

**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.09-385F
ITS GAS COST RATES)
(FILED AUGUST 31, 2009))

ORDER NO. 7817

AND NOW, this 17th day of August 2010.

WHEREAS, the Commission has received and considered the Findings of Fact, Conclusions of Law and Recommendations of the Hearing Examiner issued in the above-captioned docket (attached to the original hereof as Attachment "A") after a duly-noticed public evidentiary hearing held on May 6, 2010;

WHEREAS, the Hearing Examiner recommends that the parties' jointly submitted Proposed Settlement (attached to the original hereof as Attachment "B"), including the Gas Cost Rates ("GCR") proposed by Delmarva Power & Light Company in its Application filed August 31, 2009, be approved as just and reasonable and in the public interest for service rendered on and after November 1, 2009;

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

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the Findings of Fact, Conclusions of Law and Recommendations of the Hearing Examiner, appended to the Original hereof as Attachment "A";

2. That the Commission approves as just and reasonable and in the public interest the jointly Proposed Settlement of the parties,

appended to the original hereof as Attachment "B", and Delmarva Power and Light Company, Inc.'s proposed GCR rates;

3. That Delmarva Power & Light Company, Inc.'s proposed rates are approved as just and reasonable and in the public interest for usage on or after November 1, 2009 as set forth below:

<u>Rate Schedules</u>	<u>2008-2009</u>		<u>Proposed-2009-2010</u>	
	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	109.812¢/ccf	N/A	93.959¢/ccf
Non-electing MVG	\$8.5538/Mcf	\$9.7555/Mcf	\$9.5152/Mcf	\$7.9076/Mcf
		of Contract MDQ		of Contract MDQ
Electing MVG and LVG	\$8.5538/Mcf	Varies	\$9.5152/Mcf	Varies
		of Contract MDQ		of Contract MDQ
Standby Service	\$8.5538/Mcf	N/A	\$9.5152/Mcf	N/A
		of Standby MDQ		of Standby MDQ

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/ Alisa Carrow Bentley
Secretary

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

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ITS GAS COST RATES)
(Filed August 31, 2009))

FINDINGS of FACT, CONCLUSIONS OF LAW AND RECOMMENDATIONS
OF THE
HEARING EXAMINER

DATED: August 3, 2010

RUTH ANN PRICE
SENIOR HEARING EXAMINER

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APPENDICES

Exhibit "A"- Proposed Settlement Agreement of the Parties dated May 6, 2010

Appendix "A"- Settlement Agreement in *In The Matter Of The Application Of Delmarva Power & Light Company for Approval Of Modifications To Its Gas Cost Rates*, PSC Docket No.08-266F(Filed August 29, 2008), PSC Order No. 7658 (October 6, 2009), Exhibit "B".

Exhibit "B"- Proposed Form of Order for the Commission in PSC Docket No. 09-385F

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**FINDINGS of FACT, CONCLUSIONS OF LAW AND RECOMMENDATIONS
OF THE
HEARING EXAMINER**

Ruth Ann Price, duly appointed Hearing Examiner in this Docket pursuant to 26 Del. C. §502 and 29 Del. C. ch. 101, by Commission Order No. 7642, dated September 9, 2009 and Commission Order No. 7664 dated October 6, 2009, reports to the Commission as follows:

I. APPEARANCES

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

By: TODD GOODMAN, Esq., Associate General Counsel
 C. Ronald McGinnis, Jr., Regulatory Affairs Lead
 Philip L. Phillips, Jr., P.E., Manager of Gas Operations
 and Planning
 Michael S. Poncia, Director of Gas Delivery

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

By: REGINA IORII, Esq., Deputy Attorney General
 Courtney Stewart, Public Utilities Analyst III

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

By: KENT WALKER, Esq., Deputy Attorney General
 G. Arthur Padmore, Public Advocate
 Michael D. Sheehy, Deputy Director, Public Advocate

II. BACKGROUND

A. DELMARVA'S 2009-2010 GCR APPLICATION

1. On August 31, 2009, Delmarva filed an Application ("Application") with the Delaware Public Service Commission (the "Commission") seeking to decrease its Gas Cost Rate ("GCR") factors, effective on and after November 1, 2009, with proration, and with such revised factors to continue in effect until October 31, 2010. Ex. 10.¹ The approved rates for 2008-2009 and the proposed rates for 2009-2010 are as follows:

<u>Rate Schedules</u>	<u>2008-2009</u>		<u>Proposed-2009-2010</u>	
	<u>GCR Demand Charge</u>	<u>GCR Commodity Charge</u>	<u>GCR Demand Charge</u>	<u>GCR Commodity Charge</u>
RG, GG and GL	N/A	109.812¢/ccf	N/A	93.959¢/ccf
Non-electing MVG	\$8.5538/Mcf	\$9.7555/Mcf	\$9.5152/Mcf	\$7.9076/Mcf
		of Contract MDQ		of Contract MDQ
Electing MVG and LVG	\$8.5538/Mcf	Varies	\$9.5152/Mcf	Varies
		of Contract MDQ		of Contract MDQ
Standby Service	\$8.5538/Mcf	N/A	\$9.5152/Mcf	N/A
		of Standby MDQ		of Standby MDQ

See Application, Ex. 10 at 2.

2. The rates proposed in Delmarva's Application would result in a GCR decrease of 14.4% for RG, GG and GL customers. Residential space heating customers using 120 ccf in a winter month would experience a decrease of \$19.02 (or 10.2%) in their total bill. *Id.* at Application's Briefing Sheet. Commercial and industrial customers served on Service Classifications GG and non-electing MVG would experience decreases in their winter bills ranging from 6.2%-11.6% and

¹ In this Report, the exhibits admitted into evidence at the evidentiary hearing are cited as "Ex." and references to the evidentiary hearing transcript will be cited as "Tr.____."

12.3%-16.1%, respectively, depending on load and usage characteristics. *Id.*

3. In addition, Delmarva's Application requested approval of the Company's proposals to reconcile and "true-up" actual versus estimated Weighted Average Commodity Cost Rate assignments for sales under the Large Volume Gas (LVG) service and for the 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 Ex. 10 at ¶4.

4. On September 9, 2009, in PSC Order No. 7642, the Commission allowed the proposed 2009-2010 GCR factors, reconciliation and true-ups, and non-firm surcharge to become effective on a temporary basis, subject to refund, effective with meter usage on and after November 1, 2009, with proration. In addition, the Commission thereafter designated this Hearing Examiner to conduct public evidentiary hearings and to report to the Commission proposed Findings and Recommendations based on the evidence presented. See PSC Order No. 7664 (October 6, 2009).

5. By letter dated October 9, 2009, G. Arthur Padmore, the Public Advocate, exercised his office's statutory right of intervention in this docket. The Commission did not receive any other petitions for intervention in this docket.

