

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

IN THE MATTER OF THE APPLICATION OF)
THE DELAWARE ELECTRIC COOPERATIVE,)
INC., FOR APPROVAL OF CHANGES IN) PSC DOCKET NO. 04-202
DEPRECIATION RATES FOR ELECTRIC PLANT)
PURSUANT TO 26 *DEL. C.* § 313)
(FILED MAY 28, 2004)

IN THE MATTER OF THE APPLICATION OF)
THE DELAWARE ELECTRIC COOPERATIVE,)
INC., TO RESET ITS POST-TRANSITION)
REGULATED RATES UNDER 26 *DEL. C.*) PSC DOCKET NO. 04-288
§ 1006(b)(2)(d) AND TO REVISE ITS)
POST-TRANSITION STANDARD OFFER)
SERVICE PRICE UNDER 26 *DEL. C.*)
§ 1006(b)(2)(c) (FILED JULY 10, 2004))

FINDINGS, OPINION AND ORDER NO. 6610

BEFORE COMMISSIONERS: ARNETTA McRAE, Chair
JOSHUA M. TWILLEY, Vice Chair
JAYMES B. LESTER, Commissioner
JOANN T. CONAWAY, Commissioner
DALLAS WINSLOW, Commissioner

APPEARANCES:

On behalf of The Delaware Electric Cooperative, Inc.:

JANET E. ARNOLD, ESQUIRE
J. WILLIAM ANDREW
MARK A. NIELSON

On behalf of the Division of the Public Advocate:

JOHN CITROLO

On behalf of the Delaware Public Service Commission Staff:

JAMES McC. GEDDES, ESQUIRE
ASHBY & GEDDES
Rate Counsel

and

BRUCE H. BURCAT, Executive Director

CONNIE S. MCDOWELL, Chief of Technical Services
KAREN L. NICKERSON, Secretary
JANIS L. DILLARD, Regulatory Policy Administrator
Delaware Public Service Commission Staff

BACKGROUND

1. Pursuant to the Electric Utility Restructuring Act of 1999, 26 *Del. C.* ch. 10 (the "Restructuring Act"), after the end of the applicable "transition period," retail customers in the service territory of the Delaware Electric Cooperative, Inc. ("DEC") who do not otherwise receive electric service from an electric supplier are provided "standard offer service" ("SOS") by the "standard offer service supplier" (which, in this case, is DEC). See 26 *Del. C.* §§ 1001(15), (16); 1006(b)(2)a.-c.

2. The transition period for all customer classes in DEC's service territory was to end on March 31, 2005. 26 *Del. C.* § 1004(b). Pursuant to the Restructuring Act, on July 30, 2004, DEC filed a cost-of-service study, an application to reset its post-Transition Period regulated rates, and the pre-filed testimony of Mark A. Nielsen, Vice President of Staff Services; J. William Andrew, then Vice President of Engineering & Operations; J. Steven Sharbutt, Vice President and Principal of GDS Associates; Gary D. Cripps, Vice President of Finance & Information Technology; and Russell E. Shipe, CPA and Cost Management Consultant. In its application, DEC sought to implement its proposed changes in service rates and "Terms and Conditions" on April 1, 2005, pursuant to 26 *Del. C.* § 1006(b)(1)(d) and coincident with the end of the Transition Period.

3. On August 31, 2004, in Order No. 6469, we established this proceeding, assigned the matter to Senior Hearing Examiner William F.

O'Brien, and directed that public notice of DEC's Application and this proceeding be published. In accordance with the Order, public notice was published on September 7, 2004.

4. By Order No. 6477 (Sept. 14, 2004), we consolidated this docket with PSC Docket No. 04-202, which was established to evaluate DEC's proposed depreciation rates, so that all issues affecting DEC's post-Transition Period rates could be considered together. In Order No. 6477 (Sept. 14, 2004), we noted that we had previously allowed DEC to implement its requested depreciation rates on a temporary and interim basis, which resulted in a decrease in depreciation rates. (See PSC Docket No. 04-202, Order No. 6438 (June 24, 2004)).

