BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION	**)**	
OF DELMARVA POWER & LIGHT COMPANY	**)**	
FOR APPROVAL OF MODIFICATIONS TO	**)**	**PSC DOCKET NO. 07-239F**
ITS GAS COST RATES	**)**	
(FILED SEPTEMBER 4, 2007)	**)**	

ORDER NO. 7439

AND NOW, this 16th day of September, 2008;

WHEREAS, the Commission having received and considered the Findings and Recommendations of the Hearing Examiner ("Report"), dated September 3, 2008, issued in the above-captioned docket, which was submitted after a duly-noticed public evidentiary hearing;

AND WHEREAS, the Commission finds that the proposed rates and tariff changes are just and reasonable and that adoption of the Hearing Examiner's Report 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 September 3, 2008 Findings and Recommendations of the Hearing Examiner, appended to the original hereof as Attachment "A";

2. That the Commission approve Delmarva Power & Light Company's proposed rates and tariff changes (made effective on a temporary basis on September 18, 2007) with meter readings on and after November 1, 2007 until October 31, 2008 as shown below:

GCR GCR

Rate Schedules	Demand Charge	Commodity Charge
RG, GG and GL	N/A	96.517¢/ccf
Non-electing MVG	$10.20/Mcf of Billing MDQ	$8.2710/Mcf
Electing MVG & LVG	$10.20/Mcf of Billing MDQ	Varies
Standby Service	$10.20/Mcf of Standby MDQ	N/A

3. That the Commission approves as just, reasonable, and in the public interest, Delmarva Power & Light Company's proposals contained in the Proposed Settlement Agreement appended to the original hereof as Attachment "B".

4. That Delmarva Power & Light Company shall file such tariff sheets as may be needed consistent 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/ Dallas Winslow
Commissioner

/s/ Jaymes B. Lester
Commissioner

/s/ Jeffrey J. Clark
Commissioner

ATTEST:

/s/ Karen J. Nickerson
Secretary

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

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER & LIGHT COMPANY FOR APPROVAL OF MODIFICATIONS TO ITS GAS COST RATES (FILED SEPTEMBER 4, 2007)	))) PSC DOCKET NO. 07-239F))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: September 3, 2008

RUTH ANN PRICE
SENIOR HEARING EXAMINER

TABLE OF CONTENTS

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER & LIGHT COMPANY FOR APPROVAL OF MODIFICATIONS TO ITS GAS COST RATES (FILED SEPTEMBER 4, 2007)	)))))	PSC DOCKET NO. 07-239F

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

Ruth Ann Price, duly appointed Hearing Examiner in this docket pursuant to 26 *Del. C.* § 502 and 29 *Del. C.* 101, by Commission Order No. 7285, dated September 18, 2007, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, Delmarva Power & Light Company ("Delmarva" or “the Company”):

TODD L. GOODMAN, ESQUIRE

On behalf of the Public Service Commission Staff (“Staff”):

Ashby & Geddes

BY: JAMES McC. GEDDES, ESQUIRE

On behalf of the Division of the Public Advocate (“DPA”):

G. ARTHUR PADMORE, PUBLIC ADVOCATE
JOHN CITRILLO, DEPUTY DIRECTOR

II. BACKGROUND

A. THE APPLICATION

1. On September 4, 2007, Delmarva filed its annual application (“the application") with the Delaware Public Service Commission (the

“Commission”) to adjust its Gas Cost Rate (“GCR”) factors, effective on and after November 1, 2007, with proration, and with such revised factors to continue in effect until October 31, 2008. The proposed rates, as compared to the current, approved rates, are as follows:

	Present		Proposed	
Rate Schedules	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	102.357¢/ccf	N/A	96.517¢/ccf
Non-electing MVG	$8.8630/Mcf of Billing MDQ	$9.3298/Mcf	$10.20/Mcf of Billing MDQ	$8.2710/Mcf
Electing MVG & LVG	$9.98/Mcf of Billing MDQ	Varies	$10.20/Mcf of Billing MDQ	Varies
Standby Service	$9.98/Mcf of Standby MDQ	N/A	$10.20/Mcf of Standby MDQ	N/A

2. In addition, the application requests approval of the Company's proposals to: (a) reconcile actual versus estimated commodity cost rate assignments for LVG and electing MVG customers; and (b) reconcile actual versus estimated commodity cost rate assignments for sales to Flexibly Priced Sales Service Customers and true-up of fuel expense and margins.

3. The impact on customers would mean that those served under service classifications RG, GG and GL would experience approximately a 5.7% reduction in the level of the GCR. Residential space heating customers using 120 Ccf per month in the winter would experience a decrease of 4.0% or $7.01 per month in their total bill. Commercial and industrial customers using “GG” and non-electing “MVG” service classifications would experience decreases in their winter bills in the ranges of 2.4% to 4.5% and 4.3% to 5.7%, respectively, in monthly

billings depending on applicable service classification and load/consumption characteristics.

4. On September 18, 2008, pursuant to PSC Order No. 7285, the Commission allowed the new proposed GCR factors, reconciliation and true-ups, and non-firm surcharge to become effective on a temporary basis, subject to refund, effective with meter readings on and after November 1, 2007, with proration. In addition, the Commission designated the undersigned hearing examiner to conduct public evidentiary hearings and to report to the Commission her proposed findings and recommendations based on the evidence presented.

