

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

IN THE MATTER OF THE APPLICATION OF)
DELMARVA POWER & LIGHT COMPANY FOR) PSC DOCKET NO. 06-284
A CHANGE IN NATURAL GAS BASE RATES)
(FILED AUGUST 31, 2006))

ORDER NO. 7152

AND NOW, this 20th day of March, 2007;

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

AND WHEREAS, the Hearing Examiner recommends that the Proposed Settlement Agreement, dated February 15, 2007, which is endorsed by all the parties, and which is attached to the original hereto as "Attachment B," be approved;

AND WHEREAS, the Proposed Settlement Agreement reflects a total base rate revenue increase of \$9 million, or approximately 3.9 percent of total gas revenues, based on an overall rate of return of 7.73 percent and a return on equity of 10.25 percent;

AND WHEREAS, under the terms of the Proposed Settlement Agreement, a generic statewide proceeding will be initiated for the purpose of investigating "decoupling" mechanisms for gas and electric distribution utilities;

AND WHEREAS, the Commission finds that the proposed rates and tariff changes are just and reasonable and that adoption of the Proposed Settlement Agreement is in the public interest;

Now, therefore, **IT IS ORDERED:**

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the March 15, 2007 Findings and Recommendations of the Hearing Examiner, appended hereto as "Attachment A."

2. That the Commission approves the tariff changes and rates contained within the Proposed Settlement Agreement, which is attached to the original hereto as "Attachment B," effective for natural gas service rendered on and after April 1, 2007.

3. 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/ Karen J. Nickerson
Secretary

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

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DELMARVA POWER & LIGHT COMPANY FOR A) PSC DOCKET NO. 06-284
CHANGE IN NATURAL GAS BASE RATES)
(FILED AUGUST 31, 2006))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: MARCH 15, 2007

WILLIAM F. O'BRIEN
SENIOR HEARING EXAMINER

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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. 7041, dated October 3, 2006, reports to the Commission as follows:

I. APPEARANCES

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

ANTHONY WILSON, ESQUIRE.

On behalf of the Public Service Commission Staff:

ASHBY & GEDDES
BY: REGINA A. IORII, ESQUIRE.

On behalf of the Division of the Public Advocate:

G. ARTHUR PADMORE, PUBLIC ADVOCATE.

II. BACKGROUND

1. On August 31, 2006, Delmarva Power & Light Company ("Delmarva Power" or the "Company") filed an application with the Delaware Public Service Commission ("Commission") seeking approval for an overall increase in natural gas base (delivery) rates of \$14,967,000, or approximately 6.62 percent over currently approved rates. The Application also included proposed modifications to the

Company's gas tariff relating to "Reconnect" and "Premise Collection" fees and a new Bill Stabilization Adjustment ("BSA") mechanism. The BSA, if approved, would allow the Company to adjust its base (delivery) rates to reflect actual changes to the revenue it collects on a per customer basis, thereby "decoupling" revenues from sales.

2. On October 3, 2006, the Commission entered PSC Order No. 7041 suspending the rates proposed in the Application and appointing a Hearing Examiner and Rate Counsel to process the docket. On October 12, 2006, Delmarva Power filed with the Commission revised tariff leaves designed to increase its gas rates by \$2,500,000 annually, which it is permitted to do under 26 *Del. C.* §306(c)(authorizing an interim rate increase of up to \$2.5 million annually or 15 percent, whichever is less). On October 17, 2006, the Commission, by PSC Order No. 7035, approved the requested interim increase to become effective November 1, 2006, under bond and subject to refund.

3. On the evening of November 29, 2006, a duly noticed public comment hearing was conducted within Delmarva Power's service territory, in Wilmington, Delaware. No one from the public appeared at the public comment hearing and no member of the public submitted written comments.

4. After conducting discovery, and pursuant to the schedule set in the proceeding, Commission Staff and the Division of the Public Advocate ("DPA") filed written direct testimony on January 19, 2007. Staff took the position that Delmarva Power should be allowed an additional revenue requirement of \$6,565,000, while DPA recommended an increase of \$7,917,000. The parties then engaged in additional

discovery and conferred with each other in an effort to reach an agreement on the issues in the proceeding.

