

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

IN THE MATTER OF THE PROVISION OF )  
STANDARD OFFER SUPPLY TO RETAIL )  
CONSUMERS IN THE SERVICE TERRITORY ) PSC DOCKET NO. 04-391  
OF DELMARVA POWER & LIGHT COMPANY )  
AFTER MAY 1, 2006 )  
(OPENED OCTOBER 19, 2004) )

**FINDINGS, OPINION, AND ORDER NO. 6598**

BEFORE COMMISSIONERS:

ARNETTA McRAE, Chair  
JOSHUA M. TWILLEY, Vice Chair  
DR. DONALD J. PUGLISI, Commissioner  
JAYMES B. LESTER, Commissioner  
JOANN T. CONAWAY, Commissioner

APPEARANCES:

On behalf of Delmarva Power & Light Company:

RANDALL V. GRIFFIN, ESQUIRE

On behalf of the Division of the Public Advocate:

G. ARTHUR PADMORE, ESQUIRE

On behalf of Intervenor PEPCO Energy Services, Inc.:

MR. WAYNE HUDDERS

On behalf of Intervenor Washington Gas Energy Services:

RANSOME E. OWAN, PH.D.

On behalf of Intervenor Constellation Energy Commodities Group, Inc.  
and Constellation NewEnergy, Inc.:

GREGORY K. LAWRENCE, ESQUIRE  
McDERMOTT, WILL & EMERY LLP

On behalf of Intervenor Delaware Energy Users' Group:

BRIAN R. GREENE, ESQUIRE  
CHRISTIAN & BARTON, L.L.P

On behalf of the Delaware Public Service Commission Staff:

JAMES McC. GEDDES, ESQUIRE  
ASHBY & GEDDES  
Rate Counsel

and

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

**BACKGROUND**

1. Pursuant to the Electric Utility Restructuring Act of 1999, 26 Del. C. ch. 10, after the end of the applicable "transition period," retail customers in an electric distribution company's service territory who do not otherwise receive electric service from an electric supplier are provided "standard offer service" ("SOS") by the "standard offer service supplier." See 26 Del. C. §§ 1001; 1006(a)(2)a.-c.; 1006(b)(2)a.-c.

2. The transition period for all customer classes in the service territory of Delmarva Power & Light Company ("DP&L") ended in September 2003. As part of the resolution of DP&L's merger into the PEPCO Holdings, Inc. family, the Delaware Public Service Commission (the "Commission") accepted DP&L's offer to serve as the SOS supplier for its service territory until May 1, 2006. See PSC Order No. 5941, Hearing Examiner's Report, App. A (Settlement) at ¶ D.1, *aff'd sub nom. Constellation New Energy, Inc. v. Public Service Commission*, 825

A.2d 872 (Del. Super. 2003); see also 26 Del. C. §1010(a)(2). As a condition of the Commission's approval of the merger, DP&L agreed to price its SOS to the various customer classes just slightly above the retail market prices prevailing during the earlier transition period. Subject to a few exceptions, such SOS prices would prevail until May 1, 2006. See Order No. 5941, Hearing Examiner's Report, App. A (Settlement) at ¶¶ B, C. The SOS prices would then be reviewed in connection with a process intended to result in the selection of an SOS supplier for the period beginning May 1, 2006. See Order No. 5941, Hearing Examiner's Report, App. A (Settlement) at ¶ D.1-2.

3. The Commission was aware that in other jurisdictions where legislation had been enacted to foster retail electric competition, the lapse of "frozen" or "standstill" supply rates had generally resulted in significantly higher SOS or default supply rates. In light of that awareness, and in an attempt to ensure a seamless transition to SOS service after April 2006, on October 19, 2004, the Commission, by Order No. 6490, opened this docket to "explore issues related to the selection of an SOS supplier for DP&L's service territory and the appropriate prices to be charged for SOS after that date." See PSC Order No. 6490 (Del. PSC October 19, 2004 at ¶ 3).