5. Notice of the application, including information on how to intervene in the proceeding, was published on September 25 and 26 in *The News Journal* newspaper. The notice provided an explanation of temporary rates placed into effect by the Commission and gave information concerning how members of the public could participate and submit comments concerning the Company's proposal.

6. The Division of the Public Advocate filed a timely notice to participate in the proceeding on September 27, 2007. No other party petitioned for intervention.

7. Further, on September 25 and 26, 2007, the Company announced, through publication in *The News Journal* newspapers, that a public comment hearing would be held on November 15, 2007 at the Carvel State Office Building in Wilmington.

B. PUBLIC COMMENT SESSION

8. A duly noticed public comment hearing was conducted on the evening of November 15, 2007 at the Carvel State Office Building in

Wilmington, Delaware.[1] In addition to publication of the notice in *The News Journal* newspaper, the Company directly notified the organizations that participate in its “Project Concern” as well as the Association of Community Organizations for Reform Now (“ACORN”).

9. Representatives from the Commission Staff, the DPA, and the Company appeared at the hearing. The hearing initially began at 7:10 p.m. I adjourned the hearing for approximately five (5) minutes to allow members of the public to arrive. At 7:16 p.m., I again called the session to order and, finding that no members of the public had arrived, I adjourned the meeting at approximately 7:19 p.m.

III. SUMMARY OF THE EVIDENCE

10. On April 23, 2008 and May 21, 2008, public comment sessions and evidentiary hearings were held for consideration of Delmarva’s application. The record, as developed at the hearing, consists of a 25-page verbatim transcript and 11 exhibits with subparts. No members of the public attended either the public comment sessions or the evidentiary hearings.

A. Summary of Testimony.

11. At the evidentiary hearing on April 23, 2008, the parties presented their witnesses who summarized their testimonies and adopted their prefiled testimonies for the record.

[1]The Public Comment Hearing held on November 15, 2007 was a jointly held session with the public comment sessions for PSC Docket No. 07-237, Delmarva’s environmental surcharge case entitled, In The Matter Of The Application Of Delmarva Power & Light Company For A Change In The Gas Environmental Surcharge Rider Rate, filed on August 31, 2007 and the instant case, PSC Docket No. 07-239F. No members of the public attended the sessions for either of these cases.

12. **Company's Direct Testimony.** With its application, Delmarva submitted the pre-filed direct testimony of four witnesses: C. Ronald McGinnis, Jr., Regulatory Team Lead, Regulatory Affairs Department for PHI Service Company, Hallie M. Reese, Vice President of Gas Delivery, and Charles L. Driggs, Manager of Gas Operations and Planning. In addition, Delmarva submitted the prefiled rebuttal testimonies of W. Thomas Bacon, Jr., Director -- Regulatory & Natural Gas Planning for PHI Service Company and C. Ronald McGinnis, Jr. At the evidentiary hearings, Mr. McGinnis and Mr. Bacon appeared to give live testimony. Mr. McGinnis sponsored as his own prefiled direct and rebuttal testimonies (Exs. 3 and 4) and he adopted the prefiled testimonies of Hallie M. Reese (Ex. 7) and Charles L. Driggs (Ex. 8). Mr. Bacon sponsored his own prefiled direct and rebuttal testimonies (Exs. 5 and 6).

13. Mr. McGinnis presented a chart, which I have duplicated below, demonstrating the impact on each rate class for the proposed GCR.

	Present	Proposed	
Rate Schedules	GCR Commodity Charge	GCR Commodity Charge	Change
RG, GG and GL	102.357¢/ccf	96.517¢/ccf	(5.840)¢/ccf
LVG & MVG Demand	$9.98/Mcf Billing MDQ	$10.20/Mcf Billing MDQ	($0.22)Mcf
LVG & Electing MVG	Varies Monthly	Varies Monthly	N/A
Non-Electing MVG Commodity	$8.8630/Mcf	$8.2710 Mcf	($0.5920)/Mcf

Ex. 3 at 3. This chart reveals that not only residential customers, non-electing MVG customers, LVG, and electing MVG demand customers will experience some level of a decrease.

14. Mr. McGinnis provided testimony regarding development of the proposed GCR and its impact on the various customer classes, reconciliation of actual versus estimated commodity cost rate assignments for LVG and electing MVG customers, and reconciliation of actual versus estimated commodity cost rate assignments for sales to Flexibly Priced Sales Service Customers and true up of fuel expense and margins. Ex. 3 at 3.

15. Mr. McGinnis' prefiled testimony noted that the GCR of $106.972¢/ccf that went into effect on November 1, 2006 resulted in an over-recovery of $4.6 million based upon nine months of historical data and three months of updated estimates. Ex. 3 at 3. Mr. McGinnis stated that pursuant to PSC Docket No. 00-314 margins from Capacity Release, Off-System Sales and Swaps are one hundred percent (100%) credited to the GCR until a total credit of $1.7 million for the 12-month period ending every June is reached. Ex. 3 at 4. After the threshold of $1.7 million is reached, the margins are shared with eighty percent (80%) returned to the Firm customer through revenue credits and twenty percent (20%) retained by the Company as gross profit. *Id.* Through monthly comparison of actual and estimated gas cost and recovery for the period (nine months of historical data and three months of updated estimates), Mr. McGinnis determined that the projected over-recovery for the period was approximately $4.6 million or 3.5% of estimated recoverable gas expenses which is within the 4.5% deadband for over-recoveries requiring a supplemental GCR filing. Ex. 3 at 5.

