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.08-266F
ITS GAS COST RATES	)	
(FILED AUGUST 29, 2008)	)	

ORDER NO. 7658

AND NOW, this 6th day of October, 2009:

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

AND WHEREAS, the Hearing Examiner recommends that the Gas Cost Rates ("GCR") proposed by Delmarva Power & Light Company in its January 26, 2009 Supplemental Application, be approved as just and reasonable for service rendered on and after March 1, 2009;

AND WHEREAS, the Hearing Examiner also recommends that the Proposed Settlement Agreement dated May 27, 2009, which is endorsed by all the parties, and which is attached to the original hereof as Attachment "B," be approved as reasonable and in the public interest.

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

1. That by and in accordance with the unanimous vote of the Commissioners, the Commission hereby adopts the Findings and

Recommendations of the Hearing Examiner appended to the Original hereof as Attachment “A,” subject to the requirement that should the Company secure the agreement of Staff and the Public Advocate to temporarily modify the hedge amounts from the 50% or 1/12 monthly requirements set forth in the Settlement Agreement, the Company will immediately notify the Commission in writing of said modification, the effective date of said modification, and the planned duration of said modification.

2. That by and in accordance with the unanimous vote of the Commissioners, the Commission approves the Proposed Settlement appended to the original hereof as Attachment “B,” and Delmarva Power & Light Company’s proposed GCR rates, subject to the requirement that should the Company secure the agreement of Staff and the Public Advocate to temporarily modify the hedge amounts from the 50% or 1/12 monthly requirements set forth in the Settlement Agreement, the Company will immediately notify the Commission in writing of said modification, the effective date of said modification, and the planned duration of said modification.

3. That by and in accordance with the unanimous vote of the Commissioners, Delmarva Power & Light Company’s proposed rates per Ccf are approved as just and reasonable rates effective as set forth below:

	Effective 11/01/08 (Interim) GCR Demand Charge	GCR Commodity Charge	Effective 03/01/09(Supp.App.) GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	$117.560¢/Ccf	N/A	$109.812¢/Ccf
Non-Electing	$8.5538/Mcf	$10.5303/Mcf	$8.5538/MCF	$9.7555/Mcf
MVG	Bidding MDQ		Billing MDQ	
Electing MVG And LVG	$8.5538/Mcf Billing MDQ	Varies	$8.5538/Mcf Billing MDQ	Varies
Standby Service	$8.5538/Mcf Billing MDQ	N/A	$8.5538/Mcf Billing MDQ	N/A

4. 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/ Katie Rochester
Acting Secretary

E X H I B I T "A"

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FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: August 3, 2009

MARK LAWRENCE
HEARING EXAMINER

TABLE OF CONTENTS

PAGE

IN THE MATTER OF THE APPLICATION)
OF DELMARVA POWER & LIGHT COMPANY)
FOR APPROVAL OF MODIFICATIONS TO) PSC DOCKET NO.08-266F
ITS GAS COST RATES)
(FILED AUGUST 29, 2008))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

Mark Lawrence, duly appointed Hearing Examiner in this Docket, pursuant to *26 Del. C.* § 502 and *29 Del. C.* ch. 101, by the Commission's Order No. 7444 dated September 16, 2008,and the Commission's Order No. 7532 dated February 5, 2009, reports to the Commission as follows:

I. APPEARANCES

On behalf of Delmarva Power & Light Company ("the Company" or "Delmarva"):

By: TODD GOODMAN, Esq., Assistant General Counsel
C. Ronald McGinnis, Jr., Regulatory Affairs Lead
Phillip L. Phillips, Jr., P.E., Manager of Gas Operations and Planning
W. Thomas Bacon, Jr., Dir., Natural Gas Supply and Regulatory Planning

On behalf of the Public Service Commission Staff ("Staff"):

Ashby & Geddes, P.A.
BY: JAMES McC GEDDES, Esq.
Courtney A. Stewart, Public Utilities Analyst II
Richard W. LeLash, Staff Consultant

On behalf of the Division of the Public Advocate ("DPA"):

By: KENT WALKER, Esq., DEPUTY ATTORNEY GENERAL
G. Arthur Padmore, Public Advocate
Michael Sheehy, Deputy Director, Public Advocate
Andrea C. Crane, The Columbia Group, DPA Consultant

II. BACKGROUND

A. INITIAL APPLICATION

1. On August 28, 2008, Delmarva filed an Application ("Application") with the Delaware Public Service Commission (the "Commission") seeking to increase its Gas Cost Rate ("GCR") factors, effective on and after November 1, 2008, with proration, and with such revised factors to continue in effect until October 31, 2009. The approved rates for 2007-2008 and the proposed rates for 2008-2009 are as follows:

	2007-2008		**Proposed-2008-2009**	
Rate Schedules	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	96.517¢/ccf	N/A	117.560¢/ccf
Non-electing MVG	$10.20/Mcf of Billing MDQ	$8.2710/Mcf	$8.5538/Mcfof Billing MDQ	$10.5303/Mcf
Electing MVG and LVG	$10.20/MCf of Billing MDQ	Varies	$8.5538/Mcf of Billing MDQ	Varies
Standby Service	$10.20/Mcf of Standby MDQ	N/A	$8.5538/Mcf of Standby MDQ	N/A

(See PSC Order No. 7444, dated Sept.16, 2008, p.5)

The rates proposed in Delmarva's Application would result in a GCR increase of 14.8% for RG, GG and GL customers. Residential space heating customers using 120 ccf in a winter month would experience an increase of $25.25(or 14.8%) in their total bills. (*Id.*) Commercial and industrial customers served on Service Classifications GG and non-electing MVG would experience increases in their winter bills ranging from 8.7%-17.1% and 16.1%-22.3%, *respectively*, depending on load and usage characteristics. (*Id.*)

2. In addition, Delmarva's Application requested approval of the Company's proposals to reconcile and "true-up" actual versus estimated monthly commodity cost rate assignments for sales under the Large Volume Gas (LVG) service and for so-called

"electing" customers taking service under the Medium Volume Gas (MVG) Service, and for sales made under the Flexibly Prices Sales (FPS)Service. (See Application dated 8/29/08, ¶4).

3. On September 16, 2008, in Order No. 7444, 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, 2008, with proration. In addition, the Commission designated this Hearing Examiner to conduct public evidentiary hearings and to report to the Commission proposed Findings and Recommendations based on the evidence presented.

4. The Company published notice of the Application in The News Journal, including information on how to intervene in this proceeding, on September 23 and 24, 2008. The Division of the Public Advocate (DPA) timely intervened in the proceeding. No other party petitioned for intervention.