6. On September 15 and 16, 2009, the Company published notice of the Application in *The News Journal* newspaper, including information as to how to intervene in this Docket.

B. PUBLIC COMMENT SESSION

7. A duly noticed² Public Comment Session was conducted at 7 p.m. on November 17, 2009 in the Auditorium of the Carvel State Office Building located at 820 North French Street in Wilmington, Delaware.³ Public notice of the hearing included newspaper notice in the legal classified section of *The News Journal* newspaper on October 18, 2009 and in *The Delaware State News* newspaper on October 20, 2009.

C. EVIDENTIARY HEARING

8. An evidentiary hearing was conducted on May 6, 2010 in the Third Floor Conference Room in the Carvel State Office Building in Wilmington. No members of the public attended the evidentiary hearing. The record, as developed at the hearing, consists of a fifty-five (55) page verbatim transcript and ten (10) hearing exhibits.

9. At the May 6, 2010 evidentiary hearing, the parties jointly submitted a proposed Settlement Agreement ("Proposed Settlement"), which, if adopted by the Commission, would resolve all issues in this Docket. See Exhibit "A" attached hereto; Evidentiary Hearing Ex. 4. 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 of Fact, Conclusions of Law and Recommendations.

² The Affidavit of Publication of Notice of the Public Comment Session and the Evidentiary Hearing are included in the record as composite Exhibit 1.

³ The public comment session was originally scheduled for October 27, 2009. Notice of cancellation for that date and rescheduling of the public comment session for November 17, 2009 was published in *The News Journal* on October 18, 2009 and in *The Delaware State News* newspapers on October 20, 2009.

III. SUMMARY OF THE EVIDENCE

A. COMPANY'S TESTIMONY

10. With its Application, Delmarva submitted the pre-filed testimony of four (4) witnesses: Michael S. Poncia, Philip L. Phillips, Jr., W. Thomas Bacon, Jr. and C. Ronald McGinnis, Jr. At the evidentiary hearing on May 6, 2010, the Company presented the live testimony of Messrs. Poncia, Phillips and McGinnis. Tr. 26, 30 and 46. Mr. Bacon did not attend the hearing but his pre-filed testimony (Ex. 6) was adopted at the hearing by C. Ronald McGinnis, Jr. Tr. 47.

11. Company Witness Michael S. Poncia, Delmarva's Director of Gas Delivery, first provided an overview of the Company's GCR case and summarized the rates proposed in the Company's Application. Ex. 2. Mr. Poncia testified regarding the methodology used by the Company to develop the estimated recoverable firm gas costs and calculated the proposed changes to the commodity components of the GCR rate. Mr. Poncia also explained that the overall effect of the Application 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 a decrease of 10.2% or \$19.02 in their monthly gas bills. *Id.* at 4. The decreases in the monthly bills of customers served in the non-electing MVG (medium volume) or LVG (large volume) service classifications will depend upon their usage. *Id.*

12. 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. Ex. 3 at 3. According to Mr. Phillips, Firm Sales have decreased 9%, Firm Transportation has decreased 19.1%, and Firm Throughput has decreased 12.0%. *Id.* Finally, the Company's loss factor has remained approximately 2%. *Id.* at 5.

13. **Eastern Shore Natural Gas ("ESNG") E3 Project Expenses.** In this GCR proceeding, the Company also seeks to recover \$386,910 representing the first portion of the \$1.56 million pre-certification costs incurred by the Company regarding the Eastern Shore Energylink Expansion Project ("the E3 Project"), a cancelled natural gas pipeline project. *Id.* at 2, 5 and 8. The Company is seeking \$386,910 based upon the rate of \$21,495 per month for the eighteen (18) month period from May 2009 through and including October 2010. *Id.* ESNG has informed the Company that the Pre-Certification costs between all project participants total \$3.17 million, of which the Company's share is \$1.56 million. *Id.* at 8. The Federal Energy Regulatory Commission ("FERC") has approved this allocation. See FERC's August 1, 2006 Order⁴. "Pre-certification costs" are defined as engineering, communication, governmental relations, economic studies and environmental, regulatory and legal service costs." See FERC's August 1, 2006 Order, §5.

14. The E3 project was intended to provide the Company with another natural gas pipeline source to serve Delmarva Peninsula residents. Delmarva participated in the E3 project to help reduce the Company's dependence on other pipelines while increasing upstream capacity on the Delmarva Peninsula. *Id.* at 6; FERC's August 1, 2006

⁴ *In Re Eastern Shore Natural Gas Company*, Docket No. RP06-404-000, 116 FERC ¶61,111 (August 1, 2006) (referred to herein as "FERC's August 1, 2006 Order").

Order, §2. Although the E3 Project is discussed in more detail later herein, in May 2009, ESNG notified the Company that ESNG was cancelling the E3 project and electing to terminate its Agreement with the Company. *Id.* at 8. ESNG cancelled the E3 project as a result of projected capital increases and insufficient customer capacity commitments, thereby determining that the project was not viable during the current economic downturn. *Id.* at 7-8.

15. Mr. Phillips also testified regarding the steps the Company has taken to comply with the Commission-approved Settlement Agreement in PSC Docket No. 08-266F⁵ involving a previously incurred pipeline penalty. Ex. 3 at Exhibit PLP-2, p. 5. The Settlement Agreement in PSC Docket No. 08-266F (PSC Order No. 7658 (October 6, 2009)) involved a pipeline penalty for capacity deficiency of \$68,150 for overtaking 3,326 Dth of FSS supply in January 2007. Ex. 3 at Exhibit PLP-2, p. 5. According to the Settlement in PSC Docket No. 08-266F, the Company was unable to take the entire amount of gas on the TETCO pipeline because its delivery pressure was too low. *Id.* The Company incurred the penalty because it was required to take delivery on an alternate pipeline, the Columbia pipe. *Id.* The Company, Staff and the Public Advocate agreed that for purposes of the Settlement in PSC Docket No. 08-266F *only* the penalty would be shared equally between the Company and the ratepayers. Ex. 3 at Exhibit PLP-2, p. 6. Further, Mr.

⁵ Since the issues in the current case, such as pipeline penalties and the Hedging Program, relate to Settlement Agreement in PSC Docket No. 7658 (October 6, 2009), I have attached a copy of the Settlement Agreement in the prior GCR case for 2008-2009, PSC Docket No. 08-266, as Appendix "A" so that readers who wish to refresh their recollections of the terms of the prior Settlement Agreement may do so.

Phillips testified that the Company has not incurred any pipeline penalties from June 2008 through June 2009. Ex. 3 at. 10.