16. Further, Mr. McGinnis summarized the methodologies used: (a) to develop the GCR factors and the credits associated with certain shared margin revenues; (b) to perform the reconciliations and true-ups which compare and take into account for recovery in this case the differences between costs and revenues estimated in the prior years' GCR proceedings with actual costs and revenues incurred; and (c) to true-up the flexibly priced sales service.

17. Mr. McGinnis also described two accounting adjustments that were made in the preparation of the filing. The first adjustment was made in March 2007 to correct the use of an outdated WACCOG in February 2007. Ex. 3 at 10. The adjustment was made to determine the commodity revenue for an LVG customer. *Id*. The Company determined that the fuel revenue was overstated by $13,838. In May 2007, the Company made a second adjustment - the effect of which was to reduce the recoverable gas costs in the amount of $1,909. The adjustment involved correcting the use of an incorrect WACCOG in April 2007 for flexibly priced sales service. *Id*.

18. Mr. McGinnis concluded by observing that the effect of the proposed decrease to the GCR on residential space heating customers using 120 Ccf per month in the winter months would be a decrease of $7.01, or 4.0%. Consequently, customers using 120Ccf would experience a reduction from $177.38 per month to $170.37 per month. General gas and non-electing MVG customers would experience a decrease in the commodity portion of their bills from 2.4% to 5.7% depending on usage characteristics and service classification. Ex.3 at 12.

19. Mr. McGinnis sponsored the pre-filed testimony of Hallie M. Reese, Vice President of Gas Delivery, for Delmarva. Ex. 7 at 1. Mr. McGinnis adopted Ms. Reese's testimony regarding the Company's

strategy to mitigate the volatility of wholesale natural gas market prices; actions taken by the Company to deal with the projected capacity deficiency; and the results of PSC Docket No. 06-285F.

20. Mr. McGinnis testified that Delmarva's proposed gas cost rate factors are developed to recover the total estimated level of firm gas commodity and demand expenses expected to be incurred by the Company during the 2007/2008 period. Ex. 7 at 2. Further, the gas cost factors are designed to "true-up" the projected over-recovery of actual gas costs during the 2006/2007 period ending October 31, 2007 by including those over-recovered amounts for amortization through the proposed 2007-2008 period.

21. The following chart, taken in its entirety from the prefiled testimony of Ms. Reese, reveals the effects of the proposed gas cost rate for each class of service. Ex. 7 at 3.

GAS COST RATE

	Current	**Proposed**	**Change**
RG, GG, and GL	102.357¢/ccf	96.517¢/ccf	(5.840)¢/ccf
LVG and MVG Demand	$9.98/Mcf of MDQ	$10.20/Mcf of MDQ	0.22/Mcf of MDQ
Non-Electing MVG Commodity	$8.8630/Mcf	$8.2710/Mcf	($0.5920)/Mcf
LVG and Electing MVG Commodity	Varies Monthly	Varies Monthly	N/A

22. In order to mitigate the volatility of natural gas wholesales market prices and their effects on its customers, Mr. McGinnis testified that the Company: (a) uses its Gas Hedging Program ("Program"), which was approved by the Commission in PSC Docket 97-293F; (b) purchases natural gas during the summer and puts it into storage for use during the five-month winter heating season

when demand is highest; (c) supports and sponsors several programs that educate consumers on energy use and provides financial support for consumers who have difficulty paying their bills; and (d) offers flexible payment arrangements. Ex. 7 at 3-4.

23. Further, Mr. McGinnis testified that currently the Company has a design day gas supply deficiency. In order to meet this deficiency in the next several years, the Company will use both contracted capacity and the Company's LNG facilities. In addition, the Company is evaluating several options and is seeking to enter into agreements with interstate pipeline companies. Ex. 7 at 4.

24. Mr. McGinnis testified that gas sales forecast for the 2007-08 period reveals a 1.4% a decrease in sales to GCR customers in comparison to the 2006-2007 forecast. Ex 8 at 3. This decrease reflects a change to the small customer forecast methodology. Ex. 8 at 4. A primary assumption underlying 2006-2007 forecast was that the retail price of natural gas would remain constant on an inflation-adjusted basis. Therefore, it was thought that gas prices would increase with the rate of general inflation. In fact, retail natural gas prices increased faster than the rate of general inflation. Ex. 8 at 4. The forecast for the current GCR period reflects price projections based upon the commodity markets as of early July. *Id.* The other determinants in the forecast are constant from prior periods, multi-variate econometric models for projection of sales and customer growth for the small customer classes – the residential, residential space heat, and general gas rate customers. *Id.*

25. Mr. McGinnis stated that for the MVG and LVG volumes, and GL volumes, there were no changes to the forecasting methodology. Sales forecasts for large customer sales or transportation volumes were

forecasted with essentially the same methodology that had been used since 1999. Of significant importance is that while sales forecast are projected to increase in the RG, GG, and LVG rate classes, reductions are expected in the MVG class. Ex. 8 at 6.