5. On February 20, 2007, the parties submitted a "Proposed Settlement Agreement" dated February 15, 2007, which, if approved, would resolve (or defer) all contested issues in the case. The Proposed Settlement calls for an annual revenue increase of \$9.0 million, or approximately 3.9 percent of total gas revenues, and reflects a cost of equity of 10.25 percent. It also defers consideration of the BSA until the Commission initiates a generic statewide proceeding regarding decoupling mechanisms for gas and electric distribution utilities. On March 2, 2007, the Company submitted written testimony of William R. Moore Jr. in support of the Proposed Settlement.

6. The parties met for an evidentiary hearing on March 6, 2007.¹ The parties introduced their pre-filed testimonies into the record, they described the terms of the Proposed Settlement, and they called witnesses to testify in support of the settlement agreement. The record, which consists of five exhibits and a 49-page verbatim transcript, was then closed. As there were no matters in dispute, briefs were deemed unnecessary. I have considered the entire record of this proceeding and, based thereon, I submit for the Commission's consideration these Findings and Recommendations.

¹The affidavits of publication of notice for the evidentiary hearings (as well as the public comment hearings and the filing of the Application) from *The News Journal* are included in the record as Exhibit 1. Exhibits will be cited as "Ex. __" and references to the hearing transcript will be cited as "Tr. __."

III. SUMMARY OF THE EVIDENCE

7. **Delmarva Power.** With its Application, the Company filed the written testimony and schedules of nine witnesses; Mark E. Browning, Charles L. Driggs, Kathleen A. White, W. Michael VonSteuben, Joseph F. Janocha, Kemm C. Farney, Roger A. Morin, John H. Chamberlin and Paul M. Normand. Ex. 2. The Company requested an increase in annual revenues of \$14,967,000, or approximately 6.62 percent over current total gas revenues. The Company calculated its rate base to be \$237,676,296 through the end of the test period, or March 31, 2006. The Company requested a rate of return on equity of 11.00 percent, with an overall rate of return of 8.08 percent. If the proposed BSA were rejected, then the Company requested a return on equity of 11.25 percent.

8. At the March 6, 2007 hearing, Company-witness William R. Moore, Jr. adopted all of the Company's pre-filed testimony and presented his written testimony regarding the terms of the Proposed Settlement. Ex. 2. He testified that adoption of the Proposed Settlement would be in the public interest because it balances the needs of various stakeholders and because the proposed rates will recover the Company's cost of providing service. Tr. 29. He noted that cost recovery is essential to the financial health of the Company's gas business as the Company continues to invest in system reliability. Ex. 2 (Moore) at 5.

9. **Commission Staff.** Susan B. Neidig, Public Utilities Analyst III, presented the prefiled testimony of four witnesses; David C. Parcell, Executive Vice President and Senior Economist with Technical Associates, Inc.; Michael J. McGarry, Sr., President and Chief

executive Officer of Blue Ridge Consulting Group; Howard Solganick, Senior Technical Consultant with Blue Ridge Consulting Group; and Michael J. Majoros, Vice President of Snavelly King Majoros O'Connor & Lee, Inc. Ex. 5. In its prefiled testimony, Staff recommended a \$6,564,957 increase (3.16 percent) in the Company's revenue requirement, or \$8,402,435 less than the Company's requested revenue requirement increase. Staff's proposed revenue requirement was based on several accounting adjustments to the Company's *pro forma* rate base and operating expenses and a recommended 9.75 percent return on equity, with an associated 7.49 percent overall rate of return. In addition, Staff recommended the use of the same five-year net salvage allowance approach for accumulated depreciation that the Commission approved in the Company's most recent electric base rate case (i.e., PSC Docket No. 05-304).

10. Staff also recommended that the Commission decline to implement the Company's proposed BSA because it was not supported by appropriate financial evidence (such as "backcasting") and would have a disproportionate impact on customers in smaller classes who reduced their consumption. In this regard, Staff recommended that the Commission open a generic proceeding to investigate whether revenue decoupling might be appropriate and, if so, the manner in which it might be implemented. In the event that the Commission approved the Company's proposed BSA, then Staff recommended that the Company's return on equity be reduced by 50 basis points to reflect the greater revenue security that would result from the BSA.