16. I will now address issues which were addressed by Messrs. Phillips and W. Thomas Bacon, Jr., the Company's Director of Gas Supply and Regulatory Planning as adopted by C. Ron McGinnis, Jr. at the May 6 evidentiary hearing.⁶ Mr. McGinnis generally discussed the objectives of the Company's hedging program and the objectives of the Company's overall gas procurement strategy. Moreover, as required by the Company's most recent GCR, Mr. McGinnis "addressed commodity costs related to hedge purchases made in 2008 under the . . . hedging program and the effect of such purchases have on the 2009-2010 GCR." See PSC Order No. 7658 (October 6, 2009), Exhibit A-Settlement Agreement, 5-6.

17. **Current Gas Hedging Program:** Mr. Phillips and Mr. McGinnis each addressed the Company's Gas Hedging Program which involves exchange traded and over-the counter financial arrangements to lock in prices for natural gas. See generally, Ex. 6 at 9-11. The purpose of the Company's Gas Hedging Program is to attempt to reduce gas commodity price volatility while limiting the firm customers' exposure to wholesale gas market prices. *Id.* By Commission Order in the Company's prior GCR docket, the Company's Program has "targets" for Minimum and Maximum Hedging Levels: 1) the target Minimal Level of Hedging is a percentage of monthly purchases. "At 18, 12 and 6 months prior to natural gas being purchased, 10%, 20% and 30%, respectively, of estimated purchase requirements should be hedged;" and 2) the

⁶ Since W. Thomas Bacon's pre-filed testimony was adopted by Mr. McGinnis at the evidentiary hearing, I will refer to Mr. Bacon's testimony as that of Mr. McGinnis.

target Maximum Level of Hedging is up to 70% of annual GCR purchases. Ex. 6 at 14; see PSC Order No. 7658 (October 6, 2009). These "targets" are "subject to the business judgment of the Company. . . ." Ex. 6 at 14. However, the Company has the burden of explaining any deviations from the targets. *Id.*

18. In addition to the Hedging Targets specifying the maximum and minimum quantities that may be hedged, there are also guidelines specifying when or at what times the Company may hedge. The Company has twelve (12) Hedging Guidelines to determine whether it is appropriate to hedge, such as, but not limited to the following: current prices are relatively high or low compared to historical natural gas prices, hedging for winter or summer months, hedging for storms or for a hurricane system which could disrupt gas and oil production resulting in price spikes, storage amounts and market price movements within the month and weather forecasts. Ex. 6, Sch. WTB-9. Mr. McGinnis testified that these "when or at what times" guidelines afford the Company some discretion regarding when hedging may be performed, subject to the minimum and maximum quantity targets discussed earlier. *Id.* at 14-15.

19. According to Mr. McGinnis, during the GCR period, the Company's hedging activities were consistent with its Hedge Program because the Company complied with the minimum and maximum targets that guide the Company's Hedge Program. Ex. 6 at 20, lines 4-6 and Schedule WTB-10.⁷ Mr. McGinnis explained that the Company's calendar year 2008

⁷ Mr. McGinnis further noted that during 2008 there were 15 hedge transactions that were made "in order to comply with the Hedge Program's minimum hedge percentage guidelines." Exhibit 6 at 17, lines 3-5. In addition, between January 2008 and July

hedges have caused additional costs than if the Company had not hedged its firm supply requirements.⁸ *Id.* Nevertheless, Mr. McGinnis asserted that compared to other comparable gas utilities, the Company ranks 4th out of 10 for the two-year period ending July 2009. *Id.* at 12. For example, Mr. McGinnis contended that for the single month of July 2009, the Company ranked 8th out of those same 10 utilities. *Id.* Mr. McGinnis explained this drop in ranking by noting that this rate fluctuation is due to the frequency of when the rates change- monthly, quarterly or annually. Ex. 6 at 12. He noted that Delmarva, which determines its gas costs annually, appears not be to be doing as well as other utilities in other states, such as Pennsylvania and Maryland, which determine their gas costs monthly. *Id.*

20. **12-Month, 50% Non-Discretionary Hedging Program.** Mr. Phillips testified that the Company has not yet implemented its 12-month 50% non-discretionary hedging program, which in the most recent GCR docket, the Company agreed to implement.⁹ See PSC Order No. 7658 (October 6, 2009); Settlement Agreement, p.3-5. However, it has developed a transition plan to implement the new hedging program guideline. Ex. 3 at 9. Pursuant to this 50% non-discretionary hedging program, regardless of price trends, 50% of projected city gate

2009, Mr. McGinnis opined that "the actual percentage of estimated purchases that were hedged was 68%." Exhibit 6 at 20, lines 16-18.

⁸ Mr. McGinnis testified that "While these specific 2008 hedged positions have resulted in costs that are higher than they would have been had the Company not hedged its firm supply requirements the Company's actions were consistent with the Gas Hedging Plan." Exhibit 6 at 20, lines 4-6.

⁹ In the last GCR case, PSC Docket No. 08-266F, the Commission revoked the two hedging guidelines for a minimum level of hedging and an overall target level of hedging that it approved in PSC Docket No. 00-463F. See PSC Order No. 7658 (October 6, 2009). These guidelines were replaced by a fifty percent (50%) non-discretionary hedging program. Exhibit 6 at PSC Docket No. 08-266F Proposed Settlement, p. 4.

requirements and storage injections must be hedged on a pro-rata basis (1/12th) each month over the twelve (12) months preceding the month in which the physical gas is to be delivered. Ex. 6 at PSC Docket No. 08-266F Proposed Settlement, p. 4. The Settlement Agreement in PSC Docket No. 08-266F provides that the Company may vary the 50% rule where, based upon its business judgment, there are "extraordinary circumstances" warranting it to deviate from this program, provided the Company first has obtained the agreement of Staff and the Division of Public Advocate (DPA) *Id.*

21. Mr. Phillips testified that the initial hedging plan under the new 50% non-discretionary program is based on the anticipated supply requirements with the sales forecast provided in his Schedule PLP-1 showing a total 13,095,343 mcf for all classes of customers. Ex. 5 at 9. Mr. Phillips contended that the parties would discuss this plan in the 2009 Second Quarterly Hedging Report review meeting. *Id.* Further, Management of the Gas Division would meet monthly with the people conducting the hedging program to review their results. Ex. 5 at 9.