26. Company witness W. Thomas Bacon, Jr., Director – Gas Supply & Regulatory Planning for PHI Service Company, provided testimony on the following items regarding: (a) interstate pipeline transportation and storage services; (b) firm natural gas purchase requirements; (c) natural gas commodity costs and prices; (d) natural gas hedging program annual update; (e) capacity release and off-system sales activity; and (f) update on planned capacity additions. (Ex. 5 at 3.)

27. Regarding the available natural gas supply, Mr. Bacon testified that the Company has 169,230 Mcf of peak or design day supply to meet firm sales customer needs, but based upon projected requirements there will be a shortfall of 8,873 Mcf. Mr. Bacon noted that this shortfall compares to an estimated design day shortfall of 4,117 Mcf in last year's GCR filing or a change of 4,756 Mcf. Ex. 5 at 4. The reason for the year-to-year increase in design day shortfall is a result of the higher demand factor used in the regression analysis used to estimate the design day demand. *Id.*

28. Mr. Bacon stated that there is an expected over-recovery of $4.62 million as of October 31, 2007. Ex. 5 at 7. This over-recovery is explained by lower commodity costs, higher capacity release, and off-system sales margins which were offset by lower sales, and interim GCR adjustment and higher billed pipeline demand charges. *Id.*

29. Mr. Bacon testified that the Company's natural gas commodity purchases for the period November 2007 to October 2008 are a result of three major components: (a) natural gas taken from storage; (b)

“hedged” gas purchases; and (c) “spot” gas purchases. As a percentage of the total amount of gas provided to customers, storage withdrawals represent twenty-three percent (23%), hedged purchases comprise approximately thirty-three percent (33%), and spot purchases are forty-four percent (44%) of the requirements for the November 2007 to October 2008 period. Ex. 5 at 9. The projected commodity costs for the GCR period are anticipated to be $125,813,187. Ex. 5 at 9, Schedule WTB-5, page 18, at line No. 299.

30. Mr. Bacon testified that for the 2007-08 GCR year, the Company currently has approximately 37% of its overall purchase requirements hedged at an average hedged price of $7.98 per MMBtu including hedges for storage injections. Ex. 5 at 16. For Delmarva customers, when compared to NYMEX gas futures at the close of business on July 31, 2007, the hedges in place for the twelve-month GCR period of November 2007 to October 2008 would result in about $0.9 million of lower gas commodity costs. *Id.*

31. **DPA’s Direct Testimony.** DPA submitted the prefiled testimony of one witness, Andrea C. Crane, Vice President of Columbia Group, Inc. Ms. Crane recommended that the Company’s proposed GCR rates as contained in its application, approved by the Commission on a temporary basis, should be made permanent for the period November 1, 2007 through October 31, 2008, subject to true-up in the next GCR filing. Ex. 9 at 32-33.

32. Ms. Crane further recommended that the Company should be required to demonstrate that any transactions that resulted in hedging more than one hundred percent (100%) of its firm supply requirements were beneficial to customers. Ex. 9 at 6. If the Company was unable to establish the benefit for customers, the Commission should disallow

the difference between the actual hedged costs and the NYMEX settle prices for hedged volumes. *Id.*

33. Additionally, Ms. Crane supported the use of the National Oceanic and Atmospheric Association's ("NOAA") thirty-year weather normal. However, Ms. Crane recognized that NOAA is reviewing the practice of using a thirty-year normal to determine a normal weather. Ex. 9 at 11. Therefore, Ms. Crane concluded that if NOAA should determine a different time period for determining normal weather, it may be appropriate to change to a different time period. However, until NOAA changes its practice, Ms. Crane stated that the Company should continue to use a thirty-year period to determine its sales forecasts. *Id.*

34. Ms. Crane observed that the Company's off-system sales margins ($803,000) and commodity release revenues ($3,142,000) appear low compared with historic results. Ex. 9 at 21. Margins up to $1.7 million are credited to customers at one hundred percent (100%). Margins above $1.7 million are credited to customers at the rate of eighty percent (80%) to ratepayers and twenty percent (20%) to shareholders. *Id.* Based upon the historical data for capacity release and off-system sales, the data reported in this case appears low. *Id.* Ms. Crane therefore questioned whether customers were being afforded the full credit for all of the margins to which they were entitled. Ex. 9 at 22. Further, Ms. Crane recommended that the Company provide actual data concerning the level of capacity release revenues and off-system sales margins it had received.

35. In her pre-filed testimony, Ms. Crane stated that the Company's estimated design day firm customer requirements are 178,103 Mcfs for the 2007-2008 GCR period while its firm design day supply is

only 169,230 Mcfs, resulting in a shortfall of 8,873 Mcfs. In the past several years, the design day model used by the Company has produced forecasted deficits. This shortfall is projected to be 11,976 Mcfs by the 2008-2009 GCR period. Ex. 9 at 27.

36. Ms. Crane noted that the Company has obtained new capacity with an additional 3,200Dth per day from Eastern Shore Natural Gas Pipeline ("ESNG"). *Id.* The new service from ESNG came into service on November 1, 2007. Ms. Crane noted that this new service is not upstream pipeline capacity available to Delmarva and does not impact the design day supply sources. *Id*. The Company is purchasing the ESNG capacity rather than extending and expanding its own facilities in its service territory. *Id*.