B. SUPPLEMENTAL APPLICATION

5. On January 26, 2009, the Company filed a Supplemental Application, requesting a reduction in its GCR commodity factors effective March 1, 2009. The Company's Supplemental Application was necessitated by Delmarva's projection that its over-recovered balance would be 6.9% by October 31, 2009, exceeding the 4.5% threshold established by the Commission. (See McGinnis, Ex. "3", p.12) According to Delmarva's Supplemental Application, the effect of the proposed commodity decrease on a residential space heating customer using 120 ccf per month is a decrease of $9.30 per month or (-)4.8%. Commercial and industrial customers served under Classifications GG and non-electing MVG would experience decreases in their total bills ranging from 2.1% to 3.0% and 5.3% to 6.5%, *respectively*, depending upon service classification and load characteristics. The Company's revised GCR factors were as follows:

	Proposed 2008-2009(Orig.App.) GCR Demand Charge	GCR Commodity Charge	Proposed 2008-2009(Supp.App.) GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	$117.560¢/Ccf	N/A	$109.812¢/Ccf
Non-Electing MVG	$8.5538/Mcf Bidding MDQ	$10.5303/Mcf	$8.5538/MCF Billing MDQ	$9.7555/Mcf
Electing MVG And LVG	$8.5538/Mcf Billing MDQ	Varies	$8.5538/Mcf Billing MDQ	Varies
Standby Service	$8.5538/Mcf Billing MDQ	N/A	$8.5538/Mcf Billing MDQ	N/A

(See Supp. Applic., Ex. 4, Attachment VII)

6. On February 5, 2009, in Order No. 7532, the Commission allowed the revised GCR factors, reconciliation and true-ups, and non-firm surcharge to become effective on a temporary basis, subject to refund, effective with meter reading on or after March 1, 2009.

C. PUBLIC COMMENT SESSIONS

7. A duly noticed[1] Public Comment Hearing was conducted at 7 p.m. on October 29, 2008 in Wilmington, Delaware. Public notice of the hearing included newspaper notice in the legal classified section of *The News Journal*. No customers appeared at the Public Comment Hearing. One (1) customer who was not able to attend the hearing complained in writing of the proposed increase, based on affordability issues.

D. EVIDENTIARY HEARINGS

8. Duly-noticed evidentiary hearings were conducted on April 17, 2009 and May 27, 2009 in Wilmington. No members of the public attended the evidentiary hearings. The record, as developed at the hearings, consists of a seventy three (73) page verbatim transcript and sixteen (16) exhibits. The May 27, 2009

[1] The Affidavit of Publication of Notice from *The News Journal* and the Public Notices of Evidentiary Hearings are included in the record as a portion of composite Exhibits 1 and 15. Herein, Exhibits will be cited as “Ex.__” and references to the hearing transcript will be cited as “Tr.__.”

hearing also served as a Public Comment Hearing for the Company's Supplemental Application. The PSC's Staff issued a Press Release regarding the Evidentiary Hearings on April 9, 2009.

9. At the May 27, 2009 hearing, the parties submitted a proposed Settlement Agreement ("Proposed Settlement"), which, if adopted by the Commission, would resolve all issues in the case. (See Exhibit "A' hereto; Ex. 16 of record) As there were no issues in dispute, post-hearing briefs were deemed unnecessary. I have considered all of the record evidence, including the Proposed Settlement and, based thereon, I submit for the Commission's consideration these Findings and Recommendations.

III. SUMMARY OF THE EVIDENCE

A. DELMARVA'S PRE-FILED TESTIMONY REGARDING INTITIAL AND SUPPLEMENTAL APPLICATIONS

10. With its Original and Supplemental Applications, Delmarva submitted the pre-filed testimony of four (4) witnesses. Company Witness C. Ron McGinnis, Delmarva's Regulatory Affairs Lead, first provided the overview for the Company's case and summarized the proposals and rationale for those proposals. (Exs. 3, 3A, 4, 5 & 5A) Mr. McGinnis testified with respect to the development of the estimated recoverable firm gas costs and the derivation of the proposed changes to the GCR commodity components of rates. Mr. McGinnis also explained that the overall effect of the Original and Supplemental Applications was that customers served under Service Classifications RG (residential), GG (general), and GL (lighting), with a monthly average winter usage of 120 ccf, would experience an increase of 9.4% or $15.95 in their total gas bill amount. Customers served in the non-electing MVG (medium volume) service classification would experience (total bill) increases of 10.5% to 15.8%, depending on usage characteristics. According to Mr. McGinnis, LVG (large volume) customers would experience increases of 6.6% to 14.1%, depending on usage characteristics. (Ex. 3 at 3-4.)

11. Company witness W. Thomas Bacon, Jr., Director of Natural Gas Supply and Regulatory Planning, provided testimony on

the following issues: a) the Company's utilization of storage and the LNG facility as they relate to System Capacity; b) Asset Management of the Company's portfolio; c) Modifications to the Company's Gas Hedging Program; d) Responsibility for a $68,150 Pipeline Penalty; and, e) the Company's margin sharing, capacity release and off-system sales activities. (Exs. 6, 7, 8)

12. Regarding the Company's Gas Hedging Program, Mr. Bacon provided a summary of the amounts of gas the Company hedged through October 2009, based on a percentage of the Company's projected natural gas requirements. (Ex. 6 at WTB Schedules 6,7,12). According to Mr. Bacon, in PSC Docket No. 03-378F, the Commission allowed the Company to vary an approved Settlement Agreement originally consummated in PSC Docket No. 00-463F. This Settlement Agreement providing for certain minimum levels for hedging (*i.e.* 10 percent of its requirements 18 months in advance, 20 percent 12 months in advance, and 30 percent 6 months in advance) (Bacon, Ex. 10, p. 18-20.) According to Mr. Bacon, in PSC Docket 03-378, the Commission also approved a "target" of 70 percent, which is explicitly not intended to be a maximum. (Id.)

13. Mr. Bacon testified that, from 2005 through 2008, the Company made a business judgment to hedge essentially 100 percent of its projected gas requirements.(Ex.6 at 23.) However, this did not occur after a stipulation preventing the planning of hedging in excess of 100% was approved in September, 2008. (Crane, Ex. 14, p. 22, LL 21-22, p.21, LL 19-23.) The decision for high-level hedging was apparently made because gas prices were at low levels and appeared far more likely to rise than to fall further. (Bacon, Ex. 6 at 23.) The upward trend of prices experienced from 2007 through mid-2008 confirmed the Company's judgment and, along with projected higher prices, supported continued hedging activities. However, gas prices then declined. (Bacon, Ex. 6, p. 14, Figure 2.)