5. A public comment session was held in Georgetown, Delaware on November 30, 2004, at which representatives from each of the parties appeared. No DEC customers or members of the public attended the hearing, and no customers submitted any written comments.

6. On December 17, 2004, Staff and the Division of the Public Advocate ("DPA") submitted pre-filed testimony. The DPA submitted the pre-filed testimony of Andrea C. Crane, a Vice President of The Columbia Group, Inc. Staff submitted the pre-filed testimony of Janis L. Dillard, the Regulatory Policy Administrator of the Delaware Public Service Commission; David N. Bloom, a Public Utility Analyst with the Commission; David E. Peterson, a Senior Consultant for Chesapeake Regulatory Consultants, Inc.; and Michael J. Majoros, Jr., Vice President of Snively King Majoros O'Connor & Lee, Inc.

7. Prior to the filing of DEC's rebuttal testimony, the parties requested the Hearing Examiner to suspend the procedural

schedule to allow the parties to continue settlement negotiations that were ongoing. The Hearing Examiner granted that request.

8. On March 17, 2005, the Hearing examiner presided over a duly noticed evidentiary hearing at which the parties presented a fully-executed settlement agreement and offered testimony in support of the settlement. At the conclusion of the hearing, the record, consisting of 12 exhibits and a transcript of the hearing, was closed. The parties also presented the Hearing Examiner with proposed Findings and Recommendations in order to facilitate submission of a report to the Commission prior to the March 31, 2005 end of the Transition Period under the Restructuring Act.

9. On March 17, 2005, the Hearing Examiner, having reviewed the Proposed Findings and Recommendations, issued his Report. No party took exception to any of the Hearing Examiner's proposed Findings and Recommendations.

10. On March 22, 2005, the Commission met at its regularly scheduled public meeting to consider and deliberate on the Hearing Examiner's proposed Findings and Recommendations. At that meeting, we adopted the Findings and Recommendations of the Hearing Examiner and approved the Settlement Agreement into which the parties had entered (see Order No. 6596). In that Order, we further directed DEC to make a compliance rate filing, which was to include new tariff sheets and proof that its new rates complied with the terms of the Settlement Agreement, within seven days of Order No. 6596, or March 29, 2005.

11. We set forth herein the reasoning behind our adoption of the Hearing Examiner's Findings and Recommendations and our approval of the Settlement Agreement.

DISCUSSION

DEC'S WITNESSES

12. In his prefiled testimony, DEC witness Nielsen testified about DEC's proposed revisions to its "Terms and Conditions." The first proposed revision was to eliminate the Industrial Rate Class and expand the Large Commercial-Primary class (which would benefit the single customer being served under the Industrial rate classification). The second proposed revision was to remove tariff rules that were no longer relevant or required, such as the Competitive Transition Charge. The third proposed revision was to remove rates that had no customers taking service on them. The fourth proposed revisions were changes necessary to comply with Commission requirements, and the final group of revisions was corrections for internal consistency.

13. DEC witness Andrew's pre-filed testimony addressed the adequacy of supply and supply planning, the volatility of power purchase markets, the significant growth DEC had experienced during the Transition Period, and the financial strain that growth had placed on DEC.

14. DEC witness Shurbutt's pre-filed testimony presented the cost-of-service study ("COSS") that he had conducted. The COSS demonstrated a need to increase DEC's generation rates by 14.5% due to significant increases in wholesale power costs. The study also

supported a 21.4% decrease in DEC's distribution rates. This resulted in DEC's request for an overall 1.34% rate increase (\$1.1 million).

15. DEC witness Cripps' pre-filed testimony addressed DEC's financial structure, the negative impacts of the rate freeze and increasing power purchase costs during the Transition Period and the steps that DEC had taken to manage its cost of debt.

16. Finally, DEC witness Shipe's pre-filed testimony presented the depreciation study he had performed for DEC in March 2004. That study demonstrated that the current depreciation rates were too high, causing an understatement of net margins. He recommended that the overall composite depreciation rate be reduced from 5.59% to 4.19% (which would result in a \$2.19 million decrease in DEC's annual depreciation expense). Additionally, he recommended that the overstatement in accumulated depreciation be amortized over 14 years (the estimated composite remaining life of DEC's depreciable assets).