37. Ms. Crane reflected that The Company can meet its short-term peak day shortfall by increasing output from its LNG facility. Ex. 9 at 28. Further, the Company has the capacity to increase its LNG production from 25,000 Mcfs per day to 45,000 Mcfs per day. *Id.*

38. Ms. Crane noted that the Company has used the same loss factor, 2.5%, in the past several GCR filings. *Id.* Ms. Crane noted that the actual rolling twelve-month average through June 2007 was 1.6%, while the thirty-six month average was 2.1%. Ms. Crane expressed certainty that even if the loss factor of 2.5% used in this case was not precise, the costs resulting from the loss factor are trued-up annually which ensure that ratepayers will pay rates that reflect actual costs incurred by the Company in the GCR year. Ex. 7 at 31. However, she recommended that the Commission monitor the 2.5% loss factor to determine whether its use in future GCR cases was appropriate. *Id.*

39. Ms. Crane stated that her investigation revealed that the

Company did very little to promote budget billing during this past year. Ex. 9 at 31. Delmarva did not publish any bill inserts or newsletter articles addressing budget billing during 2007. *Id.* Ms. Crane observed that only seven gas-only residential customers were added as budget billing customers. However, Ms. Crane further explained that from December 1, 2006 to December 1, 2007, the Company increased its total budget billing customers by 480 residential electric customers and 19 non-residential customers. *Id.*

40. Ms. Crane stated that the Company actually over-collected by the amount of $5.7 million, or 4.4%, which exceeded its original projection in its application of 4.6 million or 3.5%. Ex. 9 at 32. Nevertheless, Ms. Crane did not recommend any adjustment to the Company's GCR rate because it also projected an under-recovery of $1.1 million for gas costs by October 31, 2008. This under-recovery is within the deadband of 4.5% over-recovery and 6.0% under-recovery that would mandate a revision of the GCR rate. Ex. 9 at 33. Ms. Crane noted that the true-up process will provide a reconciliation of the actual and projected natural gas costs and recoveries. *Id.*

41. **Staff's Direct Testimony**. Commission Staff submitted the prefiled testimony of Michael J. McGarry, Sr., President and Chief Executive Officer of Blue Ridge Consulting Services, Inc. (Ex. 10) and Courtney A. Stewart, Public Utilities Analyst. Ex. 11. At the evidentiary hearings on April 23, 2008 and May 21, 2008, Ms. Stewart adopted the prefiled testimony of Mr. McGarry as her own. Ms. Stewart detailed her review of Delmarva's application. She recommended that the Commission approve the changes sought by the Company to modify its current GCR factors, subject to true-up. Ex. 10 at 2-3.

42. Ms. Stewart testified that the Company's Hedging Program has several strengths, such as the Company proactively manages its gas supply to mitigate the need for financial hedging by using gas storage and diversifying suppliers. Nevertheless, Ms. Stewart identified several weaknesses of the Program, including: (a) the absence of written gas hedging policies and procedures that provide the Company's current approved practices; (b) no policies and procedures exist concerning approval of hedge counterparties and managing counterparty credit risk; and (c) there are no policies regarding approved trading limits nor a written procedure for approving trades of various sizes. Ex. 10 at 6-7. In addition, Ms. Stewart reported several weaknesses in the Company's Quarterly Hedge Reports and the fact there is no procedure for periodic review of the Program. Ex. 10 at 7.

43. However, Ms. Stewart noted that the guidelines established by the Commission for the Program in PSC Docket No. 00-463F appear to be a part of the Company's overall gas procurement strategy. Further, the Company uses both financial (*e.g.* entering into a contract for the purpose of reducing risk) and non-financial hedging in the management of its gas risk (diversifying natural gas commodity, transportation, and storage supply sources). Ex. 10 at 12-13.

44. Ms. Stewart stated that the Company's implementation of its hedging strategy appears consistent with the dual objectives of mitigating gas price volatility and protecting consumers against price spikes. Ex. 10 at 14. However, Ms. Stewart cautioned that hedging is designed to produce a more *predictable*, but not necessarily *lower cost* outcome (*i.e.*, stable or less volatile prices for natural gas). *Id.*

45. Ms. Stewart recommended that the Company's target should be hedging approximately seventy percent (70%) of the current year's gas

purchases. Ex. 10 at 18. Further, Ms. Stewart recommended that the Commission continue to monitor the Company and the level of hedging in order to determine whether the 70% target level results in hedging at too high a level such that it is detrimental to ratepayers. Ex. 10 at 19.

46. In addition, Ms. Stewart recommended several changes to the Quarterly Hedging Report that should facilitate this review of the Hedging Program. Ex. 10 at 19-20. For example, she found that there is no comprehensive written document stating the Company's gas hedging goals, guidelines and procedures, credit policy, and accounting and compliance practices. Ex. 10 at 21. Further, she noted a lack of "institutionalization" of hedging knowledge within the Company. *Id.* Information concerning the Program and hedging activity are confined to a few individuals within the Company and there is a need to establish trading limits and establish levels. *Id.*

47. Further, Ms. Stewart stated that in its application, Delmarva requested that it be allowed to revise the GCR demand and commodity charge applicable to Service Classifications MVG and LVG, and to revise the volumetrically applied GCR factors applicable to Service Classifications Residential Gas Sales Service ("RG"), General Gas Sales Service ("GG"), Gas Lighting Sales Service ("GL"), and non-electing MVG, effective on November 1, 2007 with proration. Ex. 11 at 4.