4. In Order No. 6490, the Commission adopted Staff's proposal to conduct this examination in three stages: (1) exploration and resolution of the potential "mega" or "fundamental" issues in choosing a supplier and establishing SOS prices; (2) crafting the necessary rules or directives for implementing the choice of an SOS supplier(s) and establishing SOS prices; and (3) implementing the selection and

pricing mechanisms from the second stage to determine the post-May 2006 SOS supplier and SOS prices. (*Id.* at ¶ 4). The Commission noted that it would not list all of the issues to be considered during the first phase of the proceeding, but identified two questions that it sought to have answered: (1) the means by which the Commission should choose the SOS supplier(s); and (2) how the Commission should determine the price for SOS consistent with the statutory pricing standard. *Id.* at ¶ 5. The Commission delegated to Staff the authority to determine the structure of the process for the first stage, and established a deadline of February 28, 2005 for the conclusion of the first stage. *Id.* at ¶¶ 6-7. The Commission also appointed Senior Hearing Examiner William F. O'Brien as a monitor to oversee the first-stage proceedings and ensure that the proceedings ran smoothly. *Id.* at ¶ 7.

5. Pursuant to the Commission's directives in Order No. 6490, Staff scheduled and held two workshops. During the first workshop on December 15, 2004, Staff requested that the parties respond by December 30, 2004 to several questions posed by Staff regarding the "wholesale" versus "retail" SOS models that were intended to elicit more details than had been provided in the discussions regarding the essential elements and the expected benefits of each model to DP&L customers. At the January 5, 2005 workshop, the parties were permitted to make oral comments rebutting opposing positions submitted in written comments. Staff also asked several follow-up questions. Thereafter, on January 26, 2005, Staff submitted a position paper

setting forth its positions on several issues that the parties agreed were "mega" or "fundamental."

**THE FUNDAMENTAL, OR "MEGA," ISSUES: PARTIES**

**A. Goals of Competition and of SOS**

6. The first fundamental issue identified by Staff was the goal or intent of the restructuring legislation initiating retail electric competition in Delaware. Staff suggested that two goals might have been to promote retail competition or to provide low, stable rates for SOS service. Staff also questioned whether those goals were mutually exclusive and whether the decision of which goal the SOS process would achieve would determine the outcome of some of the subsequent issues (e.g., the magnitude of the Retail Adder). (Staff 1/26/05 Proposal at 6-7).

7. In Order No. 6490, the Commission had acknowledged the "competing pulls" in undertaking the SOS tasks. The Commission observed that the Restructuring Act had envisioned the emergence of a competitive marketplace after the end of the transition period; however, the reality was much different. No suppliers are soliciting residential customers, and even "competitive entreaties to larger commercial and industrial customers are far from universal." (Order No. 6490, ¶ 8). Consequently, at least on the residential side, SOS was not merely a "default" service; it was the *only* service. In that situation, the Commission observed, its duty is to ensure that prices are as low as reasonable. But because the Restructuring Act was premised on a different set of assumptions, the Commission observed that its task would be to ensure that its resolution of the SOS issues

"speaks to real-world circumstances while remaining consistent with the Act's directives." *Id.*

**B. Structuring the Provision of SOS: Wholesale or Retail Model?**

8. In its report, Staff concluded that SOS should be provided pursuant to a wholesale model. As used by Staff, "wholesale" meant the selection of the incumbent distribution utility (DP&L) as the SOS provider, under the assumption that the incumbent distribution utility would secure the power to serve SOS customers from the wholesale power market. (Staff Report at 8). Further implicit in that discussion was that DP&L would be required to procure that power on a competitive basis rather than a bilateral one, especially not on a bilateral basis from DP&L affiliates. *Id.*

9. As used by Staff in its report, "retail model" referred to selecting one or more SOS providers through some form of competitive process and having the selected SOS provider(s) assume some or all of the duties of interfacing with the retail SOS customer. The parties discussed two variations of retail models: a one-step model and a two-step model. In the one-step model, bidders bid a final retail price for all aspects of providing SOS, including procuring SOS power. In the two-step model, bidders bid a retail margin that would be the provider's compensation for all aspects of providing SOS except for procuring SOS power. Under this model, selected providers would conduct a competitive wholesale power procurement, which the Commission would then accept or reject. A third retail model was proposed for those customer classes that, under SOS, might be charged a simple pass-through of real-time PJM wholesale energy and PJM market

capacity prices; under this model, bidders would bid a retail margin but there would be no second step because the SOS power charge would be a pass-through of PJM prices. (Staff Report at 8-9).

