONY AT EVIDENTIARY HEARING REGARDING THE PROPOSED
SETTLEMENT AGREEMENT

40. Five (5) witnesses testified at the evidentiary hearing in favor of this unanimous Settlement Agreement, each testifying that the Agreement is in the public interest and should be adopted by the Commission: a) C. James Moore, the Company's Vice President; b) Jason R. Smith, Staff Public Utility Analyst; c) Andrea Maucher, DPA Public Utility Analyst; d) Andrew Lampert, DAAEP's President; and e) Amanda M. Alderson, FEA's Consultant.

41. New Rates, Rate Design, Cost of Service & Future Rate Studies: The Settling Parties have proposed that the Commission approve the proposed Settlement Agreement attached hereto as Exhibit "1." The Agreement is a "black box settlement," meaning that the Settling Parties have agreed to some terms in the Agreement, (for example, an increased revenue requirement of \$2.25 million, a return on equity of 9.75%, and the Company's actual cost of debt of 4.82% as filed), but have not stated other terms in the Agreement (for example, an agreed upon capital structure). (*Id.* at ¶16.) The Settling Parties have also agreed that, for the Company's regulatory accounting purposes and its Internal Rate of Return Model, the Company will utilize an overall rate of return of 7.53%. (*Id.*)

42. If approved, the Settlement would increase the customer charge to \$13.50 per month for both of the Company's

residential classes, RS-1¹³ and RS-2.¹⁴ (Exhibit 1, Settle. Agree. ¶17.) Currently, the customer charge is \$10.50 per month for the RS-1 Class and \$13.00 per month for the RS-2 Class. (Exh. 4) The monthly fixed charges for commercial customers would be as proposed in the Application. (Exhibit 1, Settle. Agree. (¶17.) The volumetric rates for all classes have been agreed upon "based on a compromise revenue allocation," another aspect of this black box settlement. (*Id.*; Exh. 1, Settle. Agreement, Exh. "A.") The new rates would be approved for service effective January 1, 2017. (*Id.*)

43. The Settling Parties have agreed that Chesapeake will conduct studies as to: a) whether having two (2) residential rate classes is necessary and appropriate; and b) whether phasing out declining block rates (in which the more natural gas a customer uses, the lower the average price) is necessary and appropriate. The results of both studies will be presented in the Company's next rate case. (Exhibit 1, Settle. Agree. ¶26)

44. Rate Refund: The parties agreed that the Company will refund amounts collected through Interim Rates in excess of the

¹³Rate Schedule RS-1: Residential Service, provides that: "This Rate Schedule is available to any individually metered Customer using gas in a residential dwelling or unit for space heating, cooking, water heating, or other domestic purpose with an annual consumption of two hundred and forty (240) Ccf or less." (Tenth Rev. Tariff Sheet No. 29, effective Feb. 19, 2016) (PSC Order No. 8848 (Jan. 19, 2016))

¹⁴Rate Schedule RS-2: Residential Service, provides that: "This Rate Schedule is available to any individually metered Customer using gas in a residential dwelling or unit for space heating, cooking, water heating, or other domestic purpose with an annual consumption of greater than two hundred and forty (240) Ccf." (First Rev. Tariff Sheet No. 29.2, effective Feb. 19, 2016) (PSC Order No. 8848 (Jan. 19, 2016))

\$2.25 Million revenue requirement agreed to in the Settlement Agreement. Refunds will be made based on each class' proportionate share of revenues collected through the Interim Rate increase. In addition, the Company will submit a refund plan to the Commission for its approval within thirty (30) days of the Commission approving this settlement. (Exhibit 1, Settle. Agree., ¶30)

45. As to the proposed new rates, the Settling Parties each testified that the Settlement resulted from a compromise of each party's original positions. (Tr.-138,149, 156-57; 170,176.) Chesapeake's Moore testified that the Company reduced its original revenue request from over \$4.7 million to \$2.25 million, and its original return on equity ("ROE") request from 11% to 9.75%. (Id.) Staff and the DPA compromised by increasing their respective offers regarding revenue and ROE from their initial positions. (Id.)