STAFF'S WITNESSES

17. Staff witness Dillard's pre-filed testimony addressed Staff's target Times Earned Interest Ratio ("TIER")¹ for DEC, and also presented a wholesale market analysis of regional standard offer service pricing.

18. Staff witness Bloom's pre-filed testimony described the process and sources used to develop the wholesale pricing data used in Ms. Dillard's wholesale market analysis.

¹The TIER is a measurement of an electric cooperative's ability to repay debt.

19. Staff witness Peterson's pre-filed testimony addressed the review he had conducted of DEC's proposed rates. He determined DEC's test year rate base and calculated the revenue requirement adjustment that would produce the target TIER that Staff witness Dillard recommended.

20. Finally, Staff witness Majoros addressed DEC's proposed depreciation rates and recommended additional decreases to those proposed rates.

21. Staff's witnesses' testimony resulted in a recommendation of a \$1 million rate decrease, based primarily on Staff witness Majoros' proposed depreciation rates.

THE DPA'S WITNESS

22. DPA witness Crane testified regarding numerous elements of DEC's COSS and several proposed adjustments thereto. She also calculated DEC's test year pro forma revenues and operating expenses and recommended a modified TIER that would have resulted in a slight overall rate decrease for DEC members. In addition, Ms. Crane evaluated DEC's proposed revisions to its Terms and Conditions. Finally, Ms. Crane recommended that 70.67% of DEC's uncollectible expense claim, which was currently allocated exclusively to the distribution delivery service cost function, should be allocated to the Electric Supply Service function; the result of this reallocation would be to increase DEC's proposed retail adder from 0.061 cents/kWh to 0.072 cents/kWh.

23. DPA's testimony resulted in a recommended \$1.7 million rate decrease.

THE SETTLEMENT

24. After substantial discussion and negotiation, the parties presented a proposed Settlement Agreement to the Hearing Examiner at the evidentiary hearing scheduled for March 17, 2005.

25. The Settlement Agreement provides that DEC's rates should be revised to produce total annual revenue of \$82,338,106 based upon 2003 test year data currently being experienced by DEC's owners/members, with \$22,249,730 being produced by the distribution delivery service and \$59,067,180 being produced by the electric supply service. Additionally, \$1,021,196 in other revenue would be produced based on 2003 test year data. The electric supply service revenue of \$59,067,180 will be composed of \$58,366,131 in purchased power costs and \$701,049 for the retail adder. The retail adder is broken down as follows: \$587,826 from DEC's filing and an uncollectible adjustment of \$113,223 (70.67% of the uncollectible expense) proposed by DPA witness Crane.

26. The parties agreed that the current overall test year revenue provided by DEC's rates were appropriate as defined under 26 Del. C. § 1006(a)(2)(d). Although Staff and DPA recognize that certain adjustments, such as lower TIER coverage and lower depreciation rates, might support a small reduction in the current distribution delivery service revenue requirement, they also realize that keeping the overall test year revenue at the same level as that experienced by customers during the Transition Period was in the public interest.

27. The parties further agreed that DEC's proposed changes to its Terms and Conditions were reasonable and in the public interest. Specifically, they agreed that DEC's proposal to eliminate the Industrial rate class was in the public interest, since only one Member took service under that rate and that Member would materially benefit from a transfer to the Large-Commercial-Primary rate which would be modified to accommodate that customer.

28. The parties agreed that the currently effective depreciation rates would continue in effect until DEC filed its next depreciation study (which was to be filed within three years of a Commission final Order in this docket), and that DEC would record regulatory liabilities pursuant to and in accordance with Generally Accepted Accounting Principles ("GAAP").

29. The parties also agreed to support DEC's request to implement a new PCA mechanism because they believed that this would reduce the frequency of DEC filing rate cases. Specifically, Staff believed that such a mechanism could promote competition by providing an incentive to smaller customers who might prefer stable rates to shop among third-party suppliers to obtain rates guaranteed for a period of time. The PCA will be based on purchased power costs of \$58,366,131 (the same purchased power cost included in the electric service supply rates), and this is the amount that will be subject to true-up.