10. After weighing all the written and oral comments received on this issue, Staff concluded that the wholesale model was most appropriate for SOS in Delaware. (Staff Report at 31-33). Initially, Staff noted that the point that the wholesale model has been implemented in other jurisdictions, including PJM states, had appeal. In addition, adoption of the wholesale model would avoid the need for duplicative customer service costs, would reduce the need for customer education, enable maintenance of existing payment options such as budget billing, would decrease administrative burdens, and would provide a delivery agent (DP&L) more familiar with the market. Some parties further asserted that a wholesale model would attract more bidders, would not interfere with retail competition, and that most issues involving the model had already been resolved in other jurisdictions. (Staff Report at 29).

11. Parties arguing against the retail model asserted potential legal problems relating to lack of privity of contract in the retail SOS transaction and the administrative burdens that would be placed on the Commission to contract with and oversee a retail SOS provider. Staff gave these concerns little weight in its assessment, however, because it found that the Legislature could likely resolve them prior to the transition date. Furthermore, the parties asserting these arguments had not supplied Staff with any legal analysis to support them. (Staff Report at 29).

12. The arguments in favor of the retail model fell into two primary classes. First, the retail model was more consistent with the goal of the Restructuring Act and would better promote retail competition. Second, the non-power costs of delivering SOS would be subject to competitive pressure as opposed to regulated rate setting, resulting in lower rates for consumers. Proponents of the retail model also suggested that existing or potential competitive retail providers could capture the SOS market and bundle that load with other retail loads, gaining purchasing power and lowering their retail rates. (Staff Report at 30-31).

13. Staff's conclusion that the wholesale model was preferable to the retail model in Delaware was based on several factors. First, its feasibility was "inarguable, based on experience in other jurisdictions." *Id.* at 31. Second, the retail model would either piggyback on DP&L's existing customer service functions and costs (adding little value), or would duplicate those functions and costs (raising stranded cost issues). Third, retail SOS providers, like competition retail providers, could cease to serve the load for any number of reasons, requiring the Commission to face the question of back-up capacity to serve the load and carry out the various customer service functions. Finally, under the wholesale model, the SOS provider would be an entity that has an ongoing business and physical presence in Delaware that is subject to Commission oversight, whereas, under the retail model, the SOS provider may not have such a presence. (Staff Report at 31).

14. Staff acknowledged that the retail model could well foster greater competitive retail electric service, but for this to happen, the retail model would have to bring "substantially more competitive providers to Delaware, with broader and deeper commitments to competitive retail service as well as to retail SOS." (Staff Report at 32). The proponents of the retail model had not adduced any evidence that this would happen, however, and Staff saw no record of achievement in this regard elsewhere. With respect to the potential for the retail model to result in retail margins lower than the retail adder that would be required in the wholesale model, Staff found that the "serious potential" for duplicating DP&L's costs and the cost of maintaining "back-up" SOS capability at DP&L outweighed the speculative potential for lower retail margins. *Id.*

15. DP&L, the Division of the Public Advocate ("DPA"), Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (together, "Constellation") and PEPCO Energy Services, Inc. ("PES) agreed with Staff's assessment and also advocated adoption of the wholesale model. (DP&L 2/15/05 comments; DPA 2/15/05 comments; Constellation 2/15/05 comments; PES 2/17/05 comments; 2/22/05 Transcript at 129).

16. The Delaware Energy Users' Group ("DEUG") originally advocated for a retail model, but, as DEUG noted in its comments, it abandoned that approach because it appeared "increasingly likely" that the Commission would adopt a wholesale model (DEUG 2/14/05 comments at 2). At oral argument prior to deliberations, DEUG indicated that it was ready to "throw in the towel" on the retail model. (2/22/05

transcript at 126). However, DEUG contended that an important issue was the form of the SOS (fixed price vs. hourly prices) that would be offered to large customers, and that this was a "mega" issue that the Commission should resolve in this stage of the proceeding. (2/22/05 Tr. at 127-29).

