BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF CHESAPEAKE UTILITIES CORPORATION FOR APPROVAL OF A CHANGE IN ITS GAS SALES SERVICE RATES ("GSR") TO BE EFFECTIVE NOVEMBER 1, 2010 (FILED SEPTEMBER 1, 2009)	))))))	PSC DOCKET NO. 10-296F

ORDER NO. 7974

AND NOW, this 7th day of June, 2011;

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

AND WHEREAS, the Hearing Examiner recommends that the Gas Sales Service Rates ("GSR") proposed by Chesapeake Utilities Corporation in its September 1, 2010 Application be approved as just and reasonable for service rendered on and after November 1, 2010;

AND WHEREAS, the Hearing Examiner recommends that the Proposed Settlement Agreement dated May 12, 2011, which is endorsed by all the parties, and which is attached to the original hereof as Attachment "B", be approved as reasonable and in the public interest;

NOW, THEREFORE, IT IS HEREBY ORDERED BY THE AFFIRMATIVE VOTE OF NO FEWER THAN THREE COMMISSIONERS:

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the May

23, 2011 Findings and Recommendations of the Hearing Examiner, appended to the original hereof as Attachment "A."

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

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

Service	Effective for Service Rendered On and After November 1, 2010
RS-1, RS-2, GS, MVS, LVS	$1.035
GLR, GLO	$0.668
HLFS	$0.863
Firm Balancing Rate (LVS)	$0.054
Firm Balancing Rate (HLFS)	$0.010
Interruptible Balancing Rate (ITS)	$0.001

4. That all Tariff revisions filed by the Company with this Commission on October 21, 2010, and the revised rates and charges contained therein are approved, and shall be effective on a permanent basis for gas service rendered on or after November 1, 2010, until further Order of the Commission. No later than two (2) business days from the date of this Order, the Company shall file revised Tariffs which comply with this Order.

5. 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:

/s/ Arnetta McRae
Chair

/s/ Joann T. Conaway
Commissioner

/s/ Jaymes B. Lester
Commissioner

/s/ Dallas Winslow
Commissioner

/s/ Jeffrey J. Clark
Commissioner

ATTEST:

/s/ Alisa Carrow Bentley
Secretary

ATTACHMENT "A"

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FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATE: May 23, 2011

MARK LAWRENCE
HEARING EXAMINER

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

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FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

Mark Lawrence, duly appointed Hearing Examiner in this Docket, pursuant to 26 *Del. C.* §502 and 29 *Del. C. Ch.* 101, and by Commission Order No. 7849 dated September 21, 2010, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, Chesapeake Utilities Corporation Delaware Division ("Chesapeake" or "Company"):
Parkowski, Guerke & Swayze, P.A.,
BY: WILLIAM A. DENMAN, ESQUIRE
Jennifer A. Clausius, Manager of Pricing & Regulation
Marie E. Kozel, Gas Supply Analyst
Sarah E. Hardy, Regulatory Analyst

On behalf of the Public Service Commission Staff ("Staff"):
BY: REGINA A. IORII, ESQUIRE, Deputy Attorney General
Funmi I. Jegede, Public Utilities Analyst
Richard W. LeLash, Consultant

On behalf of the Division of the Public Advocate ("DPA"):
MICHAEL D. SHEEHY, THE PUBLIC ADVOCATE
Andrea C. Crane, The Columbia Group, Inc., Consultant

On behalf of the Delaware Attorney General
KENT WALKER, ESQ., Deputy Attorney General

II. BACKGROUND

A. APPLICATION

1. On September 1, 2010, Chesapeake applied to the Delaware Public Service Commission ("Commission") for approval of changes to its Gas Sales Service Rates ("GSR") to become effective for gas service provided from November 1, 2010 through October 31, 2011.[1] (*See* Company's Application, Exhibit 3.) The GSR rates are the component of a customer's bill which reflects the costs the Company expects to incur to purchase the supply of natural gas needed to serve its customers.

2. The proposed rates, as compared to the rates in effect since November 1, 2009, are as follows:

Service Classification	**Effective 11/01/09 (approved)**	**Effective 11/01/10 (proposed)**
RS-1, RS-2, GS, MVS, LVS	$0.956	$1.035
GLR, GLO	$0.645	$0.668
HLFS	$0.797	$0.863
Firm Balancing Rate (LVS)	$0.056	$0.054
Firm Balancing Rate (HLFS)	$0.007	$0.010
Interruptible Balancing Rate (ITS)	$0.002	$0.001

3. According to Chesapeake, under the proposed rates, an average RS-2 residential heating customer using 700 Ccf of gas per year would experience an increase of $4.50 (or 5%) in average monthly billings when compared with the rate in effect prior to November 1, 2010. (*See* Company's Application, Exhibit 3, §3.) During the winter

[1] Chesapeake's Tariff No. 42 requires the Company to file an annual Gas Sales Service Rates ("GSR') Application sixty (60) days prior to November 1st of each year. Thus, Chesapeake's Application was timely filed.

season, an RS-2 customer using 110 Ccf of gas would experience an increase of $8.50 (or 6%) per winter month. (*Id.*) An RS-2 customer using 120 Ccf of gas would experience an increase of $9.50 (or 6%) per winter month. (*Id.*) As described later herein, in its Application, the Company also sought to increase the HLFS Firm Balancing Rate and decrease the LVS Firm Balancing Rate(LVS) and Interruptible Balancing Rates.(*Id.* at §2.)

4. Pursuant to 26 *Del. C.* §§304 and 306, the Commission, by PSC Order No. 7849 (September 21, 2010), permitted the above proposed rate changes to go into effect on November 1, 2010, on a temporary basis subject to refund, pending full evidentiary hearings. In PSC Order No. 7849, the Commission also designated this Hearing Examiner to conduct hearings and report to the Commission with his proposed Findings and Recommendations based on the evidence presented.

5. On January 24, 2011, on behalf of the Division of Public Advocate, the Delaware Attorney General filed a Motion to Intervene in this Docket, as permitted by 29 *Del. C.* §8716(g). On January 25, 2011, by PSC Order No. 7905, the Delaware Attorney General was permitted to intervene.

B. PUBLIC COMMENT HEARING

6. A duly-noticed[2] Public Comment Hearing concerning the Company's Application was held at the Commission's office in Dover on Tuesday, February 22, 2011 at 7:00 p.m. No members of the public

[2] The Affidavits of Publication of the Notices of the Public Comment Hearing and the Evidentiary Hearing from the *Delaware State News* and *The News Journal* newspapers are included in the record as composite Exhibit 1. The Evidentiary Hearing Exhibits will be cited as "Exh.__" and references to the hearing transcript will be cited as "T.-page#." Schedules from the Company's Application will be cited as "Sch."

attended.

III. SUMMARY OF THE EVIDENCE

A. EVIDENTIARY HEARING

7. The Commission has jurisdiction in this matter pursuant to 26 *Del. C.* §§§303(b), 304 and 306.

8. The evidentiary hearing was held on Thursday, May 12, 2011 beginning at 10 a.m. The record, as developed at the evidentiary hearing, consists of a verbatim transcript of forty-two (42) pages and twelve (12) hearing exhibits. The parties stipulated to the admissibility of all hearing exhibits. (Tr. 21-22.)

B. CHESAPEAKE'S DIRECT TESTIMONY

9. Along with its Application, the Company filed the direct testimonies of Jennifer Clausius, Manager of Pricing and Regulation (Exh.4), Marie E. Kozel, Gas Supply Analyst (Exh.6) and Sarah E. Hardy, Regulatory Analyst. (Exh.7)

10. **Direct Testimony of Jennifer A. Clausius.** The GSR Rates. Jennifer A. Clausius, Chesapeake's Manager of Pricing and Regulation, submitted pre-filed direct testimony dated September 1, 2010. (Exh. 4) Ms. Clausius' testimony first addressed the Company's calculation of the proposed GSR and balancing rates contained in the Company's Application. (Exh.4, p.3 LL 20-23 – p.4 LL 1-3.) The proposed GSR and balancing rates would be effective for the twelve-month period of November 1, 2010 through October 31, 2011. (*Id.* at p.3 LL 20-23) These rates are based upon projected sales data and gas costs for the same twelve (12) month period. (*Id.* at p.6 LL 11-13; Sch. A.1.)