THE HEARING EXAMINER'S PROPOSED FINDINGS AND RECOMMENDATIONS

30. After reviewing the parties' positions as reflected in their pre-filed direct testimony, the proposed settlement agreement,

and the parties' testimony at the March 17, 2005 evidentiary hearing in favor of the Settlement Agreement, the Hearing Examiner concluded that it was a reasonable resolution to the proceeding. He found that the Settlement Agreement produced rates that were "balanced, just and reasonable, well supported, and in the public interest." (Hearing Examiner's Findings and Recommendations at ¶ 28) (hereafter "HER at ___"). He also noted the reduced regulatory expense resulting from the settlement, which benefited DEC and its members.

31. The Hearing Examiner observed that electric utilities in other jurisdictions were requesting significant rate increases, so this Settlement Agreement provided a "real and substantial benefit to [DEC's] members, while fairly compensating [DEC] for the service it provides." (HER at ¶ 30).

32. The Hearing Examiner further found that a flexible mechanism for recovering purchased power costs would be beneficial to both DEC and its members by enabling DEC to fully recover such costs and shielding members from "rate shock" that could occur after significant increases in power costs after a period without any adjustments. It would also protect DEC from the financial volatility being experienced in the wholesale market and give members the benefit of rate reductions when power costs decrease. (HER at ¶ 31).

33. Finally, the Hearing Examiner found that the settlement's provision that the current depreciation rates would remain but that DEC would file another depreciation study within three years of the date of the Commission's final Order in this docket would insure that DEC members realized the benefits of reduced depreciation rates today

(as encompassed in the overall revenue requirement agreed to), and would pay fair and appropriate depreciation rates in the future. (HER at ¶ 32.)

OPINION

34. *Twenty-six Del. C. § 512* encourages the resolution of matters brought before the Commission through stipulations and settlements. Indeed, Section 512(a) of the Public Utilities Act specifically exhorts us to encourage the parties before it to resolve matters by stipulation or settlement. We may approve such stipulations or settlements, even if all parties do not agree, if we find that the resolution contemplated by the stipulation or settlement to be in the public interest. *26 Del. C. § 512(c)*. Here, all parties to the proceeding reached agreement on the terms and conditions of the settlement.

35. We have reviewed the record and the Findings and Recommendations of the Hearing Examiner, and we agree with the Hearing Examiner that this settlement is in the public interest. The settlement complies with the requirements of *26 Del. C. § 1006(b)(2)(c)*, which provides that if DEC is the Standard Offer Service provider (which it is), then the Standard Offer Service price must be representative of the wholesale electric market price. Staff witness Dillard's analysis establishes that the rates resulting from the Settlement Agreement are fully representative of the wholesale electric market price. Compliance with the statutory requirements regarding Standard Offer Service rates is certainly in the public interest.

36. The Settlement Agreement also results in reduced regulatory expense, which is a benefit to DEC members because it reduces the legal and other rate case expense costs that DEC will seek to recover the next time it files a rate case. In a time of rising costs for nearly every commodity, this cost limitation is certainly in the public interest.

37. Furthermore, as a result of the settlement, the rate impact on residential customers is essentially nil and the rate impact on commercial customers is modest. At the same time, the rates fairly compensate DEC for the service it provides. Again, in a time of rising costs for nearly every commodity, this facet of the settlement is in the public interest.

38. Next, we believe that a flexible mechanism for recovering power purchase costs will benefit both DEC and its members by enabling DEC to fully recover its purchased power costs as it is permitted to do under the Public Utilities Act, while shielding DEC members from the potential "rate shock" that would accompany a substantial power cost increase. Such a mechanism also protects DEC from the volatility being experienced in the wholesale power market, while giving DEC's members the benefit of quicker rate reductions when power purchase costs decrease. The mechanism set forth in the Settlement Agreement, in our view, fairly balances the needs of both DEC and its members.

39. Finally, we believe that the requirement that DEC file a new depreciation study within three years of the date of this Final Findings, Opinion and Order ensures that DEC will not over-collect depreciation in rates in the future.