14. Mr. Bacon asserted that the Company hedged an appropriate amount of its gas requirements for the 2005-08

period. (*Id*. at 18-20.) For example, Delmarva hedged approximately 60% of its firm supply requirements for the twelve (12) month period ending September 30, 2008. (Crane, Ex. 14, p. 21, LL 4-6.) According to Mr. Bacon, the Company's hedging program is intended to be a tool to help manage gas supply needs and reduce volatility in price. (Bacon, Ex. 6, p.12.) Delmarva's program is not intended to "out-guess" or "beat" market prices. (*Id*.) Prior to mid-2008 when prices began to decline; however, Delmarva's program reduced volatility immediately and resulted in the Company paying less than the market prices which Delmarva would have paid without a hedging program. (*Id.* at 12-14.) Mr. Bacon admitted, however, that no utility will consistently out-guess the market. (*Id*. at 12-13.)

15. Company witness, Philip L. Phillips, Jr., Manager of Gas Operations & Planning, discussed the overall development of Delmarva's gas sales, transportation volume forecast, and the lost and unaccounted for gas percentage utilized in the calculation of the proposed GCR. GCR and Transportation Volume increases total 8.6%. (Phillips, Ex. 9, p.2.) "Due to business closings or a shift to transportation contracts," the MVG and LVG classes have decreased 20.5% and 46.9%, *respectively*. (*Id*. at 3, LL 3-5.) Lastly, the Company has reduced its loss factor from 2.5% to 2%, due to decreased loss amounts from June, 2007 through June, 2008. (*Id*. at 4.)

16. Company witness, Michael S. Ponica, Director of Gas Delivery, submitted testimony regarding, among other things, the Company's strategy to mitigate the volatility of wholesale natural gas market prices. Mr. Ponica's testimony generally addressed the general parameters of the Company's hedging and storage programs. (Ponica, Ex. 11, pp. 3-4.) Mr. Ponica also described the Company's customer budget billing program. (*Id*. at 5-6.)

B. <u>STAFF'S TESTIMONY</u>

17. On February 9, 2009, Staff submitted the testimony of Courtney A. Stewart, Public Utilities Analyst II (Ex. 13.), and

Richard W. LeLash, an independent Financial and Regulatory Consultant (Ex. 12.) Ms. Stewart testified that Staff's review verified that the Company had developed its GCR rates in compliance with its Tariff and recommended Commission approval of the proposed rates. (Tr. 101; Ex. 13 at 3-8.) Ms. Stewart also reviewed the Company's compliance with the Settlement Agreement in Docket 00-314 regarding margin sharing. (*Id*. at 3.) In addition, Ms. Stewart reviewed the Company's monitoring of its fixed costs. (*Id*.) Lastly, Ms. Stewart reviewed the Company's efforts regarding customer education as to gas costs, and the Company's customer budget billing program. (*Id*.)

18. Mr. LeLash analyzed the Company's Gas Hedging Program and recommended certain changes including new hedging performance measures, new guidelines regarding minimum and maximum hedging levels, new purchasing methodologies, the Company's Asset Management, the Company's LNG Facility, and Margin Sharing/Off System Sales and Capacity Release. (Ex. 12.) As background, Mr. LeLash testified that gas prices have decreased since mid-2008. (*Id*. at 5-6.) As a result of this price de-escalation, (and the associated extreme price volatility), most gas utilities are reassessing their procurement programs. (*Id*.) Recent price volatility, which poses a risk to utilities and their customers, is illustrated by the two (2) periods of high prices during September – December, 2005 and the period April – July, 2008, with prices averaging $11.80 per Dth (decatherm). (*Id*.) By contrast, the 2009 Price Estimates analyzed by Mr. LeLash averaged $4.23 per Dth. (*Id*. at 6.)

19. Richard LeLash's five (5) basic "parameters" for a gas hedging program include:

(a) A hedging program should seek to minimize the effect of gas price volatility on a utility's ratepayers.

(b) A utility's cost of gas over time should reflect average market prices prevailing over a twelve (12) to eighteen (18) month period prior to a given month of use.

(c) Hedging should not seek to "beat" market prices.

(d) Hedging should be designed to cover a utility's monthly gas purchases rather than forecasted send-out requirements.

(e) The hedging framework will result in hedge prices which may be above or below market or indexed prices in any given month, but over time, the hedge positions should equal index prices.

(LeLash, Ex. 12, p. 25.)

20. Mr. LeLash disagreed with the Company's hedging program because it did not leave 50% unhedged, considering recent gas prices. (LeLash, Ex. 12, p. 25, LL 17-19.) Mr. LeLash would have the unhedged portions be purchased at monthly index prices. *Id*. According to Mr. LeLash, the Company's position was overly-oriented toward gas price increases. (LeLash, Ex. 12, p. 6, LL 3-10; p. 26, LL 7-11.)

21. Mr. LeLash testified that utilities like Delmarva must continue to recognize that gas price risk has two (2) basic dimensions: 1) the first is prices may increase market prices when gas purchases are unhedged; and 2) gas prices may decrease when gas purchases are unhedged. (*Id*., p. 6, LL 14-19.) Mr. LeLash discussed how gas prices over the last ten (10) years had increased from $2.00 per Dth to about $8.00 per Dth - a 300% increase. (*Id*. at p. 6, LL 4-6.) Under these conditions, Mr. LeLash maintains that, it is not surprising that a gas utility's hedged positions, for the most part, had lower average costs than indexed positions. (*Id*. at p. 6.) According to Mr. LeLash, it is unlikely that there will be another 300% increase over the next several years to a level of around $32 per Dth. (*Id*.) Furthermore, hedging approximately seventy (70) percent (or less) under those conditions was consistent with industry practice, whereas the Company's recent hedging activity which exceeded 70% and sometimes exceeded 100% greatly exceeded customary hedging levels. (LeLash, Ex. 12, p. 28).

C. <u>DIVISION OF PUBLIC ADVOCATE'S TESTIMONY</u>

22. The Public Advocate's Consultant, Andrea Crane of The Columbia Group, also disapproved of Delmarva's hedging, including the hedging of 86% of Delmarva's October, 2008 to March 2009 firm supply requirements. (Crane, Ex. 14, p. 18.) Thereafter, "the Company had very limited ability to hedge further once the [gas] price dropped precipitously at the end of 2008." (*Id*.) "Beginning in July [2008], prices began to decline and prices are today only a fraction of what they were in July [2008]. Unfortunately, by the time that prices began to decline, [Delmarva] found itself locked into hedged positions for the current GCR period." (*Id*. at 20) Ms. Crane's opinion was that, Delmarva's results "were disappointing, but not surprising." (Crane, Ex. 14, p. 20.) [Mr. LeLash had noted that, in five of the seven periods when Delmarva exceeded the 70% hedging target,[2] Delmarva's prices were higher than market.] (LeLash, Ex. 12, p. 28.) Like Mr. LeLash, Ms. Crane sought substantial changes to Delmarva's hedging program.[3] (*Id*. at 26-27.)