48. Ms. Stewart noted that an average residential heating customer using 120 ccf during a winter month would experience a decrease of $7.01, or 4.0% in their total bill. Ex. 11 at 5. For industrial customers, those in service classifications GG and non-electing MVG will experience decreases on their winter bills within

the ranges of 2.4% to 4.5% and 4.3% to 5.7%, respectively, depending on load usage and characteristics. *Id.*

49. Of particular interest, Ms. Stewart found that Delmarva's sales forecast for the November 2007-October 2008 GCR shows an overall decrease in sales of 1.4%. The forecast for the MVG and GL classes show the greatest sales reductions. The MVG class sales are projected to decrease by 20.1% and the GL class sales are projected to decrease by 23.8%. Ex. 11 at 9. This reduction is due to larger customers switching to firm transportation service. The GVFT class is projected to increase 10.3%, the MVFT class is projected to increase 35.6%, and the LVFT class is projected to increase 9.3%. Overall firm transportation is projected to increase 520,111 Mcfs, or 13%, when compared to last year's forecasts. *Id.*

50. When MVG and LVG companies switch to transportation service, the class of GCR customers as a whole assumes liability for the annual costs of interstate pipeline services and storage contracts. *Id.* Since these costs remain when MVG and LVG customers switch, Delmarva has the option of charging the switching MVG or LVG company a transition fee. However, the Company may also release the excess pipeline capacity back into the market sharing the profits according to the settlement agreement in Docket No. 00-314. *Id.*

51. Ms. Stewart explained that the Company used the NYMEX gas futures' closing prices on July 24, 2007 as its spot (wholesale) gas price.[2] Ex. 11 at 10. In the 2006-2007 GCR application, the Company used a blended average rate, based on the NYMEX gas futures, EIA, and

[2]Ms. Stewart noted that using this methodology is consistent with the Commission's guidelines stated in PSC Order 6956 (July 11, 2006).

PIRA rates. For that GCR period, a blended rate was warranted because of the large spread of futures' prices. For the 2007-2008 GCR period, the price spreads are narrower, therefore, using the NYMEX futures' prices is reasonable. Ex. 11 at 11.

52. For the November 2007 - October 2008 GCR period, the natural gas commodity costs are based upon the Company's commodity requirements consisting of storage withdrawals, hedged purchases, and spot purchases. Ms. Stewart testified that the Company's commodity requirements are comprised of 23% storage withdrawals, 33% hedged purchases, and 44% spot purchases. The Company estimated commodity costs of $125,813,187 for the November 2007 to October 2008 GCR period. *Id.*

53. For hedged purchases, Ms. Stewart observed that City gate deliveries[3] are hedged at 43% for the entire GCR period, with an average cost of $7.92. Storage injections are hedged at 15%; with an average cost of $8.54. From November 2007-October 2008, 37% of the plan is hedged, with an average cost of $7.98. *Id.*

54. Ms. Stewart stated that the Company's projected GCR fixed costs for the November 2007-October 2008 GCR are $23,369,223. These costs include costs for pipeline capacity and supply, costs for storage and seasonal services, and costs for supplemental and peaking sources. For the 2007-2008 GCR period, total fixed costs are projected to be 12.6% or $2,621,155 higher than the previous GCR. Further, costs for pipeline capacity and supply are estimated to be 13.2% higher or $2,260,530 than the previous GCR and costs for storage

[3]"City gate deliveries" denote the delivery point where the interstate pipelines deliver the gas to Delmarva's distribution facilities. In other

. . . (footnote continued to next page.)

and seasonal services are estimated to be 8.8% or $317,713 higher than the previous GCR. Further, fixed costs for supplemental and peaking sources are estimated to be 56.5% or $42,912 higher than the 2006-2007 GCR; totaling an increase of $42,912.

55. Ms. Stewart noted that the Company used three measures to mitigate the price volatility of natural gas: (a) the Hedging Program; (b) Storage Injections; and (c) the Good Neighbor Energy Fund, Low Income Summit, and Budget Billing.

56. Ms. Stewart explained that the Company anticipates experiencing a design day shortfall which it has taken measures to remedy, including subscribing to 24, 155 Mcf/day of new Transco Sentinel capacity. However, based upon her overall review of the Company's application, Ms. Stewart recommended that this hearing examiner and the Commission approve the Company's application.

B. The Proposed Settlement.

57. The parties reported that after several discussions and negotiations they had reached a Proposed Settlement. The Proposed Settlement consists of 6 pages and is attached hereto as Attachment "B." Ex. 2.

58. **Delmarva's Proposed Rates and Other Provisions**. In the Proposed Settlement, the parties also agreed to recommend Delmarva's proposed rates to the hearing examiner and to the Commission. In addition, Delmarva agreed not to hedge more than 100% of its estimated firm supply requirements in any given month. In the event that

words, the interstate pipelines deliver the gas to "the city gate" to be
. . . (footnote continued to next page.)

hedging exceeds 100%, the Company will explain the reason for this level in its Quarterly Hedging Report. Further, the parties agreed to discuss the merits of continuing to sell “put options” to offset the premium for buying “call options”. The Company agreed to prepare a report for the parties, to be filed prior to, or with, the Company's next GCR filing, discussing the merits of its current strategy.