40. The witnesses have testified that the inclusion of some of the uncollectible costs in the retail adder will encourage competition and, perhaps, offer more stable rates. Similarly, because consumers' rates will vary somewhat as a result of the settlement, this presents an opportunity for competition.

41. For these reasons, as well as those set forth in the Hearing Examiner's Findings and Recommendations, we hereby adopt the Findings and Recommendations of the Hearing Examiner in their entirety. (5-0).

ORDER

AND NOW, this 26th day of April, 2005, IT IS HEREBY ORDERED:

1. That the Findings and Recommendations of the Hearing Examiner dated March 17, 2005 (attached to the Original hereto as Exhibit "A") recommending that the parties' Settlement Agreement be approved are hereby approved and adopted in their entirety.

2. That the Commission retains 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/ Joshua M. Twilley
Vice Chair

/s/ Joann T. Conaway
Commissioner

E X H I B I T "A"

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§ 1006(b)(2)(c) (FILED JULY 10, 2004))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: MARCH 17, 2005

WILLIAM F. O'BRIEN
SENIOR HEARING EXAMINER

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§ 1006(b)(2)(c) (FILED JULY 10, 2004))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

William F. O'Brien, duly appointed Hearing Examiner in this Docket, pursuant to 26 Del. C. § 502 and 29 Del. C. ch. 101, by Commission Order No. 6469, dated August 31, 2004, reports to the Commission as follows:

I. INTRODUCTION

A. Appearances

The following counsel and parties entered appearances and participated in the proceeding:

On behalf of Delaware Electric Cooperative:
BY: JANET E. ARNOLD, ESQUIRE

HUDSON, JONES, JAYWORK & FISHER
BY: J. TERENCE JAYWORK, ESQUIRE.

On behalf of the Public Service Commission Staff:
ASHBY & GEDDES
BY: JAMES McC. GEDDES, ESQUIRE.

On behalf of the Division of the Public Advocate:
BY: G. ARTHUR PADMORE, PUBLIC ADVOCATE.

B. Procedural Background

1. On July 30, 2004, Delaware Electric Cooperative ("Applicant" or "Cooperative") filed a cost-of-service study, an application to reset its post-Transition Period regulated rates pursuant to and in accordance with the requirements of the Electric Utility Restructuring Act of 1999 ("Act"),² and pre-filed written testimony in support of the Application and cost-of-service study. The Cooperative sought to implement its proposed changes in service rates and "Terms and Conditions" on April 1, 2005, pursuant to the terms of 26 *Del. C.* § 1006(b)(1)(d) and coincident with the end of the Transition Period.

2. On August 31, 2004, in PSC Order No. 6469, the Commission established this proceeding, assigned the matter to this Hearing Examiner, and directed that public notice of the Application and Commission proceeding be published. In accordance with the Order, Public Notice was published on September 7, 2004.³

3. On September 14, 2004, in PSC Order No. 6477, the Commission consolidated PSC Docket No. 04-202, which was established to evaluate the Cooperative's depreciation rates, and PSC Docket No. 04-288 so that all issues impacting the Cooperative's post-Transition Period rates could be considered together in the same proceeding. In that Order, the Commission noted that it had previously, by PSC Order

²See 26 *Del. C.* § 1006(b)(2)(d).

³The affidavits of publication of notice were moved into the record evidence as Exhibit No. 1.

No. 6438, dated June 24, 2004, allowed the Cooperative to implement the requested depreciation rates on a temporary and interim basis, which resulted in a lowering of those rates.

4. The Parties to this proceeding are the Applicant, the Commission Staff ("Staff") and the Division of the Public Advocate (the "Public Advocate").

5. The procedural schedule for the proceeding was agreed to and submitted by the Parties and approved by letter dated October 13, 2004.

6. Public Notice of the public comment hearing, scheduled for November 30, 2004, and the evidentiary hearings, scheduled to begin March 17, 2005, was published in the *Delaware State News* and *The News Journal* newspapers on November 10, 2004, and November 11, 2004, respectively.

7. A public comment hearing was held in Georgetown, Delaware on the evening of November 30, 2004, at which representatives of each of the Parties appeared. No customers or members of the public attended the hearing, however, and no customers submitted any written comments.