11. According to the Company, the proposed increase in GSR

rates during 2010-11 reflects an anticipated increase of $1,280,161 in fixed gas costs since the Company's GSR last changed on November 1, 2009.(Clausius, Exh.4, p.7, LL 12-14) This projected increase of 12.9% in fixed costs is primarily attributable to the cost of the Company's increased daily firm transportation entitlements on upstream pipelines: the Transcontinental Gas Pipeline ("Transco"), the Columbia Gas Transmission Pipeline ("Columbia"), the Columbia Gulf Transmission Company ("Columbia Gulf"), and the pipeline owned and operated by Eastern Shore Natural Gas Company ("ESNG"), the Company's subsidiary.[3] (*Id.* at LL 14-16, p.21 at LL 3-6; Kozel, Exh. 6, p.4, LL 9-14; Crane, Exh.11, p.10 L 16)

12. During this GSR period, in addition to the anticipated increase in fixed gas costs, the Company also projects an 11% decline in sales volume from 45,209,210 Ccf to 40,229,580 Ccf. (Clausius, Exh.4, Sch. E.) According to Ms. Clausius, this projected increase in fixed gas costs, coupled with declining sales volume, will be somewhat offset by an anticipated $2,134,794 decrease (6.33%)in the Company's variable or commodity gas cost. (Clausius, Exh. 4, p.7, LL 6-7 & Sch. E; Crane, Exh. 11, p.10 LL 14-16) According to Ms. Clausius, this decrease in the Company's variable gas cost primarily resulted from a reduction in the projected cost of flowing commodity gas for the

[3] According to Staff Consultant Richard LeLash,"…[t]he Company's physical distribution system on the Delmarva Peninsula constrains its operation and procurement." (LeLash, Exh.9, p.5, LL 8-10) DPA Consultant Andrea Crane testified that because the Company "is not directly connected to any pipeline except for its affiliate ESNG," …"in order to access natural gas …[the Company] generally has had to acquire capacity on two pipelines, ESNG and an upstream pipeline, to transport gas to its service territory."(Crane, Exh.11, p.11, LL 13-17). "45% of the Company's total gas costs...are fixed costs which the Company must incur, and ratepayers must pay, regardless of sales." (*Id.*at p.19 LL 14-15.) "25% of all costs included in the GSR are costs paid to an affiliate [ESNG] that will not vary with usage." (*Id.* at LL 16-17.)

upcoming year as compared to the flowing commodity gas costs included in the previous GSR filing. (Clausius, Exh.4, p.7, at LL 7-11.) However, despite the decrease in the variable gas cost, the Company's current filing reflects an increased average cost of $1.018 per Ccf, compared to the Company's 2009-10 average cost of only $0.0925 per Ccf.[4] (*Id.* at LL 19-21.)

13. The projected gas costs in this GSR docket are the same gas costs used to calculate transportation balancing rates. (*Id.* at p.23 LL 22-23 – p.24 LL 1-2.) In its Application, the Company seeks to increase the HLFS Firm Balancing Rate, but decrease the LVS Firm Balancing Rate, and Interruptible Balancing rates. (*See* Company's Application, Exh. 3, §2.) A comprehensive discussion of the calculation of the Company's balancing and interruptible rates is beyond the scope of this Report but can be found on pages 27 though 30 of Ms. Clausius' direct testimony. (*See* Exh.4.)

14. <u>Revenue Margin Sharing</u>. Ms. Clausius also testified regarding the Company's revenue margin sharing requirements. (Exh.4, pp. 11-13 & Sch. D-2) Shared margins include margins with different thresholds at which sharing begins, which the Company receives from: a) interruptible transportation service, b) off-system sales; and c) capacity releases. (*Id.* at p.11, LL 15-18.)

15. As to a)above, "the Company is permitted to retain 100% of

[4] Ms. Clausius testified that there are three (3) steps involved in calculating the proposed GSR rates for the three (3) GSR categories: 1) develop the sales and associated gas supply requirements forecast; 2) forecast supplier rates and calculate annual purchased gas costs associated with serving customers; and 3) a calculation of the three (3) separate GSR charges: a fixed rate, a commodity rate and a system average rate. (Exh.4,pp. 8-9.) The remainder of this third step and an extensive description of how the subject GSR rates were calculated can be found on pages 9 through 11 of Ms. Clausius' pre-filed direct testimony. (*See* Exh. 4.)

all margins received from interruptible transportation customers up to $675,000 per year and 10% of all interruptible transportation margins exceeding $675,000 per year. (*Id.* at p.12, LL 3-9.) According to Ms. Clausius, "the Company is not projected to reach the sharing threshold for interruptible transportation margins in this twelve month determination period." (*Id.* at LL 9-12 & Sch. A.2.) As to b) above, the Company does not project any off-system sales for this GSR period. (*Id.* at LL 15-16.)

16. As to c) above, capacity releases, effective November 1, 2009, in the gas sales rates ("GSR"), the Company was required to credit 90% of the capacity release credits received from its Asset Manager to Delaware ratepayers, with 10% being credited to the Company. (*Id.* at p.12, LL 1-3.) In this GSR period, the Company projects a total of $466,764 of these capacity release credits, with 90% or $420,088 being credited to the ratepayers. (Clausius, Exh. 4, Sch. A.2.)

17. Regarding capacity releases from its subsidiary ESNG to the Delaware Division transportation customers, the Company continues to credit 100% to the Delaware firm sales customers. (Clausius, Exh.4, p.12 LL 18-23 – p.13 LL 1-10.) In calendar year 2010, the Company received $1,782,899 of these capacity release credits. (Crane, Exh.11, p.19, LL 17-19.)

18. <u>Future TETCO Capacity.</u> After an open season held in November, 2009, the Company executed a Precedent Agreement with Spectra Energy for capacity on Spectra's Texas Eastern Transmission, LP ("TETCO") pipeline. (Kozel, Exh. 6, p.6, LL 12-22.) The Precedent

Agreement, for capacity which is not planned to be effective until November 2012, is for 30,000 Dts or approximately 16% of the total project capacity. (*Id.*; Clausius, Exh.5, p.17 LL 15-18) Between now and November 2012, the Company and Spectra Energy have entered into an Interim Agreement for interim capacity. (*Id.* at LL 16-20.)

19. TETCO supplies natural gas originating from the Rocky Mountains and the Marcellus Shale. (Kozel, Exh.6, p.6 LL 12-22 & at p.7 LL 3-5.) Hence, TETCO is one of the Company's supply sources "other than primarily from the Gulf of Mexico," thereby diversifying the Company's supply sources for a design day and otherwise.[5] (*Id.* at p.6, LL 22 – p.7 LL 1-5.) Since the TETCO line did not directly interconnect with the ESNG transmission line, the Company executed a precedent agreement with ESNG to extend its transmission facilities to a point near Honeybrook, Pennsylvania where it would interconnect with the TETCO line. (Kozel, Exh. 6, LL 5-11.)

20. The Delaware PSC had formally intervened in a FERC action involving the ESNG extension. This proceeding was to determine whether the ESNG could construct an eight (8) mile extension and a new interconnect in Pennsylvania connecting the TETCO and the ESNG pipelines for transportation to Delaware via the ESNG pipeline.[6] (Kozel, Exh.6, p.7, LL 5-11; Jegede, Exh.8, p.20 LL 15-21 – p.21 LL 1-7.) It is likely that 75% of this $19.5 million construction cost

[5] "The design day requirement is the gas that the Company projects its customers would utilize under extremely cold conditions." (Crane, Exh.11, p.16, LL 15-17) Currently, the Company provides 77,093 Dth of daily deliverability which is approximately 111% of its design day requirement. (LeLash, Exh.9, p.10 LL 15-17.) For an in-depth discussion of the design day requirement, see page 14 of the Company's Rebuttal testimony. (Exh.5, Clausius Rebuttal)

[6] "FERC" is the Federal Energy Regulatory Commission which regulates, among other things, the interstate transmission of natural gas. *See* FERC Docket No. CP10-75-000 regarding documents filed in the ESNG docket.

would have been allocated to Delaware ratepayers if the project had not come to fruition. (Crane, Exh.11, p.21 LL 17-19.) This issue is discussed in further detail in the Direct, Rebuttal and Settlement sections of this Report.