22. Mr. McGinnis testified that between September 2007 and July 2008, the price of natural gas sharply increased. Ex. 6 at 16. Since July 2008, the price of natural gas has sharply declined. *Id.* In fact, from July 2008 through July 2009, the natural gas futures daily closing price declined as much as 76%. *Id.* Mr. McGinnis stated that during 2008 the Company made a total of 51 hedge transactions, of which seven of the transactions hedged the Company's estimated injections into storage and 44 were hedges of estimated purchases

directly delivered to customers. Ex. 6 at 16; see Ex. 6, Schedule WTB-10 for a summary of 2008 hedge transactions. Further, Mr. McGinnis explained that the 2008 hedge transactions were made mainly for one of three reasons: (1) to comply with the minimum hedge percentage guideline, (b) as a result of decreases in the market, and (c) to reduce the inside-the-month commodity price risk. *Id.*

23. In addition, Mr. McGinnis asserted that between February 21, 2008 and July 17, 2008, the Company made 15 hedge transactions in order to comply with the Hedge Program's hedge percentage guidelines. Ex. 6 at 17. Between July 9, 2008 and December 23, 2008, Mr. McGinnis noted that the Company entered into 27 hedge transactions due to declines in the natural gas futures market price and the shortening of time between when the gas was purchased and delivered to customers. Ex. 6 at 17.

24. **Margin Sharing.** C. Ronald McGinnis, Jr., the Company's Regulatory Team lead, testified regarding how margins from the Company's Capacity Release, Off-System sales and Swaps are credited to the GCR. Ex. 5 at 4. Currently, these margins are credited 100% to the ratepayers in the GCR up to \$3.0 million for the twelve (12) month GCR period ending every June. Margins in excess of \$3.0 million are credited 80% to the GCR and 20% to the Company. Ex. 5 at 4; see PSC Order No. 7658 (October 6, 2009); Settlement Agreement §I.; Ex. 5 at 4. As to the Company's fourteen (14) Interruptible Gas Transportation customers, the margins are credited 80% to firm full-requirements customers through the GCR and 20% to the Company. Ex. 5 at 5. According to its filing, the Company included GCR credits of \$5.72 million for

capacity release revenues and \$2.38 million for off-system sales margins. Ex. 5, Sch. CRM-10.

25. **Gas Cost Rate (GCR) Calculations.** Mr. McGinnis reiterated that the Company was seeking Commission approval to decrease the GCR to be effective with usage on or after November 1, 2009, with proration. Ex. 5 at 2. Mr. McGinnis testified extensively to the actual calculation of the proposed GCR, including the proposed GCR Commodity Cost and Demand Cost factors and a reconciliation of firm gas expenses and revenues for the twelve (12) months ending July 31, 2009. *Id.*; see Schedule CRM-1. "Calculation of the proposed GCR factors is based on the gas sales forecast ... and the delivered cost of purchased gas, the average pipeline rate, and the system design day load ... and the Large Volume Gas (LVG) and Medium Volume Gas (MVG) customer Maximum Daily Quantities ("MDQ")." *Id.* at 2, lines 11-15.

26. **2008 Gas Cost Audit Report.** Mr. McGinnis testified that the Company's Internal Auditing Department was in the process of completing the 2008 audit. Ex. 5 at 9. The 2008 audit includes a review of a customer billing sample, regulatory accounting sales records, gas costs, and gas cost revenue. *Id.* The final audit report will be review by Price-Waterhouse-Coopers LLC before it is filed with the Commission.¹⁰

¹⁰ On information and belief, the Company filed a report regarding the 2008 audit after it filed its Application. However, the Company did not supplement its testimony on this issue either before or during the evidentiary hearing and the report was not introduced into evidence at the evidentiary hearing. The audit report was not filed in the docket of this case, and the Company has not asked that the 2008 audit report be considered in this matter. Consequently, I will not discuss the audit report because it is not part of the evidence in this matter.

B. THE DIVISION OF PUBLIC ADVOCATE'S TESTIMONY

27. **Overview of GCR case.** Andrea C. Crane, President of The Columbia Group, submitted pre-filed direct testimony, dated January 25, 2010, on behalf of the Division of Public Advocate ("DPA"). (Ex. 7.) However, Ms. Crane did not attend the evidentiary hearing. Michael Damian Sheehy, Deputy Public Advocate, adopted Ms. Crane's testimony at the May 6, 2010 evidentiary hearing. Tr. 51-52. Mr. Sheehy recommended that the Commission approve the GCR rates reflected in the Company's Application, subject to true-up in the Company's next GCR proceeding. *Id.* at 8, 35.

28. **E3 Project.** Like Staff's witness Ms. Stewart, Mr. Sheehy recommended that the Company be permitted to recover its pre-certification costs regarding the E3 Project "but reduce the carrying costs to reflect the return approved in DPL's last base rate case." *Id.* at 30. Moreover, Mr. Sheehy likewise recommended that Delmarva continue discussions with ESNG to substantially reduce the twenty (20) year re-payment period for the E3 pre-certification costs, and reduce the 10.7% after-tax interest currently payable by Delmarva and its ratepayers to ESNG. *Id.* at 27, 30. Mr. Sheehy recommended that the after-tax interest rate be limited to 7.73%, the amount awarded to the Company in its most recent base-rate case. *Id.* at 30. If the after-tax interest rate of 7.73% was applied rather than 10.7% rate, the Company's annual payments would be reduced from \$257,936 to \$199,564, saving the Company \$58,372 annually. *Id.* Mr. Sheehy stated that "this recommendation proves a reasonable balance between denying complete recovery of the E-3 costs, and allowing ESNG to recover excess returns

from a project that provided no direct benefit for taxpayers. *Id.* at 30.

29. **Hedging Program.** Mr. Sheehy confirmed that the Company was in the process of implementing the 50% non-discretionary hedging program, but has not been able to do so to date, due to the Company's rather heavily hedged positions. *Id.* at 20-21. Mr. Sheehy strongly criticized Delmarva's 2009 hedging results. According to Mr. Sheehy, during calendar year 2009, the Company's Hedging Plan "resulted in gas costs that were \$55.15 million above the weighted average NYMEX strip price. This means that ratepayers paid gas price[s] which were approximately 50% higher than market prices." (*Id.* at 20-21.) According to Mr. Sheehy, this resulted from the Company hedging 86% of Delmarva's firm supply requirements for the 2008-2009 winter heating season, and 62% of firm supply for the period of April 2009 to September, 2009. *Id.* at 19. Thereafter, the Company had very limited ability to hedge further once gas prices began significantly dropping in July 2008. *Id.* at 18.

30. According to Mr. Sheehy, "by the time that prices began to decline, [Delmarva] found itself locked into hedged positions for the current GCR period." *Id.* at 18. Mr. Sheehy opined that Delmarva's results "were disappointing, but not surprising." *Id.* Mr. Sheehy and Ms. Stewart participated in the Company's adoption of the 12 month, 50% non-discretionary hedging program in the prior GCR Docket. Finally, Mr. Sheehy concluded that the parties are now diligently working toward implementing a new Hedging Program in a changing natural gas market. *Id.* at 18, 20.