8. On December 17, 2004, Staff and the Public Advocate submitted prepared written testimony addressing the Application. Prior to the filing of Applicant's rebuttal testimony, the Parties requested suspension of the procedural schedule, except for the scheduled hearing on March 17, 2005. This request was made to allow for the continuation of ongoing settlement negotiations. The Parties' request was not opposed and was therefore granted.

9. On March 17, 2005, a hearing was conducted in Dover at which time the Parties presented a fully executed Settlement Agreement and offered testimony in support of the settlement. In addition, because the Cooperative's Transition Period under the Act ends on March 31, 2005, and the new rates must be in effect on April 1, 2005, the Parties presented the Hearing Examiner with proposed Findings and Recommendations in order to facilitate submission of his Report in time for Commission consideration of the matter at its March 22, 2005 meeting.

10. At the conclusion of the hearing, the evidentiary record, consisting of twelve exhibits and a *verbatim* transcript of the hearing, was closed.⁴ I have considered the entire record and the comments of the Parties supporting the settlement, and submit for the Commission's consideration these Findings and Recommendations.

II. SUMMARY OF EVIDENCE

A. The Applicant

11. With the cost-of-service study, the Cooperative submitted the written direct testimony of five witnesses: (1) Mark A. Nielson, Vice-President of Staff Services (Ex. 2); (2) J. William Andrew, then Vice-President of Engineering & Operations (Ex. 3); (3) J. Steven Shurbutt, Vice-President and Principal in the firm of GDS Associates (Ex. 4); (4) Gary D. Cripps, Vice-President of Finance & Information Technology for the Cooperative (Ex. 5); and (5) Russell E. Shipe, CPA and Cost Management Consultant (Ex. 6).

⁴Hearing exhibits will be cited as "Ex. ___."

12. Mr. Nielson testified to the Cooperative's proposed revisions to its "Terms and Conditions," including (1) elimination of the Industrial Rate Class and expansion of the Large Commercial-Primary class, so as to benefit the single customer currently taking service under the Industrial Rate Class; (2) removal of tariff rules that are no longer relevant or required, such as the Competitive Transition Charge; (3) removal of rates that do not have customers taking service on them; (4) changes necessary for compliance with Commission requirements; and (5) a number of corrections for internal consistency.

13. Mr. Andrew presented testimony regarding the adequacy of supply and supply planning, the volatility of power purchase markets, the significant growth that the Cooperative has experienced during the Transition Period, and the financial strain that this growth has placed on the Cooperative.

14. The Cooperative presented J. Steven Shurbutt, a consulting engineer and Vice-President and Principal of GDS Associates. Mr. Shurbutt presented the cost-of-service study, which he conducted. Mr. Shurbutt's cost-of-service study demonstrated a need to increase the Cooperative's generation rates by 14.5% due to significant increases in the cost of power purchased at wholesale. The cost-of-service study supported the Cooperative's request for a 21.4% decrease in distribution rates. This resulted in the Cooperative's request for an overall increase in rates of 1.34%.

15. Cooperative Witness Gary D. Cripps, Vice-President of Finance & Information Technology, presented testimony addressing the

Cooperative's financial structure, the negative impacts of the rate freeze and increasing power purchase costs during the Transition Period, and the steps taken by the Cooperative to manage its cost of debt.

16. Finally, the Cooperative presented the testimony of Russell Shipe, a CPA and Cost Management Consultant. Mr. Shipe presented the depreciation study he conducted for the Cooperative in March 2004, which demonstrated that the depreciation rates in effect at that time were too high, causing an annual understatement of net margins. Mr. Shipe recommended that the overall composite rate of depreciation be decreased from 5.59% to 4.19%. In addition, Mr. Shipe recommended that the overstatement in the accumulated provision for depreciation be amortized over 14 years, which is the estimated composite remaining life of the Cooperative's depreciable assets.

B. Commission Staff

17. Staff presented the pre-filed testimony of four witnesses: (1) Janis L. Dillard, Regulatory Policy Administrator (Ex. 7); (2) David N. Bloom, Public Utility Analyst (Ex. 8); (3) David E. Peterson, a senior consultant with Chesapeake Regulatory Consultants, Inc. (Ex. 9); and (4) Michael J. Majoros, Vice-President of Snavelly King Majoros O'Connor & Lee, an economic consulting firm (Ex. 10).