21. Eastern Sussex County Capacity Charges. According to Ms. Clausius, "[the Company previously] agreed to specify the amount of capacity charges for delivery points in eastern Sussex County, Delaware that the Company is seeking to recover in its GSR rates." (Clausius, Exh.4, p.31, LL 12-14.) Effective November 1, 2010, the Company will have 5,363 Dt of firm transportation entitlements at delivery points located in eastern Sussex County on the ESNG Pipeline at the total annual cost of $1,115,540. (*Id*. at LL 19-22.) The Company provided to Staff and the DPA a schedule detailing customer and Mcf sales data for actual and forecasted sales in eastern Sussex County.[7] (LeLash, Exh.9, Sch.6)

22. Eastern Shore Natural Gas - "E3 Project." In this GSR proceeding, the Company also seeks reimbursement of $190,572 of the Pre-Certification costs incurred by the Company for the Eastern Shore Energylink Expansion Project.[8] ("the E3 Project")(Clausius, Exh. 4,

[7] The parties debated whether or not the Company's forecasts of residential and commercial customer growth for the eastern Sussex County area have been "overly optimistic" in recent years. (*See,e.g.,*Clausius Rebuttal, Exh.5, pp. 13-16 vs. LeLash, Exh.9, pp. 26-27.) The Company purchased approximately $1.15 million of firm transportation entitlements through July, 2010 at delivery points for this area. (Crane, Exh.11, p.18 LL 18-20 – p.19 LL 1-3) This issue was settled by the parties as described in Section IV of this Report.

[8] In PSC Order No. 7837 (Sept. 7, 2010), the Commission authorized the reimbursement of $306,300 to the Company consisting of $112,847 for E3 project costs incurring during the twelve (12) month GSR period ending October 31, 2009, plus $193,453 for costs incurred during the subsequent 12 month period ending October 31, 2010. (*Id.*at Exh. B-Settlement Agree. §6 & HE's Report §13.) In this docket, the Company has included in the GSR costs of $188,891 for the year ending October 31, 2010 and $190,572 for the year ending October 31, 2011. (Crane, Exh.11, p.29 LL 3-8) By virtue of the parties'

p.35, LL 17-19 & Sch. B.) The E3 project, a natural gas pipeline project, was terminated by Eastern Shore Natural Gas ("ESNG"), a Chesapeake subsidiary. (*Id.* at p.35, LL 15-19 & at p.36, LL 14-19.)

23. The Pre-Certification costs among all E3 project participants totaled approximately $3.1 million, of which Chesapeake's Delaware Division's apportioned share was originally $1,149,999. (*See* PSC Order No. 7837 (Sept. 7, 2010-HE's Report §13; FERC's August 1, 2006 Order, §5.) Pre-certification costs are defined as "engineering, communication, governmental relations, economic studies and environmental, regulatory and legal service costs." (*See* FERC's August 1, 2006 Order, §5.)

24. The E3 project would have provided Chesapeake with a second natural gas pipeline to serve residents of the Delmarva Peninsula. (*See* PSC Order No. 7837 (Sept. 7, 2010) HE's Report §14.) ESNG intended to construct a sixty-three (63) mile natural gas supply pipeline from the Cove Point LNG facility in Calvert County, Maryland to the Delmarva Peninsula. (Clausius, Exh.4, p.35 LL 21-23 – p.36 LL 1-5) The pipeline would have been placed beneath the Chesapeake Bay. (*Id.*)

25. The E3 project would have reduced the Company's dependence on the Transco and Columbia Gas Transmission pipelines, while assisting Chesapeake in satisfying its design day requirement.[9] (*See* PSC Order No. 7837 (Sept. 7, 2010), HE's Report §14.) However, in May

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Settlement Agreement, the parties have agreed that these E3 Project costs should be included in the GSR.

[9] In this docket, the Company informed the Commission that it had recently added upstream capacity on two (2) additional pipelines: the Columbia Gulf Transmission pipeline and the Texas Eastern Transmission, LP i.e. "TETCO" pipeline. (*See* Paragraphs 11, 18-20, *supra*.) Downstream capacity is via the pipeline owned by the Company's subsidiary, ESNG. (Crane, Exh.11, p.18 LL 4-5)

2009, ESNG terminated the E3 project due to insufficient customer commitments and projected capital increases, concluding that the project was not viable during the current economic downturn. (*Id.*)

26. To reduce the amount of interest charges which the ratepayers would pay, the Settlement Agreement in the Company's prior GSR rate case required the Company to seek FERC approval to shorten the cost recovery period from twenty (20) years to no more than five (5) years. (Clausius, Exh.4, p.37 LL 11-19) Effective March 1, 2011, FERC held that the E3 Project's participants including the Company are required to recover the pre-certification costs within a five (5) year cost recovery period. (*See* FERC's February 14, 2011 Order, §1.)

27. Now that FERC has ordered a five (5) year cost recovery period, the ratepayers will save a substantial amount of interest charges beginning March 1, 2011. (Clausius Rebuttal, Exh.5, p.5 LL 15-18) Through February 2016, the GSR will reflect this amortization of the E3 costs, net of tax deferred benefits. (*Id.* at p.40 LL 7-19.)

28. **Testimony of Marie E. Kozel**. The Company also pre-filed the testimony of Gas Supply Analyst, Marie E. Kozel. In addition to testifying as to the Company's daily firm transportation commitments discussed previously herein, Ms. Kozel also testified as to Chesapeake's gas storage activities. (Exh.6, pp. 8-9.)

29. Gas Storage. To meet its customers' winter gas needs, the Company has six (6) storage sources. (*Id*. at p.8, LL 1-6.) In addition to three (3) sources which the Company itself manages, the Company's Asset Manager directs three (3) additional sources on behalf of the Company. (*Id*.)

30. In April 2009, the Company transferred its entire gas inventory to an Asset Manager.[10] (*Id.* at p.8, LL 9-11.) Pursuant to the parties' Agreement, the Company has the right to receive gas upon demand. (*Id.* at LL 11-13.) The Company specifies the amount of gas to be injected or withdrawn. (*Id.* at L 14.) However, subject to the Company's storage and tariff limitations, in its discretion, the Asset Manager retains the right to withdraw and inject gas. (*Id.* at LL 16-19.) Each month, the Asset Manager reconciles the paper balance for each storage service it manages. (*Id.* at LL 19-20.)

31. Ms. Kozel testified that the three (3) storage services currently used by the Company's Asset Manager are: Eminence Storage Service ("ESS"), Washington Storage Service ("WSS") and Firm Storage Service ("FSS"). (Exh.6, p.8, LL 5-9.) Except for FSS, these storage services are "base loaded" as firm, fixed sources for injection and withdrawal. (*Id.* at LL 19-22; p.9 LL 1-10.)

32. According to Ms. Kozel, the Company manages three (3) storage services on the ESNG pipeline, including General Storage Service ("GSS"), Leidy Storage Service ("LSS"), and Liquefied Natural Gas Storage Service ("LGA"). (*Id.* at p.9, LL 11-13.) The Company cannot base-load withdrawals or injections for any of these storage services. (*Id.*) GSS provides year-around swing storage while LSS and LGA are seasonal storage facilities permitting injections from April

[10] Effective March 31, 2009, the Company executed a three (3) year contract with an Asset Manager. (Kozel, Exh.6, p.13, LL 3-4). In addition to managing the Company's gas storage, the Company's Asset Manager provides capacity management, supply and dispatch scheduling on upstream pipelines, firm and interruptible gas supply, balancing of supply resources, and performs a monthly accounting of these matters. (*Id.* at LL 4-8) The Company's subsidiary ESNG does not offer storage or peaking supply. (LeLash, Exh.9, p.5 LL 12-14) The parties settled issues related to the Company's Asset Manager, as described in Section IV of this Report.

through October, and withdrawals from November through March. (*Id.* at LL 14-18.)