C. STAFF'S TESTIMONY

31. **Overview of Staff's Testimony.** On February 5, 2010, Staff submitted the pre-filed testimony of Courtney A. Stewart, Public Utilities Analyst III and Richard W. LeLash, an independent Financial and Regulatory Consultant. Ex. 8 (Stewart) and Ex. 9 (LeLash), respectively. At the evidentiary hearing, Ms. Stewart adopted the testimony of Mr. LeLash, who did not attend the hearing. Therefore, I will refer to Mr. LeLash's testimony as that of Ms. Stewart.

32. Staff Analyst Stewart outlined the steps she took to investigate the Company's filing. She testified that even before the Application was filed, she used the monthly reports submitted by the Company entitled "Comparison of Gas Expense and Recovery" to keep track of the pertinent items and issues that would be presented in the next GCR. Ex. 8 at 9. Ms. Stewart testified that she reviewed the totals for firm sales, total GCR revenue, total gas cost, and the monthly over- or under-recovery report, the percentage of over- or under-recovery and the year-to-date deferred fuel balance. *Id.* Further, Ms. Stewart reviewed the Company reports involving the development of annual commodity and demand expenses, sales and gas cost rate revenues for the classes of service and pipeline purchases, storage injections and withdrawals and hedge program financial settlements. *Id.*

33. Ms. Stewart further stated that she asked the Company for additional clarification of the customary reports consisting of changes to the MVG and LVG contract MDQs in Mcf, spreadsheets that detailed the line-item charges to firm and non-firm transportation

customers, accounting reports for Company accounts for Gas-System Purchases, Gas Injections and Withdraws, Flexibly Priced Sales and Revenue from Off-System Capacity and additional support for monthly GCR sales totals for residential, MVG, LVG and special contracts.

34. Staff Analyst, Courtney Stewart, testified that Staff verified that the Company had developed its GCR rates in compliance with its Tariff. Ms. Stewart recommended Commission approval of the proposed rates. Ex. 8 at 5. If the Commission adopts the proposed rates, an average residential heating customer using 120 ccf during a winter month will experience a decrease of \$19.02, or 9.9% of his total monthly bill. Ex. 8 at 7.

35. Ms. Stewart testified that these GCR rates will be effective from November 1, 2009 through October 31, 2010. *Id.* at 5. These rates will be subject to a true-up in Delmarva's next GCR case based on the Company's actual gas procurement costs and revenue during the above period. *Id.* According to Ms. Stewart, Staff has required that the Company update the Commission in the next GCR case regarding the steps the Company has taken to curb rising fixed costs. *Id.* at 16. During the last three (3) GCR periods, the Company's fixed costs (*i.e.*, transportation and storage contracts) have risen 12.6% (2007-08), 9.77% (2008-09) and 10.32% (2009-10). *Id.*

36. Based upon her review of the Company's data, Ms. Stewart included nine conclusions and recommendations resulting from her review of the Company's Application:

(a) As stated above, Ms. Stewart recommended the rates requested by the Company in its Application be approved, Ex. 8 at 5, line 1-5;

(b) Her review concluded that the Company is complying with the settlement agreement in PSC Docket No. 07-239F relating to its Natural Gas Commodity Risk Management Policy *Id.*, line 6-7.;

(c) The Company is complying with the settlement in PSC Docket No. 08-266F regarding margin sharing *Id.*, line 8-9.;

(d) The Company should continue to update Staff and the DPA on the progress of the Liquefied Natural Gas ("LNG") review *Id.*, line 10-11.;

(e) The Company should continue to update Staff and the DPA on its Request For Proposal for an asset manager *Id.*, line 12-13.;

(f) The Company should update Staff and the DPA on changes to the Natural Gas Risk Management Policy and Credit Policy *Id.*, line 14-15. Further, the Company should provide documentation that employees affected by the Natural Gas Risk Management Policy are aware of the policy and any changes to it *Id.*, line 16-17.

(g) As stated above, Ms. Stewart recommended that in its next GCR filing the Company include the steps it has taken to mitigate increased fixed costs *Id.*, line 19-20;

(h) Ms. Stewart recommended that Delmarva continue its energy efficiency efforts and its public outreach campaigns *Id.*, line 21-22; and

(i) Further, Ms. Stewart asserted that the Company's next GCR filing should include measures that the Company plans to take to

meet its legislatively-mandated goal of reducing the use of natural gas by ten percent (10%) over the next several years Ex. 8 at 6, line 1-3.

37. **Testimony of Richard W. LeLash.** Richard W. LeLash, an independent financial consultant, retained by the Commission to review the Company's GCR application submitted pre-filed direct testimony dated February 5, 2010. Ex.9 at 3. As stated previously, Mr. LeLash did not attend the evidentiary hearing. At the evidentiary hearing, Mr. LeLash's testimony was adopted by Ms. Stewart. Tr. 57-58. Ms. Stewart testified that the Company's forecasted demand for the 2009-2010 period has declined from 180,213 Mcf to 172,306 Mcf representing a 4.4% decrease for the current GCR. *Id.* at 13. Ms. Stewart opined that over the next five (5) years it is projected that the declining demand levels will reduce demand volume by 10,860 Mcf by the 2013-2014 period. *Id.*

38. Ms. Stewart noted that the Company has an 8% reserve through 2014-15 when the maximum capacity reserve for most gas utilities is 5%. *Id.* at 14. Further, Ms. Stewart expressed concern that the 8% capacity reserve could rise to 19%, depending on the production of the Company's Liquefied Natural Gas Supply. According to Ms. Stewart, "[w]hile it may be prudent to maintain a 5% reserve, a reserve of almost 20% is not cost effective [for ratepayers]." *Id.* at 15.

39. **E3 Project Expenses.** Regarding the cancelled E3 Project¹¹ for which the Company is seeking to recover \$386,910 in this filing and a total recovery of \$1.56 million in pre-certification costs, Ms. Stewart noted that the Company entered into a Precedent Agreement with Eastern Shore Natural Gas ("ESNG"), whereupon ESNG initiated a pre-certification process. Ex. 9 at 17. As part of the Precedent Agreement, the Company entered into a Letter Agreement with ESNG which obligated it to pay a proportionate share of the pre-certification costs if the Project projected was not certificated. When the Project was cancelled in December 2007, Delmarva became liable for its portion of the pre-certification costs. Ex. 9 at 18.

40. Ms. Stewart noted that the Letter Agreement was not shared with the Commission even though Delmarva's ratepayers would be charged with paying these costs for the Company. *Id.* Further, Ms. Stewart commented that interested parties were not given sufficient time to intervene into the FERC proceeding to dispute the Settlement Agreement recovery of pre-certification cost recovery. *Id.* at 19. However, based upon the Letter Agreement and the FERC-approved Settlement Agreement, "the Company is liable for 50% of the first \$3.0 million in expenses and for 33% of expenses in excess of \$3.0 million, with a cap of \$2.0 million total." *Id.* at 19 and Sch. 10.

