BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE,
THE DELAWARE ENERGY OFFICE,
THE OFFICE OF MANAGEMENT AND BUDGET,
AND THE CONTROLLER GENERAL

IN THE MATTER OF INTEGRATED RESOURCE PLANNING FOR THE PROVISION OF STANDARD OFFER SUPPLY SERVICE BY DELMARVA POWER & LIGHT COMPANY UNDER 26 *DEL. C.* § 1007(c) & (d): REVIEW AND APPROVAL OF THE REQUEST FOR PROPOSALS FOR THE CONSTRUCTION OF NEW GENERATION RESOURCES UNDER 26 *DEL. C.* § 1007(d) (OPENED JULY 25, 2006)	)	PSC DOCKET NO. 06-241

FINDINGS, OPINION AND ORDER NO. 7199

BEFORE:

ARNETTA McRAE, Chair
JAYMES B. LESTER, Commissioner
JOANN T. CONAWAY, Commissioner
J. DALLAS WINSLOW, Commissioner
JEFFREY J. CLARK, Commissioner

and

John A. Hughes, Secretary
Delaware Department of Natural Resources and Environmental Control, Delaware Energy Office

Jennifer W. Davis, Director
Office of Management and Budget

Russell T. Larson, Controller General
Office of the Controller General

APPEARANCES:

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For Conectiv Energy Inc.:

RICHARD PURCELL, Project Manager

I. THE STATUTORY BACKGROUND

The EURCSA

1. In response to the resulting consumer outrage occasioned by the announcement of the imminent rate increases as a result of the expiration of a three-year rate freeze, in March 2006 the Delaware General Assembly enacted the Electric Utility Retail Customer Supply Act of 2006 (the "EURCSA"). Under the EURCSA, Delmarva Power & Light Company's ("DP&L") customers were provided the option to defer the rate increase over a 20 month period (with the payment of carrying costs) or to shoulder the entire rate increase effective May 1, 2006. 26 *Del. C.* § 1006(a)(3)a.

2. The EURCSA authorized DP&L, subject to the Delaware Public Service Commission (the "Commission") approval, to take any or all of the following actions in order to meet its standard offer service ("SOS")[1] requirements: (a) enter into short- and long-term contracts for the procurement of power necessary to serve its customers; (b) own and operate electric generation facilities; (c) build generation and transmission facilities (subject to any other requirements in the Delaware Code regarding siting, etc); (d) invest in demand-side resources; and (e) any other Commission-approved action to diversify its retail load. *Id.* at § 1007(b)(1)-(5). Such actions could be taken only after DP&L had filed an application to take such action or had such action approved as part of its Integrated Resource Plan ("IRP"). *Id*. at § 1007(b).

3. The EURCSA required DP&L to file an IRP on December 1, 2006,[2] and on December 1 of every two years thereafter. *Id*. at § 1007(c)(1). The General Assembly directed DP&L to "systematically evaluate all available supply options during a ten (10) – year planning period in order to acquire sufficient, efficient and reliable resources over time to meet its customers' needs at a minimal cost." *Id*. The General Assembly further instructed that the IRP set forth DP&L's supply and demand forecasts for that 10-year period and the resource mix with which DP&L proposed to satisfy its supply

[1] *See* 26 *Del. C.* §§ 1001(18), 1006(a)(2)a.-c.

[2] In addition to the Commission, DP&L must file the IRP with the Controller General (the "Controller"), the Director of the Office of Management and Budget ("OMB"), and the Energy Office of the State of Delaware (which is part of the Delaware Department of Natural Resources and

obligations during that period. *Id*. The General Assembly specifically forbade DP&L from relying "exclusively on any particular resource or purchase procurement process," and mandated that DP&L "explore in detail all reasonable short- and long-term procurement or Demand-Side Management strategies, even if a particular strategy is ultimately not recommended … ." *Id*. at § 1007(c)(1)1. Finally, the EURCSA specified that at least 30% of DP&L's resource mix was to include "purchases made through the regional wholesale market via a bid procurement or auction process …" to be overseen by the Commission subject to the procurement process approved in Docket No. 04-391, as it may be modified. *Id*.