33. According to Ms. Kozel, by entering into fixed prices prior to the winter, the Company attempts to minimize its exposure to the fluctuating winter gas market. (*Id.* at p.10, LL 6-10.) However, to ensure gas supply for its customers, the Company also makes spot purchases and uses short-term purchase agreements. (*Id.* at LL 1-10.) Some spot supply is required to satisfy varying demand, and also to comply with pipeline tariffs. (*Id.* at LL 12-15.) For its design day requirements, the Company will: 1) obtain rights to call in excess of its Transco and Columbia entitlements; and 2) continue to maintain "no requirements" contracts with several suppliers. (*Id*. at p.14, LL 6-13.)

34. The Company's Natural Gas Commodity Procurement Plan. Ms. Kozel also testified as to the Company's Natural Gas Commodity Procurement Plan ("the Plan").[11] (Exh.6) The Plan specifies when physical gas hedges will be placed.[12] (Crane, Exh.11, p.26 LL 13-15) According to Ms. Kozel, the Plan's purpose is to limit the Company's exposure to price fluctuations in the natural gas market. (Kozel, Exh.6, p.11, LL 17-20.)

35. Ms. Kozel testified that the Plan permits the Company to hedge 70% of its firm supply requirements over a twelve-month period

[11] The Plan became effective on or about July 12, 2007. Prior to its current requirements, the Plan was modified on a short-term basis in December, 2008 and again in November, 2009. (Kozel, Exh.6, p.10 L 22 – p.11 LL 1-8).

[12] "Hedging" in this context is when the Company enters into a transaction which fixes some of its future gas needs at a defined, set price. (Kozel, Exh. 6,p.10 LL 17-22.) A hedge is essentially a forward purchase which locks in gas prices over an extended period. (*Id.*)

prior to delivery. (*Id.* at p.11, LL 20-22 – p.12 LL 1-2.) The remaining volumes are purchased at market price. (*Id.*) Thus, "the Plan contemplates that 50% of the Company's firm supply requirements will effectively be hedged prior to the month of delivery." (Crane, Exh.11, p.26 LL 10-12)

36. Hedging. Additional Requirements. According to Ms. Kozel, by PSC Order No. 7837 (September 7, 2010), the Commission "established [the current] thresholds for increases or decreases in the hedged volumes depending on changes in natural gas prices, including a true-up provision for any shortfall."[13] (*Id.* at p.12, LL 2-7; *see* Order No. 7837, §8.) If the Company seeks to exceed the 70% of the eligible portfolio threshold, the Company must obtain prior approval of Staff and the DPA. (Crane, Exh.11, p.27 LL 15-18) If purchase quantities are otherwise modified outside of these parameters, the Company must notify the Commission Staff and the Public Advocate within five (5) business days. (Kozel, Exh.6, at p.12 LL 8-11.)

37. Finally, in PSC Order No. 7837 dated September 7, 2010, "the Company agreed to modify the quantity hedged to be firm requirements less storage withdrawals plus storage injections." (*Id.* at LL 11-13; *see* Order §8.) The Company agreed that this would be

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[13] In Exhibit "A" of the Settlement Agreement incorporated into PSC Order No. 7837, the parties agreed upon the following four (4) hedging thresholds for increases and decreases in hedged volumes depending on changes in natural gas prices, including true-up: 1) if prices for a given month rise above 125% of the weighted average cost of gas from the most recent GSR filing, purchases will decrease to 75% of the original projected amount; 2)if prices for a given month rise 150% of the weighted average cost of gas from the most recent GSR filing, purchases will decrease to 50% of the original projected amount; 3)if prices for a given month fall below 25% of the weighted average cost of gas from the most recent GSR filing, purchases will increase to 125% of the original projected amount; and 4) if prices for a given month fall below 50% of the weighted average cost of gas from the most recent GSR filing, purchases will increase to 150% of the original projected amount. (*See* PSC Order No. 7837, Settlement Agree., §8.)

implemented over a period of two (2) years, at which time the Plan will be reviewed again. (*Id.* at LL 13-15.) In addition to its Quarterly hedging reports, the Company submits to the Commission a confidential Annual Report regarding hedging. (Clausius, Exh.4, p.31, LL 8-12; Crane Exh.11, p.26 LL 15-16.)

38. <u>**Testimony of Sarah E. Hardy**. Budget Billing.</u> Finally, the Company filed the testimony of Regulatory Analyst Sarah E. Hardy. (Exh.7) Ms. Hardy testified about the Company's budget billing program. (*Id.* at p.4, LL 10-11.) This program currently allows the Company's customers to pay predictable monthly payments from September through May to help avoid receiving large winter gas bills which they may have trouble paying. (*Id.* at LL 11-14.) The Company informed its customers about the budget billing program in the May, June, July and August, 2010 bills. (*Id.* at LL 14-18.)

C. STAFF'S DIRECT TESTIMONY.

39. <u>**Testimony of Funmi I. Jegede**. The GSR Rates.</u> Public Utilities Analyst Funmi I. Jegede filed testimony dated March 11, 2011. (Exh.8) Ms. Jegede first reviewed the accuracy of the Company's proposed GSR and balancing rates, and recommended Commission approval of those rates. (*Id.* at p.11 LL 15-22 – p.12 LL 1-4; p.4 LL 9-11.)

40. According to Ms. Jegede, the Company's proposed GSR rates reflect that the Company's commodity gas costs have substantially decreased. (*Id.* at p.7, LL 8-20.) Although the Company's fixed costs attributed to increased daily firm transportation entitlements have increased, there remains an overall $854,635 decrease (or $0.093 per Ccf) in total projected system firm gas costs used to develop the GSR

rates for this determination period. (*Id.*)

41. TETCO Interim & Future Capacity. For this GSR period, the Company has included $770,400 for reimbursement of the TETCO capacity costs. (Jegede, Exh.8, p.19 LL 5-8 *citing* Clausius, Exh.4, Sch. C.2, p.1.) The Company's Precedent Agreement to obtain capacity from Spectra Energy's TETCO pipeline originating from the Rocky Mountains will not become effective until November 2012. (Kozel, Exh.6, p.6, LL 12-22; p.7 LL 3-5.) The Precedent Agreement required the construction of a pipeline interconnect which is discussed next.

42. TETCO Pipeline Interconnect & FERC Action. According to Ms. Jegede, the Commission has formally intervened in the FERC action addressing whether the Company could construct an eight (8) mile main extension and a new interconnect in Pennsylvania, connecting the ESNG and TETCO pipelines.[14] (Jegede, Exh.8, p.20 LL 15-21 – p.21 LL 1-7; Kozel, Exh.6, p.7, LL 5-11.) Approximately 75% of this cost will be utilized by and allocated to Delaware ratepayers. (Crane, Exh.11, p.21 LL 17-19.)

43. In another FERC action, FERC was faced with ESNG's proposed 19% increase in its revenue requirement to pay for the TETCO project, and whether ESNG had established the reasonableness of its cost allocation and rate design.[15] (Jegede, Exh.8, p.21 LL 14-17) In January 31, 2011, FERC accepted ESNG's filing, but suspended ESNG's proposed cost allocation and rate design pending further hearings. (*See* FERC's Order dated Jan. 31, 2011, §11.) A Settlement Judge was also

[14] *See* FERC Docket No. CP10-75-000 regarding documents filed in the ESNG docket addressing whether ESNG could build the line which the Company contracted for.
[15] *See* FERC Docket No. RP11-1670, ESNG's base rate case.

appointed. (*Id.* at §15.) Confidential settlement discussions are current taking place. (T-30) Thus, this proceeding is still pending. (*Id.*)

44. TETCO Capacity vs. Bundled Peaking Supply. Moreover, Staff sought a cost comparison between the TETCO and ESNG capacity and the cost of traditional bundled peaking supply.[16] (Jegede, Exh. 8, p.20, LL 8-12.) The Company provided a cost comparison in its Rebuttal testimony which is discussed in section 3(E) of this Report.