11. At the hearing, Ms. Neidig testified that adoption of the Proposed Settlement would be in the public interest because it avoids further litigation costs, yields a reasonable outcome in light of

Staff's filed position, and balances the interests of all the parties. Tr. 45. Ms. Neidig noted that \$1.5 million of the \$2.5 million difference between Staff's filed position and the negotiated settlement can be traced to the movement from Staff's recommended 9.75 percent return on equity to the 10.25 percent from the settlement, and the associated interest synchronization adjustment. The 10.25 percent, however, is within the return-on-equity range initially recommended by Staff.

12. **Division of the Public Advocate.** DPA filed the testimony of Andrea C. Crane, who addressed the Company's revenue requirements and made numerous adjustments to cost of capital, rate base, operating expenses and operating income. Ex. 3. Ms. Crane recommended a rate increase for Delmarva Power of \$7,916,701, based on a cost of equity of 9.70 percent and an overall cost of capital of 7.47 percent. In addition, Ms. Crane opposed the Company's proposed BSA, which would sever the relationship between the Company's revenues and its sales.

13. Ms. Crane recommended numerous adjustments to the Company's proposed rate base and operating income. Based on her proposed eliminations of post-test year compliance costs, construction work in progress, the prepaid pension asset, and the purchased gas cost from the Company's cash working capital, Ms. Crane recommended a rate base of \$213,011,902, or approximately \$24.7 million less than the Company's claim. Based on her adjustments to salaries and wages, incentive awards, severance costs, payroll taxes, facilities costs, fleet vehicle expense, injuries and damages expenses, advertising costs, gas association dues, rate case costs, disposition of sale proceeds, depreciation, allowance for funds used during construction,

and interest synchronization, Ms. Crane recommended a *pro forma* operating income at present rates of \$11,217,429.

14. At the evidentiary hearing, Ms. Crane testified that adoption of the Proposed Settlement would result in just and reasonable rates. Tr. 37. She noted that the proposed revenue increase from the settlement is very close to her recommended increase, after substituting the settlement's 10.25 percent cost of equity for her recommended 9.7 percent. She also noted that the increase appears to be fairly distributed among the customer classes.

15. **The Proposed Settlement Agreement.** On February 20, 2007, the parties submitted a "Proposed Settlement Agreement" dated February 15, 2007, which will be attached to the proposed Order in this case as "Attachment B." Ex. 4. Under the Proposed Settlement, the parties agree that the total base revenue increase awarded the Company will be \$9 million, or \$6.5 million above the temporary \$2.5 million revenue increase already in place. The increase is based on a cost of equity of 10.25 percent and a 7.73 percent overall rate of return. The parties agree to distribute the revenue increase among the customer classes in accordance with "Exhibit 1" to the Proposed Settlement. Under the terms of the settlement, the rate increase will take effect on April 1, 2007.

16. Depreciation rates are specified in the Proposed Settlement, at "Exhibit 3." The depreciation rates include a revised plant-removal cost component, which is based on the last five years of actual cost of removal experience in each plant account. This methodology, along with the rates used in this case for common depreciation expense, were approved by the Commission in the Company's most recent electric base rate case, PSC Docket No. 05-304. The Proposed Settlement, however,

does not prohibit the parties or the Commission from re-examining depreciation rates for removal costs in a future base rate case.

17. In addition to the changes in rates, the parties have agreed to certain changes to Delmarva Power's Rules and Regulations, as set forth in three revised Tariff leaves, which are attached to the Proposed Settlement as "Exhibit 2." The changes in Rules and Regulations include the proposed increases in the Reconnect and Premise Collection fees. The settlement does not, however, include the proposed BSA mechanism. Instead, the parties agree to participate in a generic statewide proceeding initiated by the Commission for the purpose of investigating decoupling mechanisms for gas and electric distribution utilities.

IV. DISCUSSION

18. The Commission has jurisdiction over this matter pursuant to 26 Del. C. § 201(a).

19. All parties to this proceeding entered into the Proposed Settlement Agreement (Ex. 4), dated February 15, 2007, which is attached to the proposed Order as "Attachment B." Under the Proposed Settlement, the parties stipulate to a revenue increase of \$9,000,000, which represents a 3.9 percent increase over total gas revenues, or a 15.4 percent increase over gas base (delivery) revenues. Delmarva Power has not increased its gas base rates since a 5.8 percent increase was approved in 2003 (in PSC Docket No. 03-127). According to the Company, the proposed increase is necessary to cover rising operating and capital expenses, which have not been offset by increases in sales. Ex. 2 (Application) at 9-10.