17. Washington Gas Energy Services ("WGES") took issue with the recommendation of a wholesale model. First, WGES disagreed with Staff's definitions of "wholesale" and "retail" models. It contended that whoever is chosen as the SOS supplier will seek to procure power from the wholesale power market to provide SOS. (WGES 2/15/05 comments at 4). In WGES' view, the "real threshold question" was whether the Commission desired to "end all electricity price regulation by selecting non-utility SOS provider(s) or continue price regulation by selecting DP&L and combining market prices with regulated administrative costs and profit margins." *Id.* at 5. Moving on to more specific criticisms of the retail model, WGES contended that it would not result in duplicative costs because DP&L would still provide customer care for transmission and distribution ("T&D") functions and another SOS provider would provide the customer care function for the commodity portion of the bill, just as is done for customers that shop. *Id.* at 9. Furthermore, there would be no need to increase customer education costs because SOS is not supposed to be a competitive service, but rather a bedrock/safety-net program that requires no promotion. *Id.* at 9-10. Third, the ability to maintain present payment options should not be affected by the selection of a non-utility SOS supplier because there are enough participants

"skilled in the stakeholder process" to resolve such implementation issues. *Id.* at 10. Fourth, WGES contended that there was no evidence that the wholesale model involved a lower administrative burden than the retail model. Fifth, WGES labeled as "weak" the argument that the wholesale model would result in a delivery agent more familiar with the market; DP&L would *always* be the delivery agent regardless of who was the SOS supplier because DP&L was responsible for local T&D. *Id.* Sixth, there was no evidence supporting an alleged inability to attract more bidders if another load serving entity ("LSE") is to be the SOS supplier. *Id.* at 11. Seventh, WGES characterized as "weak" the position that the wholesale model would not interfere with retail competition, because there was no discussion as to what class of customers this assertion would apply to. Eighth, it was a false premise to assume that selecting an LSE other than DP&L to provide SOS would be more complex than simply selecting DP&L, because the generic documents already developed for use elsewhere could be adapted for Delaware and used here. *Id.* at 11-12. Ninth, WGES dismissed the legal arguments against the retail model as unfounded. *Id.* at 12-13. Tenth, WGES denied that non-utility SOS would piggyback on DP&L's existing customer service functions and costs: WGES argues that another SOS provider would provide the same customer care function and supply services to SOS customers, and it had not been demonstrated that DP&L as a middleman brought any "added value." *Id.* at 13. Eleventh, WGES observed that any entity (including DP&L) could cease to serve the load for any number of reasons, and that the Commission ought to be more concerned with power wholesalers that have to deliver

the contracted-for power, as they were not immune to business conditions and financial distress either. *Id.* at 14. Finally, WGES argues that the Commission should ignore Staff's point that DP&L has a business and physical presence in Delaware, because all non-utility SOS suppliers and LSEs would be subject to Commission oversight and jurisdiction and had to meet the same FERC and PJM licensing requirements as DP&L. *Id.* at 14-15.

18. **Discussion and Vote.** We have read and reviewed all of the parties' very well-thought-out positions and arguments for and against the wholesale and retail models. We understand WGES concern that Staff's definitions of "wholesale" and "retail" are misnomers because whoever is selected as the SOS supplier will be procuring the power for SOS service from the wholesale market, but we find those definitions useful in the context in which we are addressing the various issues. After considering all of the parties' contentions, we believe that the wholesale model is more appropriate at this time for structuring the provision of SOS in DP&L's service territory after the expiration of the extended transition period, and agree with the comments made by the parties in support of that model. We particularly believe the wholesale model to be more appropriate because the wholesale model is well understood and can be implemented building on the knowledge gained from the experience of other states and utilities in the region who have used a wholesale model. In contrast, there is relatively little experience on which to draw to define, develop, and implement all that would be necessary to address if a retail model were to be adopted. Additionally, there has been relatively little

retail competition in Delaware, and no competition for residential and small commercial customers, despite the enactment of the Restructuring Act some five years ago. It does not appear that there will be any greater level of competition in May 2006 than there is now. This further suggests the need for caution and the use of well understood approaches to provide SOS. Consequently, we believe that adopting the wholesale model as the structure for the provision of SOS will make the transition to unregulated retail electric service easier for all involved. (3-0: Chair McRae, Commissioners Lester and Conaway voting yes).