59. In the proposed settlement, among other matters, Delmarva will modify its Quarterly Hedge Report to include a side-by-side comparison of the percent of plan hedged in the current period to the percent of plan hedged in both the previous quarter and the same quarter in the prior year. This comparison will entail Total Hedges, Hedges of City Gate Deliveries, and Hedges of Storage Injections as indicated on Page 1 of 3 of the Quarterly Hedge Report. Further, the parties will informally annually review the Hedge Program at the quarterly meeting after the 2nd Quarter Hedge Report is filed with the Commission on August 15 of each calendar year. If there are proposed modifications to the hedge program they will be reviewed as part of a GCR proceeding.

60. In addition, Delmarva’s Corporate Risk Management Committee will review the Natural Gas Commodity Risk Management Policy each December. The Company has revised its Natural Gas Commodity Risk Management Policy to address various concerns raised by Staff. Further, Delmarva agreed to revise future GCR filings to show more specifically the crediting of capacity release revenues and off-system sales margins. To that end, Delmarva will include a schedule showing the actual margins/revenues received starting in July preceding the

---

picked up by Delmarva and delivered to its customers.

first month of the true-up period, and demonstrate that the first $1.7 million of such margins/revenues is credited to the GCR, after which margins/revenues are shared 80/20 between ratepayers and shareholders.

61. Under the proposed settlement, should the Company seek recovery of any costs relating to the Eastern Shore Energylink Expansion Project, either through a GCR filing or some other filing, the Company will clearly identify the costs being claimed, provide supporting documentation for the costs, and explain why Delmarva believes the costs should be recovered from ratepayers.

IV. DISCUSSION

62. The Commission has jurisdiction in this matter pursuant to 26 *Del. C.* § 303(b).

63. In this case, neither Staff nor the DPA object to the proposed GCR factors, reconciliation and true-ups, non-firm surcharge, or to the proposed tariff (non-rate) modifications.

64. As seen in the testimony, both live and in the prefiled testimony, and in the attached Proposed Settlement, Staff and DPA agree that the Company’s proposed GCR rates, proposed reconciliation and true-ups, proposed non-firm surcharge, and the proposed tariff (non-rate) modifications are just and reasonable. For these reasons, I find that the approval of the Proposed Settlement is in the public interest and represents a fair and reasonable resolution of this matter, and I therefore recommend that the Commission adopt and approve it.

65. I have considered all of the record evidence and, based thereon, I submit for the Commission’s consideration these findings and recommendations.

V. **RECOMMENDATIONS**

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

A. That the Commission adopt as just, reasonable, and in the public interest the Company's proposed rates and tariff changes (made effective on a temporary basis pursuant to PSC Order No. 7285 on September 18, 2007 with meter readings on and after November 1, 2007 until October 31, 2008 as shown below:

Rate Schedules	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	96.517¢/ccf
Non-electing MVG	$10.20/Mcf of Billing MDQ	$8.2710/Mcf
Electing MVG & LVG	$10.20/Mcf of Billing MDQ	Varies
Standby Service	$10.20/Mcf of Standby MDQ	N/A

B. That the Commission approve as just, reasonable, and in the public interest the Company's proposals as provided in the Proposed Settlement.

A proposed Order, which will implement the foregoing recommendations, is attached hereto as "Attachment A."

Respectfully submitted,

/s/ Ruth Ann Price
Ruth Ann Price
Senior Hearing Examiner

Dated: September 3, 2008

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 MODIFICATIONS	**)**	**PSC Docket No. 07-239F**
TO ITS GAS COST RATES	**)**	
(Filed September 4, 2007)	**)**	

PROPOSED SETTLEMENT

On this 22nd day of April, 2008, 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 in this proceeding as follows.

I. INTRODUCTION AND PROCEDURAL BACKGROUND

On September 4, 2007, Delmarva filed an application (the "Application") with the Delaware Public Service Commission (the "Commission") to modify its Gas Cost Rate ("GCR") factors, effective on and after November 1, 2007, with proration, and with such revised factors to continue in effect until October 31, 2008. Delmarva also requested approval: a) to reconcile and true-up actual versus estimated Weighted Average Commodity Cost of Gas ("WACCOG") assignments for sales under the Flexibly Priced Sales service to restate fuel revenue and shared margin revenue credits; and, b) to reconcile and true-up actual versus estimated WACCOG assignments for sales under the Large Volume Gas service and for so-called "electing" customers taking service under the Medium Volume Gas service.

On September 18, 2007, in Order No. 7285, the Commission allowed the new proposed GCR factors, reconciliation and true-ups, and the LVG and electing MVG surcharge credit to become effective on a temporary basis, subject to refund, effective with meter readings on and after November 1, 2007, with proration. The Commission's Order also assigned the matter to Hearing Examiner Ruth Ann Price for further proceedings.

Pursuant to Order No. 7285, notice of the application, including information on how to intervene in the proceeding, was published. In addition, Delmarva provided notice to multiple agencies throughout its natural gas service territory. The Settling Parties request that the public notices be admitted into evidence as Exhibit 1.

The DPA made a timely intervention in the proceeding. No other party intervened.

After discussion among the Parties and with the approval of the Hearing Examiner a procedural schedule was adopted. The procedural schedule established April 23, 2008 for an evidentiary hearing.