20. If the Proposed Settlement is approved, the typical 120 Ccf bill for a residential space heating customer (for base rates only)

will increase from \$49.43 (which includes the \$1.87 interim increase that went into effect in November 2006) to \$54.55 per month. If the proposed Gas Cost Rate ("GCR") decrease is taken into account, then the current typical monthly bill, in total, will change from \$177.92 to \$177.38. Ex. 2 (Moore) at Schedule WRM-1. The GCR proposal (PSC Docket No. 06-285F) is scheduled for Commission consideration on March 20, 2007, the same day that the Commission will consider this case.

21. As noted above, the Company has agreed to withdraw from this case its proposal for a Bill Stabilization Adjustment mechanism, which would serve to "decouple" revenues from sales by providing for annual rate changes that are tied to per-customer demand. Rather, the parties agree to participate in a generic statewide proceeding dealing with decoupling mechanisms for gas and electric distribution utilities. Regarding the proposed changes to the premise collection fees and reconnect fees, which were accepted as part of the settlement, such changes will increase delivery revenues by approximately \$13,200 and will place these fees on the same level as those fees that are currently in place for the Company's electric tariff. Ex. 2 (Application) at 4.

22. Based upon my review of the entire record, I find that the approval of the Proposed Settlement would be in the public interest because it balances the interests of ratepayers and the Company and obviates the need to fully litigate the complex issues raised in the Company's Application. It is clear from the record that the agreement was a product of extensive negotiation between the parties, conducted after the completion of thorough investigations by Staff and DPA, and that it reflects a mutual balancing of various issues and positions. In addition, it is significant that the parties, all of whom maintain

that the Proposed Settlement is in the public interest, represent a wide variety of interests. Finally, I note that settlements are encouraged under Delaware law, particularly when supported by all parties. 26 Del. C. § 512.

V. RECOMMENDATION

23. In summary, and for the reasons discussed above, I propose and recommend that the Commission adopt as reasonable and in the public interest the February 15, 2007 Proposed Settlement Agreement ("Attachment B" to the proposed Order). 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 15, 2007

A T T A C H M E N T “B”

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION)
OF DELMARVA POWER & LIGHT COMPANY)
FOR APPROVAL OF A CHANGE IN) PSC DOCKET NO. 06-284
GAS BASE RATES)
(FILED August 31, 2006))

PROPOSED SETTLEMENT

On this day, February 15, 2007, Delmarva Power & Light Company (“Delmarva” or the “Company”), the Delaware Public Service Commission Staff (the “Staff”) and the Division of the Public Advocate (“DPA”), all of whom together are the “Parties” or “Settling Parties,” hereby propose a complete settlement of all issues that were raised or could have been raised in this proceeding and to establish final rates as follows.

I. INTRODUCTION AND PROCEDURAL BACKGROUND

On August 31, 2006, Delmarva filed an application with the Delaware Public Service Commission (the “Commission”), pursuant to 26 Del. C. §§ 201, 301, 304, 306 and other applicable authorities to increase its gas base rates by \$14, 967,000 along with proposed modifications to the Company’s gas tariff for Reconnect and Premise Collection fees and a Bill Stabilization Adjustment (“BSA”) mechanism. The application was accompanied by various schedules, tables, and data required by the Commission's minimum filing requirements and the pre-filed testimony of several witnesses. On October 3, 2006, by Order No. 7041, the Commission suspended the proposed rate and tariff changes for a period of seven months, required public notice through newspaper

publication, established a time for interventions, and assigned the matter to Hearing Examiner William O'Brien, Esq. for evidentiary hearings and further proceedings. DPA gave notice of its intervention in this matter. Staff also participated in the case. No other entities intervened or participated. On November 1, 2006, pursuant to 26 Del. C. § 306 and Commission Order No. 7035, Delmarva put \$2.5 million of its proposed rate increase into effect on November 1, 2006 subject to refund, evidentiary hearings and further proceedings. Pursuant to the Hearing Examiner's directive, a public notice through newspaper publication was made of a public hearing that was held on November 29, 2006 in Wilmington, DE. No one from the public appeared at the public hearing.

Pursuant to the procedural schedule established by the Hearing Examiner, the Parties engaged in discovery with respect to the application and accompanying testimony and other material filed with the Application. On January 19, 2007, Staff and DPA each submitted testimony. The Staff filed testimony in which it took the position that Delmarva should be allowed an additional revenue increase of \$6,565,000 and the DPA filed testimony supporting a revenue increase of \$7,917,000. The Parties engaged in substantial discovery with respect to their respective testimony.