**C. Selection of the Provider for SOS**

19. The next fundamental issue considered by the parties was the selection of the provider for SOS. In its report, Staff observed that if the Commission adopted the wholesale model for the provision of SOS, then by definition, DP&L was the only possible provider. Nevertheless, Staff determined that the Commission would have the authority to shape the procurement process for DP&L's wholesale supply to ensure that the SOS price was "'representative of the regional wholesale electric price.'" (Staff Report at 9, quoting 26 *Del. C.* § 1010(a)). Because Staff had recommended the wholesale model, it therefore also recommended that DP&L be selected as the SOS supplier. *Id.* at 35.

20. On this issue, every party except WGES agreed with Staff's position. (2/22/05 Tr. at 147-150). WGES contended that Staff (and the others agreeing with Staff) "seriously err[ed]" in concluding that DP&L was the only possible SOS provider if the wholesale model was

adopted, because all LSEs in PJM were eligible to procure power in the wholesale market under the same agreements that apply to both regulated and competitive energy suppliers, and all LSEs were required to be FERC- and PJM-certified to buy and trade wholesale power. Furthermore, WGES observed that the Commission had the authority to shape the procurement process without exclusively selecting one bidder or discriminating against qualified suppliers. WGES contended that selecting DP&L as the SOS supplier would entail partial price controls, whereas the selection of other LSEs would provide a competitive retail price of electricity to the customer delivered to DP&L zonal points. (WGES 2/14/05 comments at 6-7).

21. **Discussion and Vote.** We understand WGES' point that even under a wholesale model, all LSEs (including DP&L) will procure the power required to supply SOS from the wholesale market. Nevertheless, we believe it is important at this stage of the proceeding not to overly complicate the transition process. We believe that if DP&L is selected to serve as the SOS supplier, the transition will be less difficult. We are not concluding at this point that DP&L will be the SOS supplier indefinitely; we realize that in the future other approaches might be appropriate. At this point, however, we believe that it will ease the burden of transitioning to a competitive retail electric market if DP&L is appointed to serve as the SOS supplier at the expiration of the extended transition period in May 2006. (3-0: Chair McRae, Commissioners Lester and Conaway voting yes).

**D. Methods for Procuring Power for SOS**

22. Staff observed that other states that have adopted the wholesale model for SOS supply have required the SOS supplier to conduct an auction or a request for proposals ("RFP") process for power procurement, which auction or RFP process would be subject to Commission approval. (Staff Report at 10). Staff recommended that the Commission authorize a competitive bidding process, with the details to be worked out in the second stage of this docket. *Id.* at 36.

23. DP&L, the DPA, Constellation, and PES concurred in Staff's recommendation, although during oral argument prior to deliberations, Constellation suggested that the Commission had an opportunity in this order to "assist the Stage 2 process in its analysis of what form of competitive procurement at the wholesale level should be used" by instructing the parties in Stage 2 to examine other states' models as a framework to shape the discussion. (2/22/05 Tr. at 153, 155, 158-59).

24. DEUG and WGES disagreed with Staff's position. DEUG took the position that for large customers, hourly energy should be procured by DP&L from PJM. No RFP would be necessary for large customers, only for fixed-price SOS. DEUG observed in its separate issue sheet to the Commission that its proposal for large customers did not seem to be controversial or disputed.

25. WGES disagreed with an alleged proposal of DP&L to use a portfolio approach that blended prices for power. (2/22/05 Tr. at 155-56). WGES contended that using a blended price in times of rising

energy prices would put competitive suppliers at a disadvantage, and suggested that a 12-18 month period would be more appropriate. (2/22/05 Tr. at 156).

26. In oral argument prior to the deliberations, the DPA contended that the Commission should defer the issue regarding procurement for all customers, including large customers. In his view, the parties had not developed a sufficient record to approve a specific mechanism for procurement. (2/22/05 Tr. at 155).