D. <u>DELMARVA'S REBUTTAL TESTIMONY</u>

23. W. Thomas Bacon, Delmarva's Director of Natural Gas Supply and Regulatory Planning since 1994, responded that Delmarva believes that the balance of risk hedging which Delmarva has followed for years, as explained by former PSC Commissioner Puglisi, is the appropriate balance to follow: "*avoiding the loss is worth a heck of a lot more than the opportunity costs of the missed profit*." [PSC Docket No. 03-378F, Transcript of Oral Argument and Deliberation before PSC, August 31, 2004, pp. 334-345 *quoted by Bacon*, Ex. 10, p. 19, LL 17-19]. Mr. Bacon testified that "I generally agree with Mr. LeLash's overall

[2] The Commission's 70% "hedging target" was ordered in PSC Docket 03-378F. Although the parties in this Docket disagreed as to the Commission's intent in adopting that 70% hedging target, the parties' Settlement in this Docket, if approved by The Commission, would supplant the prior hedging target.

[3] Ms. Crane also recommended that the PSC open a separate hedging docket to examine Delmarva's hedging program. That issue is moot in light of the parties' settlement in this Docket.

proposition that hedge programs for regulated gas utilities need to address both aspects of price. However, the Company takes strong issue with Mr. LeLash on the specifics of his proposed changes to the Gas Hedging Program." (Bacon, Ex. 10, p. 18.)

24. According to Mr. Bacon, "Mr. LeLash clearly believes the Company's Gas Hedging Program is deficient. Conversely, the results of Delmarva's Gas Hedging Program were "favorable" when compared to the 12- and 18-month averages.(Bacon, Ex. 10, p. 17.) Mr. Bacon's Rebuttal Schedule WTB-1 shows a comparison of the Company's average overall hedge cost compared to the average of the daily gas futures contract closing prices 12 and 18 months prior to the expiration of the futures contract since the 2nd quarter of 2006 (the same beginning date as found on Mr. LeLash's Schedule 5) through March, 2009. (Ex. 10.) Included also on this 36-month chart, is the natural gas futures contract last day settle (LDS) price. (*Id.*) According to Mr. Bacon, the Company's average overall hedge cost was lower than the 12-month and 18-month average market price-72% and 83% of the time, *respectively*. (Bacon, Ex. 10, p. 26, LL 6-8.)

25. According to Mr. Bacon's rebuttal testimony, the Company believed at that time that, with natural gas market prices in the $4.00 to $5.00 per Dth range, there was more upside price risk than downside price risk. (Bacon, Ex. 10, p. 18, LL 10-12.) A heavily hedged position, over-weights in favor of rising market prices. (*Id.*) According to Mr. Bacon, Mr. LeLash's analysis ignores the current level of market prices in his analysis. Mr. Bacon believes that Mr. LeLash's analysis is "flawed" because Mr. LeLash uses a percentage increase in his comparison and not a dollar increase. (*Id.* at 17.) Mr. LeLash stated that then current gas price estimates for 2009 average $4.23 per Dth. (LeLash, p. 6, LL 1-2.) According to Mr. Bacon, instead of using the current market price, apparently to help argue that there is more downside gas price risk than upside gas price risk (i.e., it is unlikely that there will be another 300% increase in the next several years), Mr. LeLash arbitrarily

selects $8.00 per Dth to increase by 300% to arrive at a hypothetical market price of $32.00 per Dth. According to Mr. Bacon, it is plausible that the market prices could rise 300% from the current level around $4.00 or $4.50 or between $16.00 and $18.00 per Dth. As seen in the NYMEX gas futures chart above, there have been a number of instances within the last year that the daily natural gas futures price has closed above the $15.00 per Dth. (Bacon, Ex. 10, p. 17.)

26. According to Mr. Bacon, Mr. LeLash's "selection of the wrong number to inflate by 300% is perhaps the less egregious error in [Mr. LeLash's] analysis. Mr. LeLash explains that market prices have gone up 300% over the last ten (10) years. Rather than a percentage increase, a more appropriate way to characterize the change in market prices over the last ten (10) years would be to say market prices have risen by $6.00 per Dth. Casual observation of the NYMEX chart [from 2002-09] indicates that market prices have risen well over $6.00 per Dth on at least three separate occasions since 2002. (*Id*. at 18.) Based upon his direct and rebuttal testimony, Mr. Bacon's analysis of Futures Gas Market fundamentals differed from Ms. Crane's and Mr. LeLash's collective analysis.

27. In his Rebuttal Testimony, Philip L. Phillips principally addressed the testimony filed by Staff witnesses Richard LeLash and Courtney Stewart, and DPA witness Andrea Crane. First, Mr. Phillips defended the Company's current need for and maintenance of 25,000 MCF of LNG deliverability "back-up in case of equipment failure, gas supply, peak day loads, or system emergency" for customers located in the Company's mid to southern service territory. (Phillips, Ex. 10, p. 2-5.) Delmarva's full capacity is 50,000 MCF. (*Id*. at 4.) Mr. LeLash's recommendations on behalf of Staff were: 1) 45,000 of MCF capacity; and 2) a third party should evaluate "the Company's system's reliability … based upon an evaluation of LNG plant equipment and design." (LeLash, Ex. 12, p. 16, LL 10-18.)

IV. **DISCUSSION**

A. **GAS COST RATE**

28. The following uncontested matters contained in the Settlement Agreement are well supported in the record and I recommend their adoption by the Commission. First, I recommend approval of the proposed GCR rates in the Company's Original and Supplemental Applications, which took effect on a temporary basis, subject to refund, on November 1, 2008 and March 1, 2009, *respectively*. The primary purpose of the GCR annual filing is to reset the GCR to reflect that the expected future costs incurred to procure gas and to "true-up" a deferred balance which arises due to changes in market prices outside of the Company's control. Staff and Delaware's Division of Public Advocate (DPA) reviewed the proposed rates and verified that the Company's projections were reasonable and that the rates were calculated in conformance with the Company's tariff. (See Stewart (Staff), Ex. 11, pp 3-8.); (Crane (DPA), Ex. 14, pp 40-41.) More specifically, I recommend approval of the following items: (a) the proposed changes to the Gas Cost Rates (see ¶ 1, 5 *supra*); and (b) the reconciliation and true-up of actual versus estimated monthly Commodity Cost Rate assignments for sales under the Large Volume Gas service and for "electing" customers being served under the Medium Volume Gas (MVG) classification.

B. **THE SETTLEMENT AGREEMENT**

29. For the matters contained in the parties' May 27, 2009 Settlement Agreement, each issue will follow verbatim from the parties' Settlement Agreement with the Hearing Examiner's discussion following. The Settlement Agreement is attached as Exhibit "A" hereto and was marked as Exhibit "16" at the evidentiary hearings. For reasons herein after described, the parties' Settlement is well supported in the record and I recommend that the Commission approve the parties' entire Settlement in all respects, including the parties' Agreement regarding hedging.