46. Staff's Smith testified that the agreed upon ROE was consistent with recent Commission decisions involving other public utilities. (Tr.-149.) For example, the most recently litigated utility rate case resulted in the Commission awarding a 9.75% ROE to Artesian Water Company. (PSC Order No. 8816, Jan. 19, 2016, ¶119.) The DPA's Maucher testified that the DPA agreed to the Settlement because the DPA believed that, if the case was litigated, it was unlikely that the Commission would reach a significantly different decision. (Tr. 156-57.)

47. As to the new monthly residential customer charge, the amounts were eventually agreed upon despite initial disagreement as to the proper amount. The DPA's Maucher testified that the DPA was seeking an even lower customer charge because "the Public Advocate believes it is inappropriate for a regulatory utility to attempt to recover ... [for] mains and corporate overhead, which are not directly related to connecting and maintaining a customer's account." (Tr.-158) The Company's Moore, on the other hand, testified that the parties' customer charge compromise, "at least gets us closer to our fixed customer related costs...." (Tr.-137)

48. The Settling Parties reached agreement on two of the Company's proposed Service Offerings: a) Multi-family Housing Program; and b) Temporary Gas Storage Tank Program. With respect to the Multi-Family Housing Program, the Settling Parties agreed that:

19. The Company may implement the Multi-family Housing Program for multi-family housing projects with four (4) or more units with the following modifications and clarifications relating to cost recovery. For cost recovery purposes, the Company agrees to limit its contribution toward the builder's gas infrastructure costs to 50% of the net present value of savings on a project-by-project basis, with an annual aggregate cap on contributions of \$250,000. The net present value of savings from a project is the maximum amount of investment that could be added to the cost of the project without rendering the project uneconomic under the Company's approved economic test for expansion projects. The Company will record its contribution toward the builder's gas infrastructure costs as a deferred cost and will amortize it as expense over thirty (30) years, with its rate of return applied to the unamortized portion.

49. As to the Temporary Gas Storage Tank Program, the Settling Parties agreed as follows:

22. The Company may implement the Temporary Gas Storage Tank Program with the following modifications to cost recovery. When the temporary service provided is propane service, the Company will not recover in rates the costs associated with the program incurred after twelve (12) months from the placement of the tanks. The Company may, however, petition the Commission for an extension of the twelve (12) month cost recovery period when the delay that causes construction to extend past twelve months occurs for reasons beyond the control of the Company. No such extension of time, however, will exceed six (6) months. Recoverable costs under the program include behind-the-meter¹⁵ conversion costs provided such costs are incurred within the time limits described herein. The Company will record its costs under this program as a deferred cost and will amortize it as expense over thirty (30) years, with its rate of return applied to the unamortized portion.

50. The Company's Moore testified that the Commission should approve these two (2) programs to increase the availability of lower-cost, lower-emission natural gas to new customers while protecting existing customers from subsidizing expansion. (Tr. 18-39.) DPA witness Maucher testified that she recommended approval of the revised Multi-Family Housing Program because it would help encourage customer growth without undue subsidization from existing customers. (Tr. 161-62). She also testified that she recommended approval of the Temporary Gas Storage Tank program as revised because the additional provisions protected existing customers and made the program truly a "temporary" one. (*Id.* 163). Although representing

¹⁵ "Behind the meter" means "customer-owned equipment and appliances." (NRC Internal Safety Culture Task Force, p. 3, Dec. 4, 2008)

propane suppliers, DAAEP's Lambert also testified that these two (2) offerings were in the public interest. (Tr. 169-70.)