27. **Discussion and Vote.** We agree with Staff's recommendation, with which DP&L, the DPA, PES, and Constellation agree, that a competitive wholesale process for procuring power would be appropriate, but that the details should be deferred to the second stage of this proceeding. It is clear that the parties had insufficient time to examine what is clearly a very important issue, and one for which there appear to be various approaches. We disagree with WGES that DP&L made a specific proposal in response to Staff's recommendation to defer consideration of this issue to Stage 2; we have read DP&L's 2/15/05 comments several times searching for that proposal and have been unable to find it in DP&L's submission. Perhaps that proposal was made in earlier comments; but it is not before us here and we do not address it.

28. As for Constellation's suggestion that we shape the direction of the discussion of this issue in Stage 2, we decline to do so. The point of this open-ended process was to encourage consideration of various options, not for the Commission to point the parties in the direction of one particular option over another.

29. We adopt Staff's recommendation that power be procured through a competitive wholesale process, the details of which are to be considered by the parties in the next stage of the proceeding. DEUG's proposal regarding hourly SOS service for large industrial customers is also deferred to Stage 2. (3-0: Chair McRae; Commissioners Lester and Conaway voting yes).

**E. Components of the Retail Adder**

30. Staff observed that the composition of the retail adder was a relevant issue only if the Commission selected DP&L as the SOS supplier. (Staff Report at 11). The Restructuring Act does not define how the retail margin (or adder) should be set. The parties identified three categories of charges that could comprise the retail adder: (1) the actual incremental costs of being the SOS supplier, including the expense of wholesale procurement; (2) compensation for any risk assumed by the SOS supplier (described by some as "profit" and by DP&L as "imprudence, legislative, and regulatory risks"); and (3) a charge designed to level the playing field between the SOS supplier and retail competitors (which, according to its proponents, would provide "headroom" for retail competitors that have marketing and transaction costs that are not part of the SOS suppliers' cost structure to compete). *Id.* at 11-12. Because this issue is of vital importance to all of the parties and there had been insufficient time to consider and digest the various positions, Staff recommended that the "discussion of which of the components of the Retail Adder that were identified should be included in the SOS rate ... and what

magnitude the Retail Adder should be deferred to Stage 2." (Staff Report at 37).

31. DP&L did not oppose deferring the retail adder issue to Stage 2. However, it noted that a "retail margin" above wholesale market price was explicitly included in the Restructuring Act. (DP&L 2/15/05 comments at 2).

32. The DPA also supported Staff's proposal to defer this issue to Stage 2. Notwithstanding that, the DPA stated that the SOS provider should be able to recover the incremental costs of providing SOS, but that it should not be rewarded with an excessive retail adder, nor should it be permitted to charge ratepayers for a return or profit component unless it demonstrates that its investment is being used to provide SOS. (DPA 2/15/05 comments).

33. PES supported the deferral of the retail adder issue to Stage 2, but contended that "[a]ll components needed to provide the service should be reflected in the pricing of SOS," and that the "artificial removal of costs components associated with the provision of SOS will not adequately compensate the provider or assist in the development of retail competition in Delaware." (PES 2/17/05 comments at 5).

34. Constellation also supported deferring the retail adder issue to Stage 2, but also opined that "reasonable rates must be interpreted to mean that all costs associated with SOS - not just incremental wholesale costs of supply - are included in the SOS rates." (Constellation 2/15/05 comments at 3). Constellation further observed during oral argument that DEUG members were "essentially

looking for power ... at an incremental cost without ever reflecting what actual standard offer service costs to be provided to their members - or to its membership." (2/22/05 Tr. at 174-75).