45. Gas Supply Plan. In order for Staff to more quickly and accurately track the Company's capacity commitments, Staff's Ms. Jegede recommended that the Company should be required to file its Gas Supply Plan annually, as opposed to bi-annually. (Jegede, Exh.8, p.18 LL 11-13.) Finally, Ms. Jegede made a number of other recommendations which were also raised by Staff's Consultant, Richard W. LeLash, whose testimony is discussed next.

46. **Testimony of Richard W. LeLash.** Staff's Consultant Richard W. LeLash filed testimony dated March 11, 2011.[17] (Exh.9) Mr. LeLash's testimony primarily addressed the Company's gas supply, gas costs and gas purchasing practices. (*Id.* at p.3 LL 5-9.) However, some background about the Company's operation and the natural gas industry is first necessary.

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[16] Currently, the Company's Delaware and Maryland ratepayers are the only subscribers for the TETCO capacity. According to Mr. LeLash's direct testimony, "it is unclear whether…capacity will be used by the [other ESNG] divisions…."(LeLash, Exh.9, p.23 LL 4-7.)

[17] Staff filed both Public and Confidential versions of Mr. LeLash's testimony. At the evidentiary hearing, the Public version was marked as Exhibit 9 and the Confidential version was marked as Exhibit 10. This Report refers to the Public version to avoid disclosing confidential commercial and financial information. (LeLash, Exh.9, p.29 LL 11-13) The Company has agreed "to make a good faith effort [in the future] to be more selective in terms of what data and information is designated as confidential." (*See* Settlement Agreement, Exh.2,§9.,*see also* T-36-37)

47. Company's Operation & Industry Background. Although it accesses other pipelines, 100% of the Company's natural gas eventually flows through the interstate pipeline owned by the Company's subsidiary, ESNG. (*Id.* at p.5 LL 10-12.) ESNG does not offer storage or peaking supply. (*Id.* at LL 12-14.) Chesapeake serves approximately 40,000 customers, of which 91.5% are residential. (Crane, Exh.11, p.8 LL 8-9.) Although the Company has experienced "one of the highest growth levels in the country [among natural gas companies since 2000]," recent demand has considerably slowed primarily due to the recession.[18] (LeLash, Exh.9, p.5 LL 16-21 – p.6 LL 1-2)

48. According to Mr. LeLash, natural gas sales prices on the Henry Hub index[19] fluctuated from an average of $11.32 per Dth in mid-2008 to an average of only $4.38 DTH in 2010. (*Id.* at p.6, LL 9-11.) Between January and November 2010, index prices decreased 43%. (*Id.* at p.24 LL 18-21 – p.25 LL 1-2 & Sch. 7.) On the other hand, between November 2010 and January 2011, index prices increased 28%. (*Id.*)

49. While the recession and some milder winters may have "dampened" natural gas prices, gas supply from the Rockies Express ("REX") pipeline and the Marcellus Shale Formation in the Appalachian Basin has increased by about two (2) Billion Cubic Feet (BCF) per day.[20] (*Id.* at p.6 LL 15-21 – p.7 LL 1-13.)

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[18] The DPA's Consultant Andrea C. Crane testified that, from 2000 until 2009, the Company's Delaware Division grew by 7.3% *per year*, while the national average was only 2-3%. However, the Company's residential growth decreased from 8.6% in 2007 to 6.1% in 2008, to only 2.7% in 2009 and 2010. (Crane, Exh.11, p.9 LL 8-13)

[19] The Henry Hub index compiles the prices of natural gas futures contracts traded and settled on the New York Mercantile Exchange. (NYMEX) *See* www.sabinepipeline.com for a more detailed description.

[20] The increased supply is "also providing gas utilities with options concerning possible reductions in long-haul pipeline capacity and increased market area storage." (LeLash, Exh.9, p.6 L 21 – p.7 LL 1-2.)

50. Previously, the Company had been heavily dependent upon gas supply from the Gulf Coast. (*Id.* at p.11, LL 8-12.) Gulf Coast supply has a history of hurricane disruptions and higher long-haul transportation costs to Delaware. (*Id.* at p.19, LL 17-19.) According to Staff's LeLash, these facts about the Company's operation and the evolving natural gas industry require the Company to consistently reevaluate its capacity and procurement activities. (*Id.* at p.7, LL 17-18.)

51. Dover Propane Air Plant ("LPG"). According to Mr. LeLash, the Company's North Dover LPG facility does not have enough natural gas flow to allow it to inject its full output into the Company's system. (LeLash, Exh.9, p.11 LL 1-5.) Accordingly, as recommended by Staff's LeLash, the Company reduced the facility's capacity to meet peak day requirements by 15%. (Clausius Rebuttal, Exh. 5, p. 40 LL 1-5.)

52. Hedging. Mr. LeLash recommended that "… the Company should initiate a trial of the dollar cost averaging[21] methodology by splitting its hedging equally between its current methodology and dollar cost averaging." (LeLash, Exh. 9, p.25 LL 8-10.) According to Mr. LeLash, "if the Company does not modify its methodology, it should be required to develop an evaluation of dollar cost averaging to show that it is not appropriate." (*Id.* at p.25 LL 12-14.) This issue is addressed by the DPA's Ms. Crane whose testimony is discussed next.

[21] "Dollar Cost Averaging" determines hedges based upon the monthly cost of gas purchases, as opposed to defining hedge targets based upon gas volumes. (PSC Order No. 7837 (Sept. 7,2010) (HE's Report p.12.))The parties agreed upon this issue, as described in Section IV of this Report.

D. DPA'S DIRECT TESTIMONY

53. **<u>Testimony of Andrea C. Crane. Gas Hedging Plan.</u>** The Division of Public Advocate's Consultant Andrea C. Crane filed testimony dated March 11, 2011.[22] According to Ms. Crane, the Company's Gas Hedging Plan is working "relatively well" and the Company "should continue to follow its … plan as amended in PSC Docket No. 09-398F." (Crane, Exh.11, p.28 LL 15-17 & p.6 LL 8-9.) The Company agrees with Ms. Crane that Section 8 of the parties' Settlement Agreement in PSC Docket 09-398F requires Chesapeake to include a dollar cost averaging analysis in its next gas commodity procurement plan filing, not in this GSR case. (Clausius Rebuttal, p.31 LL 18-23; p.32 LL 10-11.)

54. <u>TETCO Capacity & Pipeline Interconnect.</u> For this GSR period, the Company has included $770,400 for reimbursement of the TETCO capacity costs associated with the TETCO Inter-connect. (Jegede, Exh.8, p.19 LL 5-8 *citing* Clausius, Exh.4, Sch. C.2, p.1.) According to Ms. Crane, "[w]hile bundled peaking supply is more expensive than firm capacity, the number of days over which an entity must purchase bundled peaking supply is limited." (Crane, Exh. 11, p.20 LL 16-18.)

55. Ms. Crane opined that the Company's direct testimony "failed to demonstrate that [the TETCO capacity] … justifies the incremental cost to ratepayers." (*Id.* at p.21 LL 6-7.) According to Ms. Crane, TETCO capacity costs should be disallowed unless the Company demonstrated the favorable impact on ratepayers of substituting firm capacity for bundled peaking supply. (*Id.* at p.12

[22] The DPA filed both Public and Confidential versions of Ms. Crane's testimony. At the evidentiary hearing, the Public version was marked as Exhibit 11 and the Confidential version was marked as Exhibit 12. This Report refers to the Public version.

LL 17-19.) The Company addressed these capacity issues in its Rebuttal testimony which is discussed next.

E. CHESAPEAKE'S REBUTTAL TESTIMONY

56. TETCO Capacity & Pipeline Interconnect. On April 20, 2011, the Company filed the Rebuttal testimony of Jennifer Clausius, Manager of Pricing and Regulation (Exh.5). According to Ms. Clausius, due to its TETCO upstream pipeline capacity, the Company "has been able to secure natural gas at a significantly lower commodity price this past winter than what it would have been able to procure under a bundled peaking supply arrangement." (*Id.* at p.18 LL 3-6.)