30. The following is the Settlement Agreement's Paragraph B regarding the Company's Natural Gas Hedging Program:

Natural Gas Hedging Program

> "Staff has some concerns with both the annual percentage of GCR purchases at times hedged by Delmarva and the amount of discretion afforded to the Company in the current hedging program. Although Delmarva believes its hedging program as designed continues to be appropriate, it is not opposed to modifications of the program to reduce Delmarva's discretion in hedging its gas purchases.
>
> After negotiations and consultations, the parties have agreed that Delmarva will revise its hedging program. Six gas hedging provisions or guidelines were approved by the Commission in Delaware PSC Docket No. 00-463F. The first two guidelines established 1) a minimum level of hedging, and 2) an overall target level of hedging. Pursuant to this agreement, those two guidelines will be replaced by a fifty percent (50%) non-discretionary hedging program in which 50% of projected city gate requirements and storage injections are to be hedged on a pro rata basis ($1/12^{th}$ each month) over the 12-months preceding the month in which the physical gas is to be delivered to customers. Except in the event of extraordinary circumstances as set forth below, the hedging program set forth in this paragraph will be conducted without regard to anticipated trends.
>
> The parties acknowledge that the implementation of the new hedging program will take place over time due to pre-existing hedging positions which may, in some months, be outside the parameters of the new hedge program.
>
> If in the exercise of its business judgment, the Company believes there are extraordinary circumstances that may warrant varying from the hedging program agreed to herein, the Company will seek the agreement of Staff and Public Advocate to temporarily modify the hedge amounts from the fifty percent (50%) or $1/12^{th}$ monthly requirements. Staff and Public Advocate will analyze the request and either agree or request its expedited consideration by the Commission.
>
> The Company agrees to file its Quarterly Hedging Report within 30 days following the close of the quarter.[4]
>
> The parties agree that the 50% non-discretionary program agreed to herein is subject to alteration should it prove unsuccessful in future years.
>
> Management of the Company's Gas Division will meet

[4] Currently, the Company issues hedging reports within forty-five (45) days of the quarterly close.
(Tr. 91)The 30 day requirement had been recommended by Staff Witness LeLash. (Ex. 12, p. 30, LL 13-14.)

> monthly with the individuals and/or entity conducting the hedging program to review ongoing results. In the section of the Company's pre-filed testimony for the 2009-2010 GCR filing that reviews hedge results, the Company will address commodity costs related to hedge purchases made in 2008 under the prior hedging program and the effect such purchases have on the 2009-2010 GCR."

31. **Discussion – Hedging.** In 2004, the Commission accepted the Company's position that, because the Company's Hedging Program had been fairly successful in both stabilizing prices and lowering rates, the Commission should permit the Company to continue its practice of unrestricted, high-level hedging. Thus, the Commission adopted the Company's somewhat liberal interpretation of the 2001 Settlement Agreement from PSC Docket No. 00-463F, essentially eliminating the "up to 70% target" from the 2001 Settlement.[5]

32. With the "disappointing" results of Delmarva's unrestricted hedging program in early 2009 (as stated by Ms. Crane), the parties' settlement in this case is sensible, and the Hearing Examiner recommends that the Commission approve the parties' settlement. Again, the new hedging program is as follows:

> A non-discretionary hedging program in which 50% of projected city gate requirements and storage injections are to be hedged on a pro rat basis ($1/12^{th}$ each month) over the 12-months preceding the month in which the physical gas is to be delivered to customers. If, in the exercise of its business judgment, the Company believes there are extraordinary circumstances that may warrant varying from the hedging program agreed to herein, the Company will seek the agreement of Staff and Public Advocate to temporarily modify the hedge amounts from

[5] 70% was stated to be the "target." The Commission's Order in PSC Docket 00-463F also provided as follows: "Establishment of a target level of hedging of up to 70% of annual GCR purchases, which target is not intended to be a maximum." (See Findings of Hearing Examiner, p. 11, p. 26, adopted by PSC Order No. 5711, dated May 8, 2001).

> the fifty (50%) or 1/12th monthly requirements. Staff and Public Advocate will analyze the request and either agree or request its expedited consideration by the Commission.[6]

33. The Hearing Examiner recommends that the Commission approve the parties' settlement because the parties' settlement allows the Company reasonable hedging flexibility at 1/12th per month under current market conditions, similar to programs enjoyed by other utilities, while requiring 50% of the Company's purchases to be at current market. (LeLash, Ex. 12, p. 29.) Staff witness LeLash recommended this program, particularly in light of the prevailing market conditions. (*Id*.) Ms. Crane also has approved of this type of program.

34. The following is the Settlement Agreement's Paragraph C regarding the Company's Asset Management:

<u>Asset Management</u>

> "All parties agree that the Company will inventory its gas assets and develop a Request for Proposal ("RFP") from several asset managers for the potential management of Delmarva's gas portfolio, as well as for alternative proposals to manage subsets of that portfolio as potential managers may define. The goal is to have the RFP completed so that any potential asset management agreement could be entered into no later than April, 2010. It was also agreed that performing an RFP will not obligate Delmarva to enter into an asset management agreement if, after examining the results of the RFP, Delmarva determines that the best interests of its customers and, where appropriate, Delmarva, would be to have Delmarva and/or its service company continue asset management

[6] The Settlement further provides that: "The parties acknowledge that the implementation of the new hedging program will take place over time due to pre-existing hedging positions which may, in some months, be outside the parameters of the new hedge program." (See Settlement Agreement, Ex. 16, Section III B) Also, 2008 purchases under the prior program and their effect on the 2009-2010 GCR will be disclosed in the Company's 2009-2010 GCR. (*Id*.)

> activities. Delmarva further agrees to begin formulating an RFP and to seek Staff and Public Advocate comments on the RFP documents."

35. **Discussion – Asset Management.** The Hearing Examiner agrees with this approach which was recommended by Mr. LeLash (LeLash, Ex. 12, p. 32). Mr. LeLash's sound reasoning for this approach was as follows:

> "Experience has shown that asset managers can frequently obtain greater margins and credits from capacity transactions than those obtained by the utility itself. This appears to be the case because the trading platforms maintained by asset managers are far more robust than those of utilities … It is suggested that [Delmarva] contact various asset managers to determine their interest in managing Delmarva's [gas supply] portfolio. If there were sufficient interest, the Company could then solicit bids to determine what margins and credits could be obtained. If the subsequent bids were not materially better, then the Company could simply choose not to go any further with such contracting."