35. Once again, DEUG and WGES opposed Staff's recommendation. DEUG argued that in any ruling adopting the wholesale model, the Commission should provide instructions and guidance regarding the definition and application of "retail margin," and urged that it define "retail margin" as "the incremental transactional costs incurred by [DP&L] in providing the particular type of SOS, and any return justified by the incremental risks and incremental investment undertaken by [DP&L] to provide that service." (DEUG 2/14/05 comments at 4). The definition should further include how DP&L may recover the amount to which it is entitled from customers (i.e., rate design for the retail margin). *Id.* at 5. According to DEUG, defining the retail margin in this manner will promote retail competition and attain reasonable SOS rates for large customers because: (a) the hourly pass-through SOS without any artificial adder is sufficient to encourage large customers to field offers from competitive suppliers; (b) an hourly service available only to large customers will promote participation in existing demand response programs, which benefits all of Delaware; (c) establishing a retail margin on a utility's incremental transactional costs and risks and investment (if any) to provide the SOS will result in more attractive retail offerings from competitive suppliers than an inflated retail margin; and (d) inflated retail margins, including an uncapped per-kWh charge, are unfair and

punitive to large hourly customers, particularly for the hourly pass-through SOS. *Id.* at 6-10.

36. DEUG contended that for large customers taking the hourly flow-through SOS, the rate design for the retail margin should be a per-account flat monthly fee rather than a per-kWh charge. *Id.* In this regard, DEUG argued that the Commission should require DP&L to immediately disclose, with respect to its most recent historical test year, its actual incremental transactional costs, risk and investment incurred in providing its hourly pass-through service in Delaware, Maryland, and Virginia to assist the parties and Commission in establishing a retail margin that reflects DP&L's incremental transactional costs, risk, and investment in providing an hourly pass-through SOS to large customers. *Id.* at 11.

37. DEUG noted that its hourly flow-through proposal for large customers was not controversial. Both DP&L and the DPA, however, contended during oral argument that there was an insufficient record on which to determine the retail adder or to determine what the SOS price should be for large customers. (2/22/05 Tr. at 166, 171).

38. WGES disagreed with Staff's definition of "retail margin," arguing that it was "the profit margin that applies to the entire cost-of-goods sold, i.e., to the provision of retail SOS and not just to the wholesale cost of power." (WGES 2/15/05 comments at 7). Other components of SOS, such as SOS transaction costs, market risk, regulatory risk, operations, personnel, etc., should also be compensated through the SOS price. WGES also observed that the application of retail adders in Maryland and the District of Columbia

was uneven. *Id.* at 7-8. WGES expressed concern during its oral argument that in stage 2 the parties might be told that the costs are commingled and could not be separated, and therefore a number would be pulled "out of thin air." (2/22/05 Tr. at 174).

39. **Discussion and Vote.** As with the prior issue - the method by which power to supply SOS will be procured - we again agree with Staff's recommendation that this issue be deferred to and considered in Stage 2 of this proceeding. It is clear from the volume and the tenor of the oral argument, let alone the written submissions, that this issue is critical to whatever this Commission does in the area of SOS. As DEUG's counsel put it, "it is the biggest dollar issue that the Commission can actually control." (2/22/05 Tr. at 167). It is also clear that the parties differ in their definitions of retail margin (or adder), what its components are, and whether different customer classes should have different retail margins. In light of the vital importance of this issue, we believe it is preferable to defer this issue to Stage 2 to give the parties additional time for discussion. In this regard, however, we note that the prompt provision of information is key to accomplishing the goals set forth for Stage 2, and we expect the parties to be forthcoming with such information. In order to ensure that the process proceeds smoothly, we again appoint Senior Hearing Examiner William F. O'Brien to superintend and monitor the Stage 2 process and to deal with any disputes regarding the adequate provision of relevant information, if any should arise. (3-0: Chair McRae, Commissioners Lester and Conaway voting yes).

**F. Social Benefits Issues**

40. Staff noted in its report that the only social issues discussed were demand response programs and whether renewable energy sources should be included in SOS procurement. It was noted that a requirement to include a Renewable Portfolio Standard in the electric supply in Delaware was introduced during the last legislative session; although it was not approved, it was expected to be introduced again. (Staff Report at 12).