41. According to Ms. Stewart, the total expenses were \$3,169,525 with the Company being allocated \$1,500,0000. *Id.* at Schedule 10. In addition, it appears that the Company's share of the

¹¹ ESNG's E3 Project concerned ESNG's plan to construct a gas supply link from the Cove Point LNG facility to the lower Delmarva peninsula. Ex. 9 at 17-18. The pipeline would be placed under the Chesapeake Bay. *Id.*

costs in excess of \$3.0 million will be \$56,508 for a total of \$1,556,508. *Id.* However, Ms. Stewart noted that in contrast to the amount of the Company's share of the pre-certification costs, \$1,556,508, ESNG will be liable for only 33.3% of the cost in excess of \$3.0M, or \$56,508. *Id.* at 19-20.

42. Further, Ms. Stewart opined that Delmarva's debt of approximately \$1.556 million of pre-certification costs will increase to approximately \$5.2 million by the time Delmarva's ratepayers complete the annual payment of \$257,940 to ESNG during the twenty (20) year re-payment period ordered by FERC, including interest of \$3,602,215. See FERC's Order dated 8/1/06, FERC Tariff No. 235 & LeLash, Ex. 9, at 20 & Sch. 10. However, Ms. Stewart recommended that Delmarva: 1) reduce the pre-certification amounts for any discrepancies found in the audit; 2) seek to repay the precertification costs at an accelerated rate given that the current 10.7% after-tax interest rate essentially obligates Delmarva and its Delaware ratepayers to pay \$5.2 million dollars over twenty years; and 3) should pursue an alternative amortization schedule in light of the large amounts it and Chesapeake are paying as opposed to ESNG *Id.* at 17-23.

43. **Hedging Program.** The Company's transition from its discretionary Hedging Program to the 12-month, 50% non-discretionary Hedging Program agreed upon in the most recent GCR Docket is discussed in detail in Paragraphs 18 through 24, *supra*. However, Ms. Stewart made various "recommendations" or "suggestions" regarding the Company's Hedging Program. First, Ms. Stewart made a recommendation relating to

the 50% non-discretionary plan, which requires that 50% of projected city gate requirements and storage injections to be hedged on a pro-rata basis. According to Ms. Stewart, “[s]ince the objective of hedging is to moderate price risk, the most accurate measure of monthly gas purchases would be projected city gate requirements plus storage injections minus storage withdrawals.” *Id.* at 26.

44. Second, Ms. Stewart suggested affording the Company some flexibility regarding the twelve (12) month time period in which hedge positions must be implemented according to the 50% non-discretionary plan. *Id.* According to Ms. Stewart, “lengthening the hedging interval would better smooth out any price spikes by giving the Company a longer horizon for taking its hedge positions.” *Id.* at 26-27. Ms. Stewart also suggested that the Commission be open to permitting other modifications of pre-determined hedge amounts if prices substantially rose or fell during the twelve (12) month period. *Id.* at 27.

45. Ms. Stewart recommended that, as opposed to basing hedge targets upon hedge volumes as the Company (and other gas utilities) do, the Company’s hedge volumes should be based upon “dollar-for-dollar cost averaging.” Ms. Stewart recommended a dollar cost averaging framework in order to be responsive to changing market prices for natural gas during hedge periods. *Id.* at 27-28. This framework determines hedges based on the monthly amount of gas purchases, as opposed to defining hedge targets in terms of gas volumes. *Id.* “This hedging would utilize the same annual gas volumes and, based upon the Company forecast, would determine a dollar amount to be spent on hedge positions. Effectively, a dollar cost averaging

methodology would automatically increase the volumes hedged when prices fall below the forecast and decrease the volumes when prices were above the forecast." *Id.* at 27.

IV. DISCUSSION

A. GAS COST RATE IS UNCONTESTED

46. 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 Application, which became effective on a temporary basis, subject to refund, on November 1, 2009. 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 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. Ex. 8 at 5 and Ex. 7 at 8.

47. Moreover, I recommend approval of the following items: (a) the proposed changes to the Gas Cost Rates (see ¶ 1, *supra*) and (b) the reconciliation and true-up of actual versus estimated Average Commodity Cost Rate assignments for sales under the LVG service, for the "electing" customers being served under the MVG classification, and finally for sales made under the FPS Service.

B. THE SETTLEMENT AGREEMENT

48. At the evidentiary hearing on May 6, 2010, the parties jointly submitted a Proposed Settlement Agreement Ex. 4 and attached

to this Report as Exhibit "B". In the following paragraphs, I will discuss the material provisions of the Proposed Settlement in numerical order. Regarding each issue, the issue will be presented verbatim from the parties' Settlement Agreement followed by my discussion. For reasons hereinafter described, the parties' Settlement Agreement is well supported in the record, and I recommend that the Commission approve the Settlement Agreement in its entirety.

49. Paragraph 2 of the parties' Settlement Agreement addressed the Company's confidential "Liquefied Natural Gas (LNG) Study." LNG is natural gas which has been converted temporarily to liquid form for ease of storage or transport. It is later "re-gasified" and distributed as pipeline natural gas. In the prior GCR, the Company was required to have a third-party evaluate the status of the Company's LNG facility, including the plant's output capacity, reliability, costs and pricing.¹² Tr.33-34. Paragraph 2 of the parties' current Settlement Agreement confirms that the Company had the LNG Study performed as required by the prior Settlement Agreement. Paragraph 2 of the current Settlement Agreement provides as follows:

¹² In the prior GCR Case, Paragraph III(E) of the parties' Settlement Agreement provided that:

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. Appendix "A" at p. 7, Paragraph E.

2. **LNG Study:** A copy of the Confidential LNG Study addressed in the Settlement approved in PSC DOCKET No. 08-266F has been completed and distributed to the Parties. Delmarva agrees that the Parties may speak with the Consultant retained by Delmarva to conduct the LNG Study and that the Parties have the right to provide comments on the LNG Study. Delmarva agrees to inform the Parties concerning its decisions related to any recommendations contained in the Study. The Parties will be provided the opportunity to have input into potential future actions arising out of the Study.

50. In Paragraph 2 of the Settlement Agreement, the parties agree that each would now begin analyzing the LNG Study, including discussing it with the Company's Consultant. According to Paragraph 2, each party has the right to submit comments and recommendations to the Company, but the Company is not required to follow them. At the evidentiary hearing, Mr. Phillips, Delmarva's Manager of Gas Operations and Planning, testified that the confidential LNG Study issue dovetailed with the issue of whether the Company should hire an Asset Manager at this time, which is discussed next. Tr. 34.