51. Company's Withdrawal of Certain Service Offerings Proposed

In Application: The Company agreed to withdraw the following four (4) Service Offerings it proposed in this Application at this time: a) the Municipal Natural Gas Infrastructure Expansion Program, although the parties agreed to meet to discuss this Program in the future; b) the Poultry House Transportation Program; c) the Natural Gas Compression Service; and d) the Revenue Normalization proposal. (Exhibit 1, Settle. Agree., ¶¶ 21, 23, 20, 18, respectively.)

52. Deferred Accounting-CIS System. The Settling Parties also agreed upon Deferred Accounting for costs related to the set-up and implementation of new technologies, such as a new Customer Information System ("CIS"). Specifically, the parties agreed that "[t]he costs will be recorded in a regulatory asset account separate from any other new technology systems. The Company will amortize such costs over the same time period as the related asset or expected life of the technology beginning with the implementation of new rates in the Company's next base rate case. The Company will not earn a return on the unamortized deferred costs prior to the next rate case. Cost recovery for the deferred costs will only be allowed in a future rate case and is subject to reasonable review by the Commission Staff and the DPA during that proceeding." (Exhibit 1, Settle. Agree. ¶24)

53. Post-Retirement Benefits; Rate Case Expenses: According to the Settlement Agreement, "[t]he Company agrees to withdraw its request for deferral accounting treatment for Chesapeake's pension, deferred compensation and other post-retirement benefits but may file separately for an accounting order at a later date." (*Id.* at ¶25.) Finally, according to the Settlement Agreement, "[t]he Company may also separately request, as part of this docket or otherwise, an order regarding its accounting treatment of its rate case expenses." (*Id.*)

54. Agreed Upon Tariff Amendments-Curtailment: The parties have also agreed to Chesapeake's proposed tariff amendment changing its curtailment policy as to the rate Chesapeake pays a customer if Chesapeake diverts customer-owned gas for higher priority customers. (Exh. 1, Sheet 3, Red-lined Tariff) The parties have agreed upon the following language:

"In the event that Customer-owned gas is diverted for use by higher priority Customers, the Company will reimburse the Customer by paying the cost of the Customers alternative fuel or, if the Customer has no alternative fuel, reimbursement will be at a rate equal to the higher of the Company's weighted average cost of gas (the total cost of natural gas delivered to the Company for system supply divided by the volume delivered) or the Customer's total acquisition cost of gas (including pipeline transportation charges). In the event of a supply shortage which causes the Company to purchase the Customer's gas, the Customer shall make available a copy of its contract for natural gas supply upon request; or in lieu thereof, the Customer shall supply a sworn affidavit specifying Customer's total acquisition cost of gas." (Exh. 46, Third Rev. Tariff Sheet No. 3, §2.4; Red-lined Final Tariff)

55. Bill Due Date Tariff: The parties have agreed that the Company will extend the customer bill payment due date for all

rate classes from ten (10) days to twenty (20) days as the Company requested in its Application. (Exh. 46, Third Rev. Tariff Sheet No. 24, §13.4 & Rate Class Schedules; Red-lined Final Tariff)

56. Customer Deposit Tariff: Finally, the parties have also agreed that Chesapeake shall revise its tariff to replace the interest rate on customer deposits held more than ninety (90) days from 6% per annum to a Treasury-yield calculation. (Exh. 46, Third Rev. Tariff Sheet No. 23, §13.2, Red-lined Final Tariff)¹⁶

57. Finally, relating to FEA, the Settling Parties agreed in the Settlement Agreement as follows:

"29. The Company will consolidate the volumes and charge one customer charge for the three (3) meters serving FEA located east of Route 1, pursuant to Section 3.5(b) of the Rules and Regulations contained in the Company's tariff."

58. FEA's Consultant Amanda M. Alderson testified at the evidentiary hearing that the rates proposed in the Agreement were in the public interest:

"FEA proposed a decrease for larger customers in order to offset the ongoing subsidy that large customers have been providing to residential and smaller customers. Staff and DPA disagreed with certain cost of service methods used by the Company and produced their own cost of service study showing that large use customers were further below cost of service than residential and smaller use customers." (Tr.-175.)