36. The following is the Settlement Agreement's Paragraph D regarding the issue of liability for a Pipeline Penalty:

> **Liability for Pipeline Penalty**
>
> "The Company incurred a pipeline penalty of $68,150 for overtaking 3,326 Dth of FSS supply in January, 2007. Staff raised the question as to why the Company had a capacity deficiency on a day that was not extremely cold. The Company explained that because it was unable to take the entire amount of gas nominated on TETCO pipeline due to lower than needed delivery pressure and it was necessary to take delivery of gas via the Columbia pipeline which had a higher delivery pressure at that time… Although Delmarva does not believe it should be responsible for the cost

> absent any wrongdoing related to this, Staff and Public Advocate feel that [Delmarva's] customers should not be responsible either. Further, Staff, Public Advocate and Delmarva agree that the 50% sharing of the penalty applies only to this "penalty" without precedent and that, in the future, Delmarva will report penalties, in future GCR filings, to both Staff and Public Advocate, if and when, they are incurred."

37. **<u>Discussion – Liability for Pipeline Penalty.</u>** Philip L. Phillips, Jr., P.E., Delmarva's Manager of Gas Operations and Planning, testified at the evidentiary hearing that Delmarva had not incurred a pipeline penalty for at least three (3) years prior to the time that this penalty which was levied in January, 2007. (Tr. 94; P. Phillips Ex. 10, p. 16) Mr. Phillips also testified that Delmarva's operating personnel consulted could not remember when and if Delmarva had incurred a pipeline penalty prior to the subject penalty. (Tr. 94) TETCO was the company which had inadequate pressure to supply the gas Delmarva requested. (Tr. 98) However, according to Delmarva, TETCO is not liable to Delmarva because TETCO "complied with its FERC obligations." (*Id*.) Thus, Delmarva maintained that the pipeline penalty was not incurred due to negligence or carelessness and therefore Delmarva was not liable. (Phillips, Ex. 10, p. 16)

38. According to the Company, the Company has not incurred penalties on the Transco, Texas Eastern and Eastern Shore pipeline systems because the rules by which these pipelines operate are "much more flexible" than Columbia Transmission's rules. (Bacon, Ex. 8, p. 31) For instance, these pipelines offer either late in the gas day post-cycle nominations (e.g.; after 6 p.m.) or permit shippers to effectively make end-of-gas day nominations which serve to true-up any imbalances. (*Id.*) Depending on the circumstances, these pipelines also allow shippers to retroactively change nomination to avoid a penalty.

(*Id*.) According to Delmarva, Columbia Transmission is the "most difficult pipeline to conduct business with from an operation perspective." (*Id*.) Staff (nor the DPA) provided the name of any utility which has been denied the cost of recovery for such a penalty. (Phillips, Ex. 10, p. 15.)

39. According to the Company, the Company's teams managing the interstate transportation of gas and operating the six (6) major delivery points off of Delmarva's interstate system do an "excellent job" given the high level of complexity. (Bacon, Ex. 8 at 32.) The level of complexity is greatest at the Company's Claymont/Ridge Road complex where Delmarva receives substantial amounts of gas from three (3) pipelines, Columbia, Transco, and Texas Eastern. (*Id*.) Lastly, as provided in Paragraph D of the Settlement Agreement, Staff, Public Advocate, and Delmarva agree that the 50% sharing of the penalty applies only to the "penalty in this Docket" and that this Settlement does not set any precedent. In the future, Delmarva is required to report penalties in future GCR filings, if and when they are incurred. (See Settlement Agreement, Ex. "A", Paragraph D.)

40. Sections E, F and G of the Settlement Agreement provide as follows verbatim:

E. <u>LNG Facility As It Relates To System Capacity</u>

> "The parties agree that an independent third party will conduct a review of the LNG facility related to its potential capacity and that such review should be completed prior to the Company's next GCR rate filing.
>
> Delmarva agrees to perform the review and the other parties agree, that the results of any review will not obligate Delmarva to alter its operations or planning with respect to the LNG facility if, after examining the results of the review, Delmarva agrees that the best interests of customers and, where appropriate, Delmarva would be to reject some or all of the recommendations arising out of the

review. Delmarva agrees to begin formulating a request for a third party review as soon as reasonably possible and will seek review and comment from Staff and Public Advocate on the request for review.

F. <u>Company Utilization of Storage</u>

The parties agree that this is no longer a disputed issue.

G. <u>Margin Sharing and Formula for Off-System Sales and Capacity Release</u>

Beginning in 2001-2002, a margin sharing structure was created whereby the Company retained 20% of total gas sales in excess of $1.7 million in an effort to incentivize the Company to maximize sales and margin credits for the benefit of firm customers. Since ratepayers pay all capacity-related costs, it was believed that creating this program would result in net benefit to firm customers by increased sales.

Staff raised the issue as to whether the threshold of $1.7 million was appropriate given certain structural changes in the gas industry. Staff maintains the incentives should only be given for superior performance.

Delmarva believed that the change in the current margin sharing was not appropriate and that if such change was made (an increase in the threshold), an increase in the amount of margin shared between ratepayers and the Company should be adjusted as well.

To resolve this issue, the parties have agreed that the margin sharing percentage should remain the same (80/20) and that the threshold should move from $1.7 million to $3 million. The parties believe that this is a reasonable compromise of this issue."

41. **<u>Discussion-LNG Facility and its System Capacity.</u>**

As to Delmarva's LNG Facility and its system capacity, the Settlement Agreement requires Delmarva to "conduct a review of the LNG Facility related to its potential capacity … prior to the Company's next GCR rate filing." This approach was advocated by both Ms. Crane and Mr. LeLash (Crane, Ex. 14, pp. 36-37 & LeLash, Ex. 12, p. 9). Both Ms. Crane and Mr. LeLash maintained that system capacity needed to be examined, including storage, "to enhance gas supply reliability and potentially allow off-system sales and capacity releases."[7] (LeLash, Ex. 12, p.9) The Company's review will include the additional 3,200 Dths/day of capacity which the Company began receiving from Eastern Shore Natural Gas effective November 1, 2008. (Crane, Ex. 14, p. 36).

42. As to Margin Sharing and the Formula for Off-System Sales and Capacity Release, the Settlement Agreement provides that "the Margin Sharing percentage should remain the same (80/20) and that the threshold should move from $1.7 to $3 million." Staff Witness Mr. LeLash had originally recommended that the threshold be increased from $1.7 million to $4.379 million. (LeLash, Ex. 12, pp 9, 23). $4.379 million is approximately 75% of the historical margin level. (*Id* & *Id*. at Schedule 4) Currently, the Company retains 20% of any total in excess of $1.7 million. (*Id*. at 20.) Thus, for the 2007-08 period, the Company retained $1.2 million. (*Id*.) For the 2008-09 period, if the settlement agreed to by the parties is approved by the Commission, the Company will retain 20% of any total in excess of the $3 million. (See Settlement Agreement, Ex. "A", Para. G)

[7] Delmarva's Bacon testified that the Company had $7.45 million of capacity release revenues and $1.92 million of off-system sales margins for the November, 2008 through October, 2009 period. (See Delmarva's Bacon's Response to Staff-21; Crane, Ex. 14, p. 30)