51. Paragraph 3 of the parties' Settlement Agreement addressing the Company's Asset Management, provides as follows:

3. **Asset Management:** The Parties agree that, due to changes in the natural gas market, it would be to the benefit of Delmarva's customers to proceed cautiously with the investigation into asset management addressed in the Settlement approved in PSC Docket No. 08-266F. The Parties have discussed Delmarva's progress on this issue and are in agreement as to how the data gathering phase should proceed, prior to a determination as to whether to issue a full or partial Request for Proposals. The Parties agree that to the extent the approved settlement in PSC Docket No. 08-266F needs to be modified to address the Parties' recommended path forward for exploring alternative gas asset

management options, the Commission's approval of this Agreement should serve to modify the settlement in PSC Docket No. 08-266F.¹³ Delmarva will provide the Parties with timely updates and information regarding its progress, findings and recommendations as it explores potential alternative gas asset management options.

52. In Paragraph 3 of the Settlement Agreement, the parties agree that, due to the rather volatile natural gas market since 2008, Delmarva should proceed cautiously in deciding whether or not to hire an Asset Manager. With the Company's assistance, an Asset Manager would design a comprehensive investment and corporate strategy to manage, for example, the Company's off-system sales capacity and capacity releases, which comprise approximately \$9 million of revenue in this GCR Docket. Tr. 35; Ex. 5, Sch. CRM-10. As Ms. Stewart stated, "the Company's evaluation should establish whether ... [an Asset Manager] has the potential to yield greater net margins and credits than have been earned under the Company's management." Ex. 9 at 30, lines 8-10.

53. The intent of Paragraph 3 of the Settlement Agreement is that the parties want to do what is most advantageous for the ratepayers. Tr. 34-35. At this time, the parties do not want to

¹³ In the prior GCR case, Paragraph III(C) of the parties' Settlement Agreement provided that:

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 interest of its customers and, where appropriate, Delmarva, would be to have Delmarva and/or its service company continue asset management activities.

unnecessarily bind the Company to any set timetable for hiring an Asset Manager. *Id.* At the evidentiary hearing, Mr. Phillips testified that, as opposed to issuing a Request for Proposal (RFP) as required in the prior GCR case, the parties agree to have "several large third party suppliers" Tr. 35. make presentations to the Company, "facilitated" by Staff's consultant Mr. Richard W. LeLash. *Id.* This way, the parties agree that they can better mutually explore which approach is most advantageous for ratepayers. Tr.-34-35

54. Regarding the Company's Natural Gas Hedging Program, in Paragraph 4 of the parties' proposed Settlement Agreement, the parties agreed as follows:

4. Natural Gas Hedging Program: The program reflected in the settlement in PSC Docket No. 08-266F has been implemented and is being routinely monitored and discussed by the parties. While there may be merit in both the 18-month option and the Dollar-Cost Averaging approach,¹⁴ Delmarva has not yet fully transitioned to the new 12-month program. The Parties agree that Delmarva should defer any significant changes until the Parties can assess the efficacy of the changes that have already been made pursuant to the settlement in PSC Docket No. 08-266F. The Parties agree to continue to engage in discussions concerning whether the benefits of the changes to the program in this Docket are tangible and should be implemented prior to any assessment of the changes that were instituted last year.

¹⁴Ms. Stewart (LeLash pre-filed testimony) recommended that the Company analyze whether it should adopt "a dollar cost averaging framework" in order to be responsive to changing market prices for natural gas. Ex. 9, pp. 27-28. This framework determines hedges "based on the monthly amount of gas purchases, as opposed to defining hedge targets in terms of gas volumes." *Id.* "This hedging would utilize the same annual gas volumes and, based upon the Company forecast, would determine a dollar amount to be spent on hedge positions. Effectively such a dollar cost averaging methodology would automatically increase the volumes hedged when prices fall below the forecast and decrease the volumes when prices were above the forecast." *Id.* at p. 27. According to the parties' proposed Settlement Agreement in this Docket, the "12-month approach," the "18-month approach," and the dollar cost averaging framework will each be examined when the Company's Hedging Program is reviewed in the next GCR proceeding.

55. Hedged purchases are estimated to make up 62% of the Company's commodity requirements. Ex. 8 at 15. To date, Delmarva has not fully transitioned to the 12-month, 50% non-discretionary hedging plan which the parties agreed to in the Company's last GCR, PSC Docket No. 08-266F. In any event, due to the changing natural gas market, the parties want to now again evaluate the 12-month, 50% non-discretionary plan, as well as an 18-month plan and the dollar cost averaging framework. Tr. 38 The Company, Staff and DPA and their respective consultants intend to mutually analyze the Company's future, monthly Gas Cost Reports submitted to the Commission. *Id.* Again, the parties want to mutually explore what is most advantageous for ratepayers at this time, in light of the changing natural gas market. *Id.*

56. The Company's 12-month, 50% non-discretionary plan is contained in Paragraph III (B) of the parties' Settlement Agreement adopted in the Company's last GCR. Paragraph III (B) provides as follows:

III (B). 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 (50%) non-discretionary hedging program in which 50% of 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 will be conducted without regard to anticipated trends.

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

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.

57. As to the Company's reimbursing Eastern Shore Natural Gas (ESNG) for the Company's share of the E3 Project's pre-certification costs, Paragraph 5 of the parties' Settlement Agreement provides in pertinent part as follows:

E3 Expenses: Delmarva maintains the position that the E3 expenses are based on a FERC approved tariff and are fully recoverable. Staff and DPA maintain that to the extent the incurrence of any E3 expenses may have been inappropriate, such expenses are subject to challenge in GCR proceedings. The Parties agree that the Parties' respective positions on the E3 issue are not waived or resolved by this Agreement. Delmarva is engaging in discussions with ESNG in an effort to modify the payment schedule terms and conditions to, among other things, shorten the 20-year payment term and reduce the interest rate being applied to the unpaid balance. Delmarva notes that a FERC filing by ESNG would be required to modify the terms of ESNG's Gas Tariff that pertain to the recovery of E3 Pre-Certification costs and believes that such a filing would require uniform terms that would apply to each affected customer. Delmarva agrees to notify the Parties should Delmarva be aware that such a filing is made.