18. Ms. Dillard presented testimony in support of Staff's target Times Earned Interest Ratio ("TIER") for the Cooperative, and presented a wholesale market analysis of regional standard offer service pricing. In general, the TIER is a measurement of an electric cooperative's ability to repay debt.

19. Mr. Bloom's prepared direct testimony described the process and sources used to develop the wholesale pricing data used in Ms. Dillard's wholesale market analysis.

20. Staff presented the prepared direct testimony of Mr. Peterson, who conducted a review of the Cooperative's proposed rates. In his direct testimony, Mr. Peterson determined the Cooperative's test year rate base, and calculated the required revenue requirement adjustment that would product the target TIER recommended by Staff Witness Dillard.

21. Mr. Majoros addressed the Cooperative's proposed depreciation rates in his testimony and recommended additional decreases to the proposed rates.

C. The Public Advocate

22. The Public Advocate presented the prepared direct testimony of Andrea C. Crane, Vice-President of the Columbia Group, a public utility consulting firm. (Ex. 11.) Ms. Crane's testimony included discussions of numerous elements of the Cooperative's cost-of-service study and several proposed adjustments. Ms. Crane also calculated test year, *pro forma* revenues and operating expenses for the Cooperative, and recommended a specific Modified TIER level for the Cooperative's rates that would result in an overall slight rate decrease for Cooperative Members. In addition, Ms. Crane evaluated the Cooperative's proposed revisions to its "Terms and Conditions."

III. THE PROPOSED SETTLEMENT AGREEMENT

23. At the March 17, 2005 hearing, the Parties presented a proposed Settlement Agreement (Ex. 12), which will be appended to the

proposed Order in this case as "Attachment A." The parties offer the Settlement Agreement as a compromise to the litigation positions that they presented in their pre-filed testimony. At the hearing, each Party presented a witness who testified that it was his or her opinion that the rates proposed in the Settlement were just and reasonable and in compliance with the Act and that adoption of the Settlement would be consistent with the public interest.

24. The terms of the Settlement Agreement are summarized as follows:

- (a) The current overall test year revenue provided by the rates charged by the Cooperative are appropriate;
- (b) The Cooperative's rates should be revised to produce the total annual revenue of \$82,338,106, based upon 2003 test year data currently being experienced by the Cooperative's Member/owners. Thus, the tariff rates should be revised to produce \$22,249,730 in distribution delivery service revenue and \$59,067,180 in electric supply service revenue based upon 2003 test year data. In addition, \$1,021,196 in other revenue will be produced based on 2003 test year data, resulting in total *pro forma* revenues of \$82,338,106. The electric supply service revenue of \$59,067,180 will be composed of \$58,366,131 in purchased power costs and \$701,049 for the retail adder, which includes \$587,826 proposed by DEC in its filing and the uncollectible adjustment of \$113,223 proposed by the DPA, all based upon 2003 test year data;
- (c) Revisions to the Cooperative's Terms and Conditions, as set forth in Appendix A to the Settlement, are reasonable and in the public interest. The Cooperative's proposal to close the Industrial rate is in the public interest, as the rate currently has only one Cooperative Member on it, and that member would materially benefit from a move to the Large Commercial-Primary rate, which

the Cooperative will modify so as to accommodate the customer;

- (d) The Cooperative's currently effective depreciation rates, established by Commission Order No. 6438, (Docket No. 04-202, Dated June 22, 2004), shall continue in full force and effect until the Cooperative files its next depreciation study;
- (e) The Cooperative shall file its next depreciation study within three (3) years of the date of the Commission's final Order in this proceeding;
- (f) The Cooperative shall record regulatory liabilities pursuant to and in accordance with Generally Accepted Accounting Principles (GAAP);
- (g) A new PCA mechanism for the Cooperative is appropriate so as to reduce the need for DEC to make more frequent filings requesting rate relief. The PCA will be based on purchased power costs of \$58,366,131, which is the purchased power cost included in the electric supply service rates and, therefore, the amount that will be subject to a true-up; and
- (h) Adjustment of the retail adder to reflect an allocation of a share of the uncollectible expense to the Electric Supply Service function, allocating 70.67% of the total claimed uncollectible costs to the Electric Supply Service function, based on the Cooperative's suggested revenue requirements, which will increase the proposed retail adder from 0.061 cents per kWh to 0.072 cents per kWh.