A public comment session was conducted and presided over by Hearing Examiner Price on November 15, 2007. No members of the public attended.

Both Staff and DPA served data requests upon Delmarva, which Delmarva responded to. The parties also engaged in the exchange of information on a more informal basis.

The DPA and Staff filed responsive testimony on or before February 8, 2008.

II. SUMMARY OF THE APPLICATION

Delmarva's Application proposed modifications to 2007-2008 GCR year components applicable to firm sales customers, compared with the Gas Cost Rate factors in effect for the 2006-2007 GCR year as shown below:

	2006 - 2007		Proposed	
Rate Schedules	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	102.357¢/ccf	N/A	96.517¢/ccf
Non-electing MVG	$9.98/Mcf of Billing MDQ	$8.8683/Mcf	$10.20/Mcf of Billing MDQ	$8.2710/Mcf
Electing MVG and LVG	$9.98/Mcf of Billing MDQ	Varies	$10.20/Mcf of Billing MDQ	Varies
Standby Service	$9.98/Mcf of Standby MDQ	N/A	$10.20/Mcf of Standby MDQ	N/A

III. SETTLEMENT PROVISIONS

A. Specific Settlement Provisions:

The parties agree that approval of Delmarva's Application, as filed, should be recommended by the Hearing Examiner and subsequently approved by the Commission, pursuant to the following additional provisions:

1. Delmarva will not plan to hedge more than 100% of its estimated firm supply requirements in any given month. If Delmarva is more than 100% hedged, it will provide an explanation in the Quarterly Hedging Report explaining the circumstances that gave rise to that position. The parties agree to initiate a dialogue on the merits of continuing to sell put options to offset the premium associated with buying call options. The Company will prepare a report discussing the pros and cons of its current strategy. This report will be filed prior to, or with, the Company's next GCR filing.

2. Delmarva will modify the Quarterly Hedge Report to include a page that provides a side-by-side comparison of the Percent of Plan Hedged in the current period (the period covered by the Quarterly Report) to the Percent of Plan Hedged in both the previous quarter and the same quarter in the prior year. This will be for Total Hedges, Hedges of City Gate Deliveries, and Hedges of Storage Injections as indicated on Page 1 of 3 of the Quarterly Hedge Report.

3. The parties will conduct an informal annual review of the Hedge Program each year at the quarterly meeting after the 2nd Quarter Hedge Report is filed with the Commission on August 15. Any proposed modifications to the hedge program will be reviewed as part of a Gas Cost Rate (GCR) proceeding.

4. Delmarva's Natural Gas Commodity Risk Management Policy will be reviewed by the Company's Corporate Risk Management Committee each December. An update of the review will be provided to the parties no later than 60 days after the Corporate Risk Management Committee meets.

5. The Company's revised Natural Gas Commodity Risk Management Policy adequately addresses Staff's concerns regarding:

    a. comprehensiveness – covering all gas hedging and risk management policies and procedures;

    b. procedures for approving hedge counterparties and managing counterparty credit risk; and

c. establishing trading limits for Company personnel and a procedure for approving trades of various sizes.

6. If, after reviewing Delmarva's revised Natural Gas Commodity Risk Management Policy, Staff is concerned regarding the manner in which the issues in 5 a-c above have been addressed, Delmarva shall meet with Staff in an effort to address Staff's concerns.

7. Delmarva agrees to revise its future GCR filings to more specifically show the crediting of capacity release revenues and off-system sales margins. Delmarva will include a schedule showing the actual margins/revenues received starting in July preceding the first month of the true-up period, and demonstrate that the first $1.7 million of such margins/revenues is credited to the GCR, after which margins/revenues are shared 80/20 between ratepayers and shareholders.

8. In the event that the Company seeks recovery of any costs relating to the Eastern Shore Energylink Expansion Project, either through a GCR filing or some other filing, the Company will clearly identify the costs being claimed, provide supporting documentation for the costs, and explain why Delmarva believes the costs should be recovered from ratepayers

9. The parties' agreement on the issues set forth above does not waive any rights that they may have with respect to these issues in future GCR or any other proceedings.

B. General Provisions:

1. The parties agree that the proposed GCR complies with the Tariff and its approval would be in the public interest.

2. The provisions of this Settlement are not severable.

3. This Settlement 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.

10. 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.

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/ Todd L. Goodman___________
Delmarva Power & Light
Company

By:_Todd L. Goodman_________
Print Name

Date:_4/23/08__

/s/ Michael Sheehy____________
Delaware Public Service
Commission Staff

By:__Michael Sheehy___________
Print Name

Date:_4/23/08__

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

By:_G. Arthur Padmore_______
Print Name

Date:_4/23/2008

APPENDIX A

RATES AND CHARGES

Effective with meter readings on and after November 1, 2007, with proration:

Service Classifications	GCR Demand Charge	GCR Commodity Charge
RG, GG, and GL	N/A	96.517 ¢/ccf
Non-Electing MVG	$10.20/Mcf of Billing MDQ	$8.2710/ Mcf
Electing MVG and LVG	$10.20/Mcf of Billing MDQ	Varies
Standby Service	$10.20 Mcf of Billing MDQ	N/A
Electing MVG and LVG Surcharge Credit	N/A	$0.3882/Mcf