58. "Pre-certification costs" are defined as engineering, communication, governmental relations, economic studies and environmental, regulatory and legal service costs." See FERC's August 1, 2006 Order, §5. As the DPA's Consultant Andrea Crane and Staff's Consultant Richard LeLash recommended, the Settlement Agreement requires the Company to continue discussions with ESNG to substantially reduce the twenty (20) year re-payment period for the E3 pre-certification costs, and reduce the 10.7% after-tax interest currently payable by Delmarva and its ratepayers to ESNG. Ex. 7 at 27, 30; Ex. 9 at 17-23. Mr. Sheehy also recommended that the after-tax interest be limited to 7.73%, the amount awarded to the Company in its most recent base-rate case. *Id.* at 30. If the after-tax return of 7.73% was applied rather than 10.7%, the Company's annual payments would be reduced from \$257,936 to \$199,564, saving the Company and its ratepayers \$58,372 annually. *Id.*

59. Paragraph 6 of the parties' Settlement Agreement addresses two (2) items which the Company must include in its next GCR filing, and provides as follows:

Inclusions In The Next GCR Filing: The parties have agreed that in its next GCR filing, Delmarva will:

(a) Provide a summary of the steps it is taking to mitigate any increase in fixed costs, and

(b) Provide an update of how Delmarva is planning to meet the legislatively-mandated goal of a 10% reduction in natural gas consumption over the next several years.

60. As to Paragraph 6(a) above addressing Delmarva's fixed costs, i.e. transportation and storage contracts, Staff is requiring this information because, during the last three (3) GCR periods, the Company's fixed costs have risen 12.6% (2007-08), 9.77% (2008-09) and 10.32% (2009-10). Ex. 8 at 16. However, during 2003-09, the Company's RSH and total customers increased only 1 to 1.5% per year. Ex. 9 at 16. According to Paragraph 6(a) above, in the next GCR, the Company is required to provide "a summary of the steps it is taking to mitigate any increase in fixed costs."

61. As to Paragraph 6(b) above, according to 26 *Del. C.* §1502(a)(2) entitled, "Energy Efficiency Resources Standards Act of 2009," by the year 2015, the Company is required to reduce its peak demand of its 2007 natural gas consumption, by 10%. This statute provides as follows:

(a) It is the goal of this chapter that each affected energy provider shall achieve a minimum percentage of energy savings as follows:

(2) For each affected natural gas distribution company, energy savings that is equivalent to 1% of the company's 2007 natural gas consumption by 2011, increasing to 10% by 2015.

62. The Act "designates energy efficiency as a priority energy supply resource for the state, recognizing that energy efficiency is among the least expensive ways to meet the growing energy demands of the state..." (See DE. Senate Bill (SB) 106, June 12, 2009, *Synopsis*) This Act also establishes a workgroup comprised of the Company, the PSC, gas utilities, municipalities and others. 26 *Del. C.* §1502 (c). By December 31, 2010, this workgroup is required to complete a study

and submit its findings as to how the Energy Efficiency Resources Standards will be implemented, as well as how compliance will be monitored. See 26 Del. C. §1502(c) (2). The Company's participation in this workshop will aid the Company in complying with the Settlement Agreement's requirements to update the PSC regarding the Company's intentions to reduce its consumption by 10% by the year 2015.

63. Although not included in Paragraph 6 above, during this GCR period, the Company has also agreed to better notify its Delaware ratepayers of the Company's Budget Billing Program. This Program allows customers to spread their energy costs throughout the year to help ward off higher winter energy costs. Ex. 2 at 5. As of June 2009, the Company had 122,129 gas customers and 14,087 (about 11.5%) were enrolled in the Company's Budget Billing Program. *Id.* In any event, the Company intends to better promote this Program through bill inserts, promoting the Program on the Company's website, and including Program information along with the Company's Fall and Winter, 2010 Conservation tips. *Id.* at 5-6. This Program helps limit delinquent accounts thereby benefitting paying ratepayers. Also, the Program helps to assure that customers continue their service without interruption.

64. Finally, at the evidentiary hearing, the parties each testified that the Settlement Agreement is in the public interest and appears to be a reasonable resolution of the issues raised by the Staff and the DPA. T-29, 52-53, 61. The Settlement Agreement was reached by parties representing the interests of the Company's Delaware ratepayers and the Company's shareholders. *Id.* Also, pursuant

to 26 Del. C. §512, where practicable, settlements are encouraged by the Commission.

V. RECOMMENDATIONS

65. 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 and in the public interest the Company's revised GCR charges as proposed in the Company's Application filed August 31, 2009 for service rendered on or after November 1, 2009, as follows:

<u>Rate Schedules</u>	<u>2008-2009</u>		<u>Proposed-2009-2010</u>	
	GCR Demand Charge	GCR Commodity Charge	GCR Demand Charge	GCR Commodity Charge
RG, GG and GL	N/A	109.812¢/ccf	N/A	93.959¢/ccf
Non-electing MVG	\$8.5538/Mcf	\$9.7555/Mcf	\$9.5152/Mcf	\$7.9076/Mcf
		of Contract MDQ		of Contract MDQ
Electing MVG and LVG	\$8.5538/Mcf	Varies	\$9.5152/Mcf	Varies
		of Contract MDQ		of Contract MDQ
Standby Service	\$8.5538/Mcf	N/A	\$9.5152/Mcf	N/A
		of Standby MDQ		of Standby MDQ

Ex. 10 at 2.

b. That the Commission approve as just and reasonable and in the public interest the Proposed Settlement Agreement of the parties, which is Exhibit "A" to the attached proposed Order. The Company, Staff and DPA have approved and endorsed this Settlement. A proposed form of Order, which will implement the forgoing Findings of Fact, Conclusions of Law and Recommendations is attached hereto as Exhibit "B".

Respectfully Submitted,

/s/ Ruth Ann Price_____

Ruth Ann Price
Senior Hearing Examiner

Dated: August 3, 2010

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

[The following is the Text of EXHIBIT "B" TO
PSC ORDER No. 7658 (October 6, 2009)
in PSC Docket No. 08-266F]

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))

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:

	<u>Present</u>		<u>Proposed</u>	
	<u>GCR Demand Charge</u>	<u>GCR Commodity Charge</u>	<u>GCR Demand Charge</u>	<u>GCR Commodity Charge</u>
<u>Rate Schedules</u>				
RG, GG and GL	N/A	96.517¢/ccf	N/A	117.560¢/ccf
Non-electing MVG	\$10.20/Mcf of	\$8.2710/Mcf	\$8.5538/Mcf of	\$10.5303/Mcf

	Billing MDQ		Billing MDQ	
Electing MVG and	\$10.2/Mcf of	Varies	\$8.5538/Mcf of	Varies
LVG	Billing MDQ		Billing MDQ	
Standby Service	\$10.2/Mcf of	N/A	\$8.5538/Mcf of	NA
	Standby MDQ		Standby MDQ	

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:

	<u>Prior Demand Charge</u>	<u>Prior Commodity Charge</u>	<u>Proposed Demand Charge</u>	<u>Proposed Commodity Charge</u>
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