The Parties desire to avoid the substantial cost which would be incurred if the case were to proceed to evidentiary hearings; and the Parties have conferred in an effort to resolve the issues raised in this proceeding.

As such, it is acknowledged that the Parties differ as to the proper resolution of many of the underlying issues in the rate proceeding and are preserving their rights to raise those issues in future proceedings; however, the Parties believe that settlement of the pending rate proceeding on the terms and conditions contained herein will serve the

interest of the public as well as meet the statutory requirement that rates be both just and reasonable.

II. SETTLEMENT PROVISIONS

IT IS HEREBY STIPULATED AND AGREED by Delmarva, Staff, and the DPA that the Parties will submit to the Commission for its approval the following terms and conditions for resolution of this rate proceeding:

A. Rates and Charges.

1. No refunds with respect to the interim \$2.5 million revenue increase are necessary.
2. The total base rate revenue increase should be \$9.0 million, or approximately 3.9% of total gas revenues. This is an incremental increase of \$6.5 million or approximately 2.9% of total gas revenues above the level of rates that became effective on an interim basis on November 1, 2006.
3. The Parties have agreed to the distribution of the base rate revenue changes among all classes of customers as shown in Exhibit 1.
4. A cost of equity of 10.25% for the Company is reasonable and should be adopted for this proceeding. This produces an overall rate of return of 7.73 %.
5. The rates approved for usage on and after April 1, 2007, shall be as set forth in the tariff leafs attached as Exhibit 2.

6. The Parties agree to the depreciation rates shown in Exhibit 3. These depreciation rates are based on a rolling five-year average of actual depreciation expense for the removal cost component of depreciation but this Settlement does not prohibit the parties or the Commission from re-examining this issue in a future base rate case.

B Bill Stabilization Adjustment

1. The Parties agree to participate in any generic statewide proceeding initiated by the Commission for the purpose of investigating Bill Stabilization Adjustments or decoupling mechanisms for electric and gas distribution utilities. The parties will strive to conclude any such proceeding as expeditiously as possible, recognizing there are important policy issues that need to be fully explored. The Parties reserve their rights to argue their positions on the appropriateness of a BSA or decoupling mechanism during the proceeding, which may take the form of a workshop process. The return on equity of 10.25% stated herein does not reflect the adoption of any BSA or decoupling mechanism. The parties reserve their rights to argue that a return on equity adjustment or some other adjustment may or may not be appropriate if a BSA or decoupling mechanism is adopted..

C. Miscellaneous Issues.

1. The Parties agree that the Company's proposed tariff modifications to Leaf No. 25 illustrating the proposed Reconnect and Premise Collection Fees should be approved.

D. Additional Provisions

1. The provisions of this settlement are not severable.

2. This Settlement is the product of extensive negotiations and reflects a mutual balancing of various issues and positions. This Settlement represents a compromise for the purposes of settlement and shall not be regarded as a precedent with respect to any ratemaking or any other principle in any future case. No Party to this settlement necessarily agrees or disagrees with the treatment of any particular item, any procedure followed, or the resolution of any particular issue in agreeing to this settlement other than as specified herein, except that the Parties agree that the resolution of the issues herein taken as a whole results in just and reasonable rates and that the non-rate tariff changes are reasonable and in the public interest.

3. To the extent opinions or views were expressed or issues were raised in the pre-filed testimony that are not specifically addressed in the Settlement, no findings, recommendations, or positions with respect to such opinions, views or issues should be implied or inferred. This Settlement shall not set a precedent, shall not have issue or claim preclusion effect in any future proceeding, and no party shall be prohibited from arguing a different policy or position before the Commission in any future proceeding. The purpose of this Settlement is to provide just and reasonable rates for the customers of Delmarva.

IN WITNESS WHEREOF, intending to bind themselves and their successors and assigns, the undersigned Parties have caused this Proposed Settlement to be signed by their duly-authorized representatives.

/s/ J. Mack Wathen
Delmarva Power & Light
Company

/s/ Bruce H. Burcat
Delaware Public Service
Commission Staff

/s/ G. Arthur Padmore
Division of the Public Advocate