¹⁶ Two (2) additional, notable Tariffs which the parties have agreed to include a Tariff incorporating the Company's Main Extension Economic Evaluation Requirements for New Residential Developments previously adopted by the Commission, and a Tariff increasing the number of customers who may utilize the Company's Budget Billing Plan. (Exh. 46, Fifth Rev. Sheet No. 12, §6.2 & Third Rev. Sheet No. 25 §13.5, respectively.)

59. According to Ms. Alderson, "Staff's cost of service indicated that all the major rate classes were not providing sufficient revenue to cover the full cost of service, and, therefore, no full subsidization was occurring. Based on its cost of service, Staff then proposed a 30 percent rate increase for large use customers on average and a 20 percent rate increase for residential and small use customers." (Tr. 175-76.)

60. Ms. Alderson further testified that "[t]he settlement spread of the required revenue increase is a compromise position and an acceptable middle ground between the parties' positions in this case. The residential classes combined will receive an approximate ten percent rate increase using the reduced revenue requirement proposed in the settlement, which is the middle ground between the Company's original proposed 13 percent increase and Staff's original proposed eight percent rate increase at the settlement revenue requirement." (Tr.-176)

61. Finally, Ms. Alderson testified that "[i]n addition, medium and large use customers will receive [a] nine percent revenue increase under the settlement on average, which represents a middle ground position between the Company's original proposed one percent increase, FEA's proposed four percent decrease and Staff's proposed 15 percent increase." (Tr. 176-77.)

V. Discussion

62. I incorporate Sections III, IV and V of this Report as my Findings of Fact.

63. Delaware law promotes settlements in utility rate cases. Section 512 of Delaware's Public Utilities Act directs the Commission to "encourage the resolution of matters brought before it through the use of stipulations and settlements." (26 *Del. C.* §512(a).) The Commission may, upon hearing, approve the resolution of matters by stipulations or settlements when the Commission finds such resolutions to be in the public interest. (*Id.* at §512(c).)

64. According to the United States Supreme Court, a public utility seeking a general rate increase is entitled to an opportunity to earn a fair rate of return on the value of its property dedicated to public service. *Bluefield Water Works and Improvement Co. v. Public Service Comm. of West Virginia*, 262 U.S. 679 (1923); *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

65. After considering the evidentiary record, I recommend that the Commission accept the Proposed Settlement in its entirety to resolve this Docket. I recommend that, from the record developed, the Commission should find, as required by 26 *Del. C.* §512(c), that the terms in the Proposed Settlement represent resolutions of the various issues which are "in the public interest."

66. The Commission should consider that the Settlement Agreement resulted after extensive pre-hearing investigation and the filing of voluminous pre-filed direct and rebuttal testimonies. The Settlement Agreement and the testimony is

"evidence" that its terms represent a reasonable resolution of each issue.

67. Moreover, the Commission can look to, and rely upon, the mutual conclusions of its Staff, the DPA, FEA, DAAEP and the Company - parties with disparate constituencies and positions - that the Settlement results in just and reasonable rates and is in the public interest.

**VI. RECOMMENDATIONS & PROPOSED COMMISSION ORDER APPROVING
SETTLEMENT AGREEMENT**

68. In summary, and for the reasons discussed above, I recommend that the Commission hold that the proposed Settlement Agreement is in the public interest because it results in just and reasonable rates, consistent with the Commission's traditional rate-making analysis and is in the public interest.

69. I also recommend that, as requested in the Settlement, the new rates shall take effect on January 1, 2017. A proposed Order for the Commission's consideration is attached hereto as Exhibit "2."

Respectfully Submitted,

DATED: December 5, 2016

Mark Lawrence
Senior Hearing Examiner

E X H I B I T "1"