57. The Company compared the cost of TETCO's "interim capacity"[23] with the bundled peaking supply Chesapeake would have been able to acquire on the Transco line for Zone 6 non-New York pricing, on a day-to-day basis from December 2010 through February 2011. (*Id.* at LL 6-14; Clausius Rebuttal Sch. JAC-1) Historically, the pricing of the commodity in the Company's bundled peaking arrangements were determined by Transco Zone 6 non-New York pricing. (*Id.* at LL 11-14.)

58. **T**he disparity between the TETCO firm and the bundled peaking supply prices is greatest during the winter months. (*Id.* at LL 16-18.) Additionally, due to its reliance upon TETCO, the Company is reducing its reliance upon bundled peaking supply, which would have otherwise comprised 37% of the Company's design day requirement by the winter, 2014-15. (Clausius Rebuttal, Exh.5, p.21 LL 3-7.)

[23] The Company's Rebuttal Testimony refers to "interim capacity" because the TETCO capacity back to the interconnect with the Rockies Express Pipeline is not slated to become effective until November, 2012. (Clausius Rebuttal, Exh.5, P.17 LL 15-18.)However, since the Winter of 2011, Chesapeake has been able to secure capacity on a portion of the TETCO line.(*Id.* at p.17 LL 19-21.)

59. According to Ms. Clausius, there are four (4) reasons why the Company secured the TETCO capacity as opposed to continuing its bundled peaking supply arrangements. The first two (2) reasons are as follows: 1) supply diversity i.e obtaining gas from the Rocky Mountains and the Marcellus Shale as opposed to the Company's historic reliance upon the Gulf of Mexico ("Gulf"); and 2) the reliability of the TETCO capacity as opposed to the unreliability of issuing an RFP for Gulf gas and using local marketers which sometimes go out of business.

60. The remaining two (2) reasons why the Company secured TETCO capacity are as follows: 3) the firm TETCO capacity can be released to other parties or added to the capacity managed by the Company's Asset Manager ("AM") which would add to the fixed charge received by the Company pursuant to its Agreement with the AM, which is shared with ratepayers; and 4)the firm TETCO capacity will decrease the Company's dependence on the bundled peaking supply which had been growing each year due to customer growth. (*Id.* at pp. 19-22.)

IV. DISCUSSION OF PROPOSED SETTLEMENT AGREEMENT.

61. Settlement Agreement. I attach hereto as Exhibit "A" a copy of the parties' Settlement Agreement dated May 12, 2011. ("SA") At the evidentiary hearing, the Company, Staff and the DPA each presented a witness describing why adopting the proposed SA is in the public interest.[24] I will now discuss the material issues agreed upon by the

[24] At the evidentiary hearing, the Delaware Attorney General did not present a witness but the Deputy Attorney General stated as follows: "[t]he Attorney General is totally confident that going forward the Public Advocate is fully capable of enforcing this agreement with respect to the interest of the ratepayers of Chesapeake." (T-41) The Attorney General had appeared and participated in this docket to represent the

parties. The caption of each issue contains the section of the Settlement Agreement the reader may refer to.

62. TETCO Capacity & GSR Reimbursement; Section 12 of SA. Historically, the commodity cost of the Company's bundled peaking arrangements were determined by Transco's Zone 6 non-New York prices. (Clausius Rebuttal, Exh.5, p.18, LL 11-14.) In its Rebuttal testimony, the Company compared the monthly commodity cost of TETCO's "interim capacity" with the bundled peaking supply Chesapeake would have been able to acquire on the Transco line for Zone 6 non-New York prices from December 2010 through February 2011. (*Id.* at LL 6-14; Clausius Rebuttal Sch. JAC-1.) During these three (3) winter months, the TETCO supply was, on the average, approximately 9% per month less expensive. (Exh.5, Clausius Rebuttal Sch. JAC-1.)

63. In Section 12 of the Settlement Agreement, the parties have agreed that the Company will update Staff and the DPA "on an informal basis" with the Company's comparison cost analysis of the TETCO capacity and available bundled peaking supply. Staff's Jegede testified that this will enable Staff and the DPA "to make their own assessment" as to which alternative is preferable for Delaware ratepayers. (T-35,37)

64. As to GSR reimbursement, the parties agreed as follows: a) the Company will be allowed the TETCO capacity costs and the ESNG capacity costs associated with the TETCO Inter-connect; and b) the ratepayers will receive "any capacity revenues received outside of an Asset Management Agreement associated with this capacity.…"

Company's ratepayers after the former Public Advocate retired and the office became vacant. (*Id.)* A new Public Advocate has since been appointed. (T-38-40)

65. Gas Supply Plan-Section 8. In order to more quickly and accurately track the Company's capacity commitments, Staff had recommended that the Company be required to file its Gas Supply Plan annually, as opposed to every two (2)years. (Jegede, Exh.8, p.18 LL 11-13.) In the Settlement Agreement, the parties have agreed that the Company shall file the Plan every year "commencing September 2012, and each year thereafter…." Also, Staff's Jegede testified that "[b]y agreeing to file its supply plan annually on September 30th, the Staff and the DPA will be provided with updates to changes in the company's supply plans as it coincides with the company's annual GSR filing." (T-36)

66. Hedging-Section 7. The Company "will review the dollar cost averaging framework[25] for possible implementation at the time of the next review of the Plan (Sept. 2012). Chesapeake will begin tracking paper transactions utilizing the dollar cost averaging framework and provide an update [to Staff and the DPA] on the paper program as part of its quarterly reporting." This will provide a "trial run" for Staff and the DPA to compare the results of dollar cost averaging and the Company's current hedging Plan. (T-35-36) According to Section 7 of the Settlement Agreement, until September 2011, the Company's gas purchases will continue according to the Company's current Plan.[26]

67. Eastern Sussex County Expansion-Section 10. The parties have agreed that "the Company will provide an annual status report on

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[25] "Dollar Cost Averaging" determines hedges based upon the monthly cost of gas purchases, as opposed to defining hedge targets based upon gas volumes. (PSC Order No. 7837 (Sept. 7, 2010) (HE's Report p.12.))

[26] The Company's current Hedging Plan, which governs the placing of physical gas hedges, is discussed in paragraphs 34 through 37, *supra*.

its expansion activities in eastern Sussex County as part of the Company's main extension report that is filed in the spring of each year." Staff's Jegede testified that this "will better enable Staff and the DPA to monitor customer growth in the area." (T-36)

68. Asset Manager Request for Proposal ("RFP")-Section 11. Pursuant to the parties' Agreement, the Company will update Staff and the DPA as to the Company's RFP for its Asset Manager,[27] on a confidential and "rolling basis." The current Asset Manager's Contract ends March 31, 2012. (Kozel, Exh.6, p.13 LL 3-4) The Company is required to update Staff and the DPA with, for example, a copy of the RFP, evaluation criteria, and the Company's analysis of bids.

69. Finally, Staff and the Public Advocate Sheehy observed that the settlement would conserve the parties' resources in that it would avoid additional litigation costs. (T-35,39.*)* Furthermore, the settlement would sooner provide more certainty to the utility and its ratepayers than if the case continued to be litigated. *(Id.)*

V. RECOMMENDATIONS

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

71. Gas Service Rates. Based upon the Company's Application, the testimony, and having no objection from any party, I recommend that the Commission approve the proposed GSR rates in the Company's Application. (T-29,35,39) I find that the proposed rates are just and reasonable and are in the public interest. These rates took effect, on a temporary basis, subject to refund, on November 1, 2010.

[27] The Asset's Manager's duties are described in footnote 10, *supra*.

72. Accordingly, I recommend that the Commission order that the changes to the GSR rates approved by the Commission which provisionally went into effect on November 1, 2010, be approved for the period beginning November 1, 2010, until further order of the Commission.

73. I recommend that the Commission approve the Company's GSR charges proposed in its Application effective November 1, 2010, which are as follows:

Service Classification	Effective 11/01/09 (approved)	Effective 11/01/10 (proposed)
RS-1, RS-2, GS, MVS, LVS	$0.956	$1.035
GLR, GLO	$0.645	$0.668
HLFS	$0.797	$0.863
Firm Balancing Rate (LVS)	$0.056	$0.054
Firm Balancing Rate (HLFS)	$0.007	$0.010
Interruptible Balancing Rate (ITS)	$0.002	$0.001

74. Settlement Agreement. For the reasons described in the preceding section herein, I agree with Staff, DPA and the Company that adopting the proposed Settlement Agreement would be in the public interest. Therefore, pursuant to 26 *Del. C.* §512, I also recommend that the Commission approve the parties' Settlement Agreement in its entirety.