43. According to Mr. LeLash, based on the prior seven (7) years' experience, the current $1.7 million margin threshold is "outdated." (LeLash, Ex. 12, p. 20) As shown on the Schedule 4 of Mr. LeLash's testimony, the Company's lowest level of shareable margins has been $3.094 million during the past seven (7) years, and the average margins have been $5.8 million. (*Id.*) Thus, if "the Company's incentive is supposed to be linked to superior performance, margin levels below a reasonable threshold should not result in any sharing for the Company." (*Id.*) Mr. LeLash maintained that the incentive could apply to activities which the utility is not otherwise required to perform. (*Id.*) Absent such a condition, the incentive could be designed symmetrically so that Delmarva would be penalized for poor performance to the same degree it is rewarded for better than average results. (*Id.*) According to Mr. LeLash, at a minimum, the incentive should not provide reward for results which are not directly related to reasonably good Company performance and the incentive should not give rise to activities which are unintended or reasonable, such as the acquisition of unneeded capacity. (*Id.*) According to Mr. LeLash, given that natural gas distribution companies are required to pursue the least expensive cost fuel procurement policy, the maximization of capacity credits and off-system margin appears to be an established obligation. (*Id.*) As for the symmetry of risk and reward, the current incentive mechanism does not fulfill such a criterion. (*Id.*)

44. According to Mr. LeLash, the Company's sharing incentive has become outdated because the capacity market has changed over time. (LeLash, Ex. 12, p. 22) "After the FERC's restructuring in its Order 636, capacity release and off-system sales were seen as a mechanism to ameliorate the impact of straight fixed variable tariff design by allowing secondary market transactions for capacity. (*Id.*) As gas distribution companies made the transition from bundled gas supply, various state regulatory agencies saw merit in sharing capacity credits

in order to compensate the utilities for increased staffing and to give [the utilities] an incentive to participate in the [then] emerging secondary capacity market. (*Id.*) As a general rule, early sharing provisions allowed utilities an average about 20% of the capacity credits and margins. On this basis, a sharing mechanism was justified and reasonable. (*Id.*)

45. According to Mr. LeLash, "in the current market environment, significant changes have occurred." "Gas utilities have established necessary the trading expertise, and the secondary capacity market has become firmly established." (*Id.* at LL 17-18) Thus, a significant portion of the rationale for incentives has been eliminated. (*Id.* at LL 18-19) According to Mr. LeLash, for margins in excess of an established, reasonable threshold level or "benchmark", a 20% sharing would be authorized for the Company. (*Id.* at p. 23) Such a structure provides ample incentive for "better than average" performance. (*Id.*) The parties in this Docket have agreed on $3 million as the threshold level-which is now reasonable, thereby setting aside the $1.7 million threshold. (See Settlement Agreement, Ex. 16, Para. G.) The first $3 million would be credited to Delmarva's customers beginning in July of each year. (Crane, Ex. 14, pp 28-29). After the $3 million threshold, Delmarva will receive 20% of amounts in excess thereof with Delmarva ratepayers receiving 80% thereof. (Tr. 103).

V. RECOMMENDATIONS

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

a. That the Commission approve as just and reasonable the Company's proposed revised GCR charges as proposed in the Company's January 26, 2009 Supplemental Application, effective March 1, 2009, which are as follows:

	Proposed 2008-2009(Orig.App.)		Proposed 2008-2009(Supp.App.)	
	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GLN/A	N/A	$117.560¢/Ccf	N/A	$109.812¢/Ccf
Non-Electing MVG	$8.5538/Mcf Bidding MDQ	$10.5303/Mcf	$8.5538/MCF Billing MDQ	$9.7555/Mcf
Electing MVG And LVG	$8.5538/Mcf Billing MDQ	Varies	$8.5538/Mcf Billing MDQ	Varies
Standby Service	$8.5538/Mcf Billing MDQ	N/A	$8.5538/Mcf Billing MDQ	N/A

b. For the reasons described in the preceding Section IV of this Report, I recommend that the Commission adopt as reasonable and in the public interest the entire proposed Settlement Agreement, which is attached to the proposed Order in this matter as Exhibit "B". The Company, Staff and Delaware's Division of Public Advocate have all endorsed this settlement. A proposed Order, which will implement the forgoing Findings and Recommendations, is attached hereto as Exhibit "B."

Respectfully Submitted,

/s/ Mark Lawrence________

Mark Lawrence
Hearing Examiner

Dated: August 3, 2009

E X H I B I T "B"

PROPOSED SETTLEMENT

On this day, May 27, 2009, Delmarva Power & Light Company ("Delmarva" or the "Company"), the Delaware Public Service Commission Staff (the "Staff"), and the Public Advocate ("Public Advocate"), all of whom together are the "Parties" or "Settling Parties," hereby propose a complete settlement of all issues that were or could have been raised in this proceeding as follows:

I. INTRODUCTION AND PROCEDURAL BACKGROUND

On August 28, 2008, 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, 2008, with proration, and with such revised factors to continue in effect until October 31, 2009. The Application seeks to change Delmarva's GCR in the following manner:

	Present		Proposed	
Rate Schedules	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	96.517¢/ccf	N/A	117.560¢/ccf
Non-electing MVG	$10.20/Mcf of Billing MDQ	$8.2710/Mcf	$8.5538/Mcf of Billing MDQ	$10.5303/Mcf
Electing MVG and LVG	$10.2/MCf of Billing MDQ	Varies	$8.5538/Mcf of Billing MDQ	Varies
Standby Service	$10.2/Mcf of Standby MDQ	N/A	$8.5538/Mcf of Standby MDQ	NA

In addition, the Application requested approval of the Company's proposal to reconcile and true-up actual versus estimated Weighted Average Commodity Cost of Gas ("WACCOG") assignments for sales under the Large Volume Gas service and for so-called "electing" customers taking service under the Medium Volume Gas service and for sales made under the Flexibly Prices Sales Service ("FPS").

On September 16, 2008, by Order No. 7444, the Commission permitted the proposed rates to go into effect on November 1, 2008, with proration on a temporary basis and subject to true-up and refund, pending evidentiary hearings and a final decision by the Commission.

The rates proposed in the Application result in a GCR increase of 14.8% for RG, GG and GL customers. Residential space heating customers using 120 ccf in a winter month would experience an increase of $25.25 or 14.8% in their total bill. Commercial and industrial customers served on Service Classifications GG and non-electing MVG would experience increases in their winter bills ranging from 8.7%-17.1% and 16.1%-22.3%, respectively, depending on load and usage characteristics.