IV. FINDINGS AND RECOMMENDATIONS

25. Section 512 of the Public Utilities Act encourages the resolution of matters brought before the Commission through settlement. In this case, all Parties agree to the settlement terms. At the outset, the Parties are to be commended for their work in achieving this settlement, which resolves the myriad of issues raised by the Parties in their respective prefiled testimonies.

26. Section 1006(b)(2)(d) of the Public Utility Restructuring Act of 1999 required that the Cooperative file a rate case quality cost-of-service study by September 2004, consistent with the Commission's Minimum Filing Requirements in effect on February 1, 1999. The Cooperative's filing was in full compliance with this requirement, and the Parties had a full and fair opportunity to evaluate the filing, discuss the issues, and achieve a resolution as to the rates for the Cooperative going forward.

27. Section 1006(b)(2)(c) mandates that, if the Cooperative is the Standard Offer Service provider, then the Standard Offer Service ("SOS") price must be representative of the wholesale electric market price. The Cooperative continues to be the SOS service provider, and the rates as established by the Settlement Agreement are fully representative of the wholesale electric market price, as is amply demonstrated by the analysis presented by Staff Witness Dillard.

28. Turning to the merits of the proposed Settlement Agreement, I find that, on its face, it is a reasonable resolution to this proceeding, and no party disputes it. It establishes rates that are balanced, just and reasonable, well supported, and in the public

interest. Further, as with any settlement, there is the important benefit from reduced regulatory expenses, which also inures to the benefit of the Cooperative and its Members.

29. The terms of the proposed settlement fairly balance the interests and needs of the Cooperative and its Members. Under the settlement, the Cooperative's revenues will remain at approximately current levels while the rates for supply will increase approximately 14.5 percent and distribution rates will decrease approximately 24 percent. The overall rate impact on residential customers will be approximately zero, with a modest rate impact on commercial customers.

30. At a time when electric utilities elsewhere are requesting significant rate increases, implementation of the terms of this settlement will provide a real and substantial benefit to the Cooperative's Members, while fairly compensating the Cooperative for the service it provides. The rates as proposed by the Parties to the Settlement Agreement are just and reasonable, and in full compliance with the terms of the Public Utilities Act.

31. Introduction of a flexible mechanism for recovering power purchase costs will benefit both the Cooperative and its Members, by enabling the Cooperative to fully recover its purchased power costs and shielding its Members from the potential "rate shock" of significant jumps in energy prices that might occur after a period of years without adjustment. In doing so, it will afford the Cooperative financial protection from the volatility currently being experienced in the wholesale marketplace, while giving Members the benefit of rate

decreases when power purchase costs go down. Overall, the mechanism fairly balances the needs of the Cooperative and its Members.

32. Depreciation rates will remain as approved by the Commission in Order 6438 (Docket No. 04-202, Dated June 22, 2004), and the Cooperative will file another depreciation study within three years, to permit evaluation of depreciation rates to insure that they remain appropriate and in the public interest. This will insure that Cooperative Members realize the benefits of reduced depreciation rates today, and pay fair and appropriate depreciation rates in the future.

33. In summary, having evaluated the terms of the Settlement Agreement and all applicable law, I find that the Settlement complies fully with the requirements of the Public Utilities Act, and I recommend the approval of the proposed Settlement as consistent with the law and the public interest.

34. Therefore, for the reasons discussed above, and based on the record of this proceeding, I recommend that the Commission adopt the March 17, 2005 proposed Settlement Agreement ("Attachment B" to the proposed Order) as just and reasonable and consistent with the public interest. A proposed Order, which will implement the foregoing recommendation, is attached hereto.

Respectfully submitted,

/s/ William F. O'Brien
William F. O'Brien
Senior Hearing Examiner

Dated: March 17, 2005