75. The proposed Settlement Agreement is attached hereto as Exhibit "A." I also attach a proposed Order as Exhibit "B," which will implement the foregoing recommendations.

Respectfully Submitted,

Date: May 23, 2011

/s/ Mark Lawrence

Mark Lawrence
Hearing Examiner

EXHIBIT "A"

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF	**)**	
CHESAPEAKE UTILITIES CORPORATION	**)**	
FOR APPROVAL OF A CHANGE IN ITS	**)**	**PSC DKT. NO. 10-296F**
GAS SALES SERVICE RATES ("GSR")	**)**	
TO BE EFFECTIVE NOVEMBER 1, 2010	**)**	
(Filed September 1, 2010)	**)**	

PROPOSED SETTLEMENT

On this _____ day of May, 2011, Chesapeake Utilities Corporation, a Delaware corporation (hereinafter "Chesapeake" or the "Company"), and the other undersigned parties (all of whom together are the "Settling Parties") hereby propose a settlement that, in the Settling Parties' view, appropriately resolves all issues raised in this proceeding.

I. INTRODUCTION

1. On September 1, 2010, Chesapeake filed with the Delaware Public Service Commission (the "Commission") an application (the "Application") for a change in its Gas Sales Service Rates to be effective for service rendered on and after November 1, 2010. By Commission Order No. 7849 dated September 21, 2010, the Commission allowed Chesapeake's proposed rates to go into effect on November 1, 2010 on a temporary basis pending full evidentiary hearings and a final decision of the Commission.

2. On March 11, 2011, the Delaware Public Service Commission Staff ("Staff') and the Attorney General of the State of Delaware ("AG") filed their respective

testimonies, raising certain cost recovery and reporting issues with respect to Chesapeake's application.

3. Subsequently, on April 20, 2011, Chesapeake filed its rebuttal testimony pursuant to which Chesapeake took issue with various Staff and AG recommendations regarding their cost recovery and reporting issues.

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

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

II. SETTLEMENT PROVISIONS

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

7. With respect to the Company's natural gas commodity procurement plan ("Plan"), as agreed to in the settlement to the prior GSR proceeding, Chesapeake will review the dollar cost averaging framework for possible implementation at the time of the

next review of the Plan (September 2012). Chesapeake will begin tracking paper transactions utilizing the dollar cost averaging framework and provide an update on the paper program as part of its quarterly reporting. Actual purchases will still be made according to the currently approved program.

8. Commencing September 30, 2011, and each year thereafter, Chesapeake will file its comprehensive Long-Term Supply and Demand Strategic Plan ("Supply Plan"). This is a change from Chesapeake's current practice of submitting its Supply Plan every two years.

9. In this docket, Staff expressed concern regarding the type of data that has been designated by the Company as "confidential". While the Settling Parties acknowledge that issues regarding "confidentiality" are addressed in the Commission's Rules of Practice, the Company agrees to make a good faith effort to be more selective in terms of what data and information is designated as confidential. In the event that a document contains both public and confidential (as determined by the Company) information, the Company will redact from the document only that information deemed to be confidential.

10. As part of the settlement agreement in PSC Docket No. 08-269F, the Company provided (on a confidential basis) information on its expansion into eastern Sussex County as part of the GSR filing as opposed to waiting for interrogatories. The Company agrees to continue to provide information on its expansion in advance of interrogatories. In lieu of providing this information as part of a GSR filing, the Company will provide an annual status report on its expansion activities in eastern Sussex County as part of the Company's main extension report that is filed in the spring of each year.

11. Chesapeake will provide the same information that it agreed to provide in the settlement agreement in PSC Docket No. 07-246F as part of the issuance of its next Asset Management RFP. Specifically, throughout the RFP process, the Company will provide the Staff and Public Advocate, on a confidential basis, with reasonable information and documents on the Company's upcoming Asset Management procurement process, including but not limited to, the following: (a) a copy of the RFP; (b) the number of entities receiving the Company's RFP; (c) the number of respondents; (d) evaluation criteria; (e) analysis of bids; and (1) other documents as may be requested by Staff or the Public Advocate. The Company will provide this information on a rolling basis, as it becomes available, and prior to any selection by the Company of an Asset Manager.

12. Chesapeake shall be allowed to recover the Texas Eastern capacity costs and the ESNG capacity costs associated with the Texas Eastern inter-connect. With respect to any capacity release revenues received outside of an Asset Management Agreement associated with this capacity, one hundred percent (100%) of any capacity release revenues associated with the release of this capacity will be credited to the GSR. Chesapeake will provide additional information to the Staff and Public Advocate, on an informal basis, supporting the Company's decision to acquire capacity from Texas Eastern, including information on the cost analysis comparing the cost of bundled peaking supply versus the cost of the Texas Eastern/Eastern Shore Natural Gas Company capacity.

13. As agreed in prior dockets, the Company will continue with the following practices: (a) the Company will notify the parties of any supplier refunds that may impact

the GSR charges; (b) the Company will continue to include in future GSR applications an update on steps taken to mitigate the effects of changes in gas costs; (c) the Company will provide information on the total sales volumes, costs, and margins by month for Interruptible Gas Transportation sales as part of its GSR applications; and (d) the Company will calculate the impact on its proposed GSR rates had a thirty-year average degree days been used and provide such information as part of the discovery process, when and if requested.

III. STANDARD PROVISIONS AND RESERVATIONS

14. The provisions of this Proposed Settlement are not severable except by written agreement of the Settling Parties.

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

waives any rights it may have to take any position in future proceedings regarding the issues in this proceeding, including positions contrary to positions taken herein or previously taken.

16. In the event that this Proposed Settlement does not become final, either because it is not approved by the Commission or because it is the subject of a successful appeal and remand, each of the Settling Parties reserves its respective rights to submit additional testimony, file briefs, or otherwise take positions as it deems appropriate in its sole discretion to litigate the issues in this proceeding.

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

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

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

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

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

21. This Proposed Settlement resolves all of the issues specifically addressed herein; provided, however, that this Proposed Settlement is made without admission against or prejudice to any factual or legal positions which any of the Settling Parties may assert (a) in the event that the Commission does not issue a final order approving this Proposed Settlement without modifications; or (b) in other proceedings before the Commission or other governmental body. This Proposed Settlement is determinative and conclusive of all of the issues addressed herein and, upon approval by the Commission, shall constitute a final adjudication as to the Settling Parties of all of the issues in this proceeding.

22. This Proposed Settlement is expressly conditioned upon the Commission's approval of all of the specific terms and conditions contained herein without modification. If the Commission should fail to grant such approval, or should modify any of the terms and conditions herein, this Proposed Settlement will terminate and be of no force and effect, unless the Settling Parties agree in writing to waive the application of this provision. The Settling Parties will make their best efforts to support this Proposed Settlement and to secure its approval by the Commission.

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

IV. CONCLUSION

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

Chesapeake Utilities Corporation

Dated: _____________ By: _____________________________

Delaware Public Service Commission Staff

Dated: _____________ By: _____________________________

Attorney General of the State of Delaware

Dated: _____________ By: _____________________________

Delaware Public Advocate

Dated: _____________ By: _____________________________

EXHIBIT "B"

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF CHESAPEAKE UTILITIES CORPORATION FOR APPROVAL OF A CHANGE IN ITS GAS SALES SERVICE RATES ("GSR") TO BE EFFECTIVE NOVEMBER 1, 2010 (FILED SEPTEMBER 1, 2009)	))))))	PSC DOCKET NO. 10-296F

ORDER NO.7974

AND NOW, this _____ day of _____________, 2011;

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

AND WHEREAS, the Hearing Examiner recommends that the Gas Sales Service Rates ("GSR") proposed by Chesapeake Utilities Corporation in its September 1, 2010 Application be approved as just and reasonable for service rendered on and after November 1, 2010;

AND WHEREAS, the Hearing Examiner recommends that the Proposed Settlement Agreement dated May 12, 2011, which is endorsed by all the parties, and which is attached to the original hereof as Attachment "B", be approved as reasonable and in the public interest;

NOW, THEREFORE, IT IS HEREBY ORDERED BY THE AFFIRMATIVE VOTE OF NO FEWER THAN THREE COMMISSIONERS:

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the May 23, 2011 Findings and Recommendations of the Hearing Examiner, appended to the original hereof as Attachment "A."