On January 26, 2009, the Company filed a supplemental filing, requesting a reduction in its GCR commodity factors effective March 1, 2009. The Company's supplemental filing was necessitated by Delmarva's projection that its over-recovered balance would be 6.9% by October 31, 2009, exceeding the 4.5% threshold established by the Commission. Accordingly, the Company requested changes in its supplemental filing. According to this supplemental filing, the effect of the proposed commodity decrease on a residential space heating customer using 120 ccf per month is a decrease of $9.30 per month or 4.8%. Commercial and industrial customers served under

Classifications GG and MVG experienced decreases in their total bills ranging from 2.1% to 3.0% and 5.6% to 6.5%, respectively, depending upon usage and load characteristics. The changes are set forth below:

	Prior Demand Charge	Prior Commodity Charge	Proposed Demand Charge	Proposed Commodity Charge
RG,GG, and GL	N/A	$1.1756/Ccf	N/A	$1.09812Ccf
Non-electing MVG	$8.5538/Mcf Bidding MDQ	$10.5303/Mcf	$8.5538/MCF Billing MDQ	$9.7555/Mcf
Electing MVG And LVG	$8.5538/Mcf Billing MDQ	Varies	$8.5538/Mcf Billing MDQ	Varies
Standby Service	$8.5538/Mcf Billing MDQ	N/A	$8.5538/Mcf Billing MDQ	N/A

III. Settlement Provisions

A. The parties agree that subject to the commitments and agreements set forth below, approval of Delmarva's application, as filed, should be recommended to the Hearing Examiner and subsequently approved by the Commission.

B. Natural Gas Hedging Program

Staff has some concerns with both the annual percentage of GCR purchases at times hedged by Delmarva and the amount of discretion afforded to the Company in the current hedging program. Although Delmarva believes its hedging program as designed continues to be appropriate, it is not opposed to modifications of the program to reduce Delmarva's discretion in hedging its gas purchases.

After negotiations and consultations, the parties have agreed that Delmarva will revise its hedging program. Six gas hedging provisions or guidelines were approved by the Commission in Delaware PSC Docket No. 00–463F. The first two guidelines established 1) a minimum level of hedging and 2) an overall target level of hedging, as previously addressed above. Pursuant to this agreement, those two guidelines will be replaced by a fifty percent (50%) non-discretionary hedging program in which 50% of projected city gate requirements and storage injections are to be hedged on a pro rata basis (1/12th each month) over the 12-months preceding the month in which the physical gas is to be delivered to customers. Except in the event of extraordinary circumstances as set forth below, the hedging program set forth in this paragraph will be conducted without regard to anticipated price trends.

The parties acknowledge that the implementation of the new hedging program will take place over time due to pre-existing hedging positions which may, in some months, be outside the parameters of the new hedge program.

If, in the exercise of its business judgment, the Company believes there are extraordinary circumstances that may warrant varying from the hedging program agreed to herein, the Company will seek the agreement of Staff and Public Advocate to temporarily modify the hedge amounts from the fifty percent (50%) or 1/12th monthly requirements. Staff and Public Advocate will analyze the request and either agree or request its expedited consideration by the Commission.

The Company agrees to file its Quarterly Hedging Report within 30 days following the close of the quarter.

The parties agree that the 50% non-discretionary program agreed to herein is subject to alteration should it prove unsuccessful in future years.

Management of the Company's Gas Division will meet monthly with the individuals and/or entity conducting the hedging program to review ongoing results. In the section of the Company's prefiled testimony for the 2009-2010 GCR filing that reviews hedge results, the Company will address commodity costs related to hedge purchases made in 2008 under the prior hedging program and the effect such purchases have on the 2009-2010 GCR.

C. Asset Management

All parties agree that the Company will inventory its gas assets and develop a Request For Proposal ("RFP") from several asset managers for the potential management of Delmarva's gas portfolio, as well as for alternative proposals to manage subsets of that portfolio as potential managers may define. The goal is to have the RFP completed so that any potential asset management agreement could be entered into no later than April 2010. It was also agreed that performing an RFP will not obligate Delmarva to enter into an asset management agreement if, after examining the results of the RFP, Delmarva determines that the best interests of its customers and, where appropriate, Delmarva, would be to have Delmarva and/or its service company continue asset management activities. Delmarva further agrees to begin formulating an RFP and to seek Staff and Public Advocate comments on the RFP documents.

D. Pipeline Penalties

The Company incurred a pipeline penalty of $68,150 for overtaking 3,326 Dth of FSS supply in January 2007. Staff raised the question as to why the Company had a capacity deficiency on a day that was not extremely cold. The Company explained that because it was unable to take the entire amount of gas nominated on TETCO pipeline due to lower than needed delivery pressure and it was necessary to take delivery of gas via the

Columbia pipeline which had a higher delivery pressure at that time and, accordingly, requested that sales customers pay the penalty.

Although Delmarva does not believe it should be responsible for the cost absent any wrongdoing related to this, Staff and Public Advocate feel that customers should not be responsible either. Further, Staff, Public Advocate and Delmarva agree that the 50% sharing of the penalty applies only to this “penalty” without precedent and that, in the future, Delmarva will report penalties, in future GCR filings, to both Staff and Public Advocate, if and when, they are incurred.

E. LNG Facility As It Relates To System Capacity

The parties agree that an independent third party will conduct a review of the LNG facility related to its potential capacity and that such review should be completed prior to the Company’s next GCR rate filing.

Delmarva agrees to perform the review and the other parties agree, that the results of any review will not obligate Delmarva to alter its operations or planning with respect to the LNG facility if, after examining the results of the review, Delmarva agrees that the best interests of customers and, where appropriate, Delmarva, would be to reject some or all of the recommendations arising out of the review. Delmarva agrees to begin formulating a request for a third party review as soon as reasonably possible and will seek review and comment from Staff and Public Advocate on the request for review.

F. Company Utilization of Storage

The parties agree that this is no longer a disputed issue.

G. Margin Sharing and Formula for Off-System Sales and Capacity Release

Beginning in 2001-2002, a margin sharing structure was created whereby the Company retained 20% of total gas sales in excess of $1.7 million in an effort to incentivize the Company to maximize sales and margin credits for the benefit of firm customers. Since ratepayers pay all capacity-related costs, it was believed that creating this program would result in net benefit to firm customers by increased sales.

Staff raised the issue as to whether the threshold of $1.7 million was appropriate given certain structural changes in the gas industry. Staff maintains that incentives should only be given for superior performance.

Delmarva believed that the change in the current margin sharing was not appropriate and that if such a change was made (an increase in the threshold), an increase in the amount of margin shared between ratepayers and the Company should be adjusted as well.

To resolve this issue, the parties have agreed that the margin sharing percentage should remain the same (80/20) and that the threshold should move from $1.7 million to $3 million. The parties believe that this is a reasonable compromise of this issue.

H. Additional Provisions

1. The provisions of this settlement are not severable.

2. 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.

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.

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.

Delaware Public Service Commission Staff

By:/s/ Bruce H. Burcat

Delmarva Power & Light Company

By:/s/ Todd Goodman

Public Advocate

By:/s/ Michael Sheehy