41. If a Renewable Portfolio Standard was not enacted in Delaware, Staff sought further discussion on the potential benefits of including renewable resources as a component of SOS. Staff noted that it and DP&L had been engaged in an advanced metering/energy efficiency pilot program that was currently inactive; however, its goal had been to determine whether properly designed tariffs coupled with state-of-the-art equipment would allow a functional demand side of the energy market to develop in Delaware. In Staff's view, if the pilot program indicates that a functioning demand side of the market for smaller customers can be achieved, that information should be factored into future SOS procurement processes. *Id.* at 37. Furthermore, Staff recommended that in Stage 2, tariffs should be examined to ensure that they are consistent with PJM demand response programs so as to allow customers to achieve maximum benefits from the PJM programs. *Id.* at 38.

42. DP&L, DPA, PES, and Constellation generally agreed with Staff on these issues. DP&L, however, argued that SOS should be "plain vanilla" and that the Commission should not be creating

different "flavors" of SOS such as "green" or "demand side." Rather, DP&L believed those may be premium services that could be attractive niche markets for retail competitors. (DP&L 2/15/05 comments at 2). PES supported DP&L's position on this issue. (2/22/05 Tr. at 179).

43. The DPA noted that it might be preferable to have competitive providers offer renewable resource options instead of requiring renewable resources to be included in the SOS portfolio. The DPA also recognized that this issue could be affected by future legislation. The DPA affirmed its intent to work with the parties to more fully address the issue of renewable resources in Stage 2. (DPA 2/15/05 comments at 2).

44. Finally, DEUG agreed with Staff that the social benefits issue was not limited to renewable resources, but also included demand response programs - such as an hourly pricing model like that being deferred to Stage 2. DEUG contended that the hourly pass-through SOS should be designed to give large customers every incentive and ability to respond to hourly price signals. Such customers should be allowed and encouraged to participate in PJM's demand response programs. DEUG believes that there is a significant public interest in promoting demand response programs because they benefit all ratepayers. (Source: DEUG's alternative issue sheet).

45. **Discussion and Vote.** We agree with Staff's recommendation that the issue of social benefits (including, but not limited to, the issue of renewable resources as part of an SOS portfolio and demand response programs) should be deferred to and considered in Stage 2 of

this proceeding. (3-0, Chair McRae, Commissioners Lester and Conaway voting yes).

**G. Need for Legislation**

46. The parties generally agreed that regardless of whether the wholesale model or the retail model was adopted, no new legislation would be necessary to implement the provision of SOS at this point in the process.

47. **Discussion and Vote.** We agree with the parties that no additional legislation is necessary at this time, especially in light of our decision to adopt the wholesale model (as defined by Staff) for structuring the provision of SOS and our decision to select DP&L as the SOS supplier at the end of the extended transition period. (3-0: Chair McRae, Commissioners Lester and Conaway voting yes).

Now, therefore, **IT IS HEREBY ORDERED THIS 22<sup>nd</sup> DAY OF MARCH, 2005:**

1. That the "Wholesale Model" as defined by Staff in its January 26, 2005 Stage 1 Report is hereby approved for structuring the provision of Standard Offer Service at the expiration of the extended transition period on May 1, 2006, and until such time as the Commission orders otherwise.

2. That Delmarva Power & Light Company is hereby approved as the Standard Offer Service supplier at the expiration of the extended transition period on May 1, 2006 until such time as the Commission orders otherwise.

3. That the following issues are deferred to, and shall be considered by the parties in, Stage 2 of this proceeding:

- (a) The manner in which power necessary to provide Standard Offer Supply Service is to be procured, and the details of such procurement;
- (b) The definition of "retail margin," including, but not limited to, the appropriate components of the retail margin;
- (c) Social benefit issues, such as whether renewable resources should be part of a Standard Offer Service portfolio and the encouragement and/or implementation of demand response programs.

4. That Senior Hearing Examiner William F. O'Brien is appointed to superintend and monitor the Stage 2 process and to deal with any disputes regarding the adequate provision of relevant information, if any should arise.

5. That the Commission retains the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

/s/ Arnetta McRae  
Chair

/s/ Joshua M. Twilley  
Vice Chair

/s/ Joann T. Conaway  
Commissioner

/s/ Jaymes B. Lester  
Commissioner

PSC Docket No. 04-391, Order No. 6598 Cont'd.

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Commissioner

ATTEST:

/s/ Karen J. Nickerson  
Secretary