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

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

Service	Effective for Service Rendered On and After November 1, 2010
RS-1, RS-2, GS, MVS, LVS	$1.035
GLR, GLO	$0.668
HLFS	$0.863
Firm Balancing Rate (LVS)	$0.054
Firm Balancing Rate (HLFS)	$0.010
Interruptible Balancing Rate (ITS)	$0.001

4. That all Tariff revisions filed by the Company with this Commission on October 21, 2010, and the revised rates and charges contained therein are approved, and shall be effective on a permanent basis for gas service rendered on or after November 1, 2010, until further Order of the Commission. No later than two (2) business days from the date of this Order, the Company shall file revised Tariffs which comply with this Order.

5. 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

ATTACHMENT “B”

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF	**)**	
CHESAPEAKE UTILITIES CORPORATION	**)**	
FOR APPROVAL OF A CHANGE IN ITS	**)**	**PSC DKT. NO. 10-296F**
GAS SALES SERVICE RATES (“GSR”)	**)**	
TO BE EFFECTIVE NOVEMBER 1, 2010	**)**	
(Filed September 1, 2010)	**)**	

PROPOSED SETTLEMENT

On this 12 day of May, 2011, Chesapeake Utilities Corporation, a Delaware corporation (hereinafter "Chesapeake" or the "Company"), and the other undersigned parties (all of whom together are the "Settling Parties") hereby propose a settlement that, in the Settling Parties' view, appropriately resolves all issues raised in this proceeding.

I. INTRODUCTION

1. On September 1, 2010, Chesapeake filed with the Delaware Public Service Commission (the "Commission") an application (the "Application") for a change in its Gas Sales Service Rates to be effective for service rendered on and after November 1, 2010. By Commission Order No. 7849 dated September 21, 2010, the Commission allowed Chesapeake's proposed rates to go into effect on November 1, 2010 on a temporary basis pending full evidentiary hearings and a final decision of the Commission.

2. On March 11, 2011, the Delaware Public Service Commission Staff ("Staff') and the Attorney General of the State of Delaware ("AG") filed their respective

testimonies, raising certain cost recovery and reporting issues with respect to Chesapeake's application.

3. Subsequently, on April 20, 2011, Chesapeake filed its rebuttal testimony pursuant to which Chesapeake took issue with various Staff and AG recommendations regarding their cost recovery and reporting issues.

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

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

II. SETTLEMENT PROVISIONS

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

7. With respect to the Company's natural gas commodity procurement plan ("Plan"), as agreed to in the settlement to the prior GSR proceeding, Chesapeake will review the dollar cost averaging framework for possible implementation at the time of the

next review of the Plan (September 2012). Chesapeake will begin tracking paper transactions utilizing the dollar cost averaging framework and provide an update on the paper program as part of its quarterly reporting. Actual purchases will still be made according to the currently approved program.

8. Commencing September 30, 2011, and each year thereafter, Chesapeake will file its comprehensive Long-Term Supply and Demand Strategic Plan ("Supply Plan"). This is a change from Chesapeake's current practice of submitting its Supply Plan every two years.

9. In this docket, Staff expressed concern regarding the type of data that has been designated by the Company as "confidential". While the Settling Parties acknowledge that issues regarding "confidentiality" are addressed in the Commission's Rules of Practice, the Company agrees to make a good faith effort to be more selective in terms of what data and information is designated as confidential. In the event that a document contains both public and confidential (as determined by the Company) information, the Company will redact from the document only that information deemed to be confidential.

10. As part of the settlement agreement in PSC Docket No. 08-269F, the Company provided (on a confidential basis) information on its expansion into eastern Sussex County as part of the GSR filing as opposed to waiting for interrogatories. The Company agrees to continue to provide information on its expansion in advance of interrogatories. In lieu of providing this information as part of a GSR filing, the Company will provide an annual status report on its expansion activities in eastern Sussex County as part of the Company's main extension report that is filed in the spring of each year.

11. Chesapeake will provide the same information that it agreed to provide in the settlement agreement in PSC Docket No. 07-246F as part of the issuance of its next Asset Management RFP. Specifically, throughout the RFP process, the Company will provide the Staff and Public Advocate, on a confidential basis, with reasonable information and documents on the Company's upcoming Asset Management procurement process, including but not limited to, the following: (a) a copy of the RFP; (b) the number of entities receiving the Company's RFP; (c) the number of respondents; (d) evaluation criteria; (e) analysis of bids; and (1) other documents as may be requested by Staff or the Public Advocate. The Company will provide this information on a rolling basis, as it becomes available, and prior to any selection by the Company of an Asset Manager.

12. Chesapeake shall be allowed to recover the Texas Eastern capacity costs and the ESNG capacity costs associated with the Texas Eastern inter-connect. With respect to any capacity release revenues received outside of an Asset Management Agreement associated with this capacity, one hundred percent (100%) of any capacity release revenues associated with the release of this capacity will be credited to the GSR. Chesapeake will provide additional information to the Staff and Public Advocate, on an informal basis, supporting the Company's decision to acquire capacity from Texas Eastern, including information on the cost analysis comparing the cost of bundled peaking supply versus the cost of the Texas Eastern/Eastern Shore Natural Gas Company capacity.

13. As agreed in prior dockets, the Company will continue with the following practices: (a) the Company will notify the parties of any supplier refunds that may impact

the GSR charges; (b) the Company will continue to include in future GSR applications an update on steps taken to mitigate the effects of changes in gas costs; (c) the Company will provide information on the total sales volumes, costs, and margins by month for Interruptible Gas Transportation sales as part of its GSR applications; and (d) the Company will calculate the impact on its proposed GSR rates had a thirty-year average degree days been used and provide such information as part of the discovery process, when and if requested.

III. STANDARD PROVISIONS AND RESERVATIONS

14. The provisions of this Proposed Settlement are not severable except by written agreement of the Settling Parties.

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

waives any rights it may have to take any position in future proceedings regarding the issues in this proceeding, including positions contrary to positions taken herein or previously taken.

16. In the event that this Proposed Settlement does not become final, either because it is not approved by the Commission or because it is the subject of a successful appeal and remand, each of the Settling Parties reserves its respective rights to submit additional testimony, file briefs, or otherwise take positions as it deems appropriate in its sole discretion to litigate the issues in this proceeding.

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

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

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

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

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

21. This Proposed Settlement resolves all of the issues specifically addressed herein; provided, however, that this Proposed Settlement is made without admission against or prejudice to any factual or legal positions which any of the Settling Parties may assert (a) in the event that the Commission does not issue a final order approving this Proposed Settlement without modifications; or (b) in other proceedings before the Commission or other governmental body. This Proposed Settlement is determinative and conclusive of all of the issues addressed herein and, upon approval by the Commission, shall constitute a final adjudication as to the Settling Parties of all of the issues in this proceeding.

22. This Proposed Settlement is expressly conditioned upon the Commission's approval of all of the specific terms and conditions contained herein without modification. If the Commission should fail to grant such approval, or should modify any of the terms and conditions herein, this Proposed Settlement will terminate and be of no force and effect, unless the Settling Parties agree in writing to waive the application of this provision. The Settling Parties will make their best efforts to support this Proposed Settlement and to secure its approval by the Commission.

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

IV. CONCLUSION

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

Chesapeake Utilities Corporation

Dated: 5/12/11 By: /s/ Jeffrey R. Tietbohl

Delaware Public Service Commission Staff

Dated: 5/12/11 By: /s/ Janis L. Dillard

Attorney General of the State of Delaware

Dated: 5/12/11 By: /s/ Kent Walker

Delaware Public Advocate

Dated: 5/12/11 By: /s/ Michael Sheehy