4. Under the EURCSA, in developing its IRP, DP&L must "investigate all possible opportunities for a more diverse supply at the lowest reasonable cost." *Id*. at § 1007(c)(1)b. The General Assembly stated that DP&L may consider the economic and environmental value of the following items: (a) resources that use new or innovative baseload technologies (such as coal gasification); (b) resources that provide short- or long-term environmental benefits to Delaware citizens (*e.g.*, wind and solar power); (c) facilities that have existing fuel and transmission infrastructure; (d) facilities that use existing brownfield or industrial sites; (e) resources that promote fuel diversity; (f) resources or facilities that support or improve reliability; and (g) resources that encourage price stability. *Id*. at § 1007(c)(1)b.1.-7.

Environmental Control ("Energy Office") (hereafter collectively referred to as the "State Agencies"). 26 *Del. C.* § 1007(c)(1).

5. Finally, the EURCSA directed DP&L to file a proposal to obtain long-term contracts on or before August 1, 2006, "to immediately attempt to stabilize the long-term outlook for [SOS]" in DP&L's service territory. *Id.* at § 1007(d). The General Assembly required the application to contain a proposed form of RFP for construction of new generation resources within Delaware to serve SOS customers. The General Assembly required the RFP to include a proposed form of output contract, which at a minimum would include capacity and energy, and could also include ancillary electric products and environmental attributes between DP&L and the providers of the new generation. The General Assembly specified the term of such contracts to be between 10-25 years. In addition, DP&L was directed to set forth selection criteria "based on the cost-effectiveness of the project in producing energy price stability, reductions in environmental impact, benefits of adopting new and emerging technology, siting feasibility, and terms and conditions concerning the sale of energy output from such facilities." *Id.*

6. The EURCSA authorized the Commission and the Delaware Energy Office (the "Energy Office") to approve or modify the RFP terms prior to issuance. The Commission and the Energy Office were instructed to "ensure that each RFP elicits and recognizes the value of:

a. proposals that utilize new or innovative baseload technologies,

b. proposals that provide long-term environmental benefits to the state,

c. proposals that have existing fuel and transmission infrastructure,

d. proposals that promote fuel diversity,

e. proposals that support or improve reliability, and

f. proposals that utilize existing brownfield or industrial sites."

Id. at § 1007(d)(1)a.-f. The General Assembly ordered DP&L to issue its RFP on November 1, 2006, and set December 22, 2006 as the deadline for receipt of bids. *Id* at § 1007(d)(1).

7. The General Assembly directed the Commission, in conjunction with the Energy Office, the Controller General and the Director of the OMB, to retain an independent consultant with expertise in energy procurement (at DP&L's expense) to oversee the development of the RFP and to assist the State Agencies in their review of bids received. *Id*. at § 1007(d)(2). The General Assembly further ordered the State Agencies to evaluate the proposals received on or before February 28, 2007, authorizing them to "determine to approve one or more of such proposals that result in the greatest long-term system benefits … in the most cost-effective manner." *Id*. at § 1007(d)(3). Once the State Agencies identify such proposal(s), DP&L is required to enter into contracts with the selected bidders. *Id*.

THE PROCEDURAL BACKGROUND

The Commission Opens This Docket to Review the Proposed RFP

8. On August 1, 2006, DP&L filed its proposed RFP and draft Power Purchase Agreement ("PPA"), and on August 8, 2006, the Commission opened this docket to perform its oversight and review tasks as set forth in the EURCSA. (Order No. 7003).[3]

9. On October 31, 2006, the Commission and Energy Office issued Order No. 7066, in which they determined the criteria to be included in DP&L's RFP. In Order No. 7066, as amended by Order No. 7081 dated November 21, 2006, the Commission and Energy Office adopted a "big funnel" approach designed to encourage as many potential bidders to submit proposals. *Id*. at 15-16, ¶32. To that end, the Commission and Energy Office adopted their Independent Consultant's (the "IC") positions on issues such as contract size (*id*. at 24-25, ¶ 53), plant location (*id*. at 25, ¶ 54), bid fee (*id*. at 26, ¶ 56), products to be purchased (*id*. at 26-32, ¶¶ 57-68), a regulatory out clause (*id.* at 34-35, ¶ 76), threshold requirements (*id*. at 35-42, ¶¶ 77-92), security requirements (*id*. at 43-49, ¶¶ 93-107), terms and conditions and their negotiability (*id*. at 49-50, 85-97, ¶¶ 108-110 and 196-228), and the methodology to be used for evaluating the price and non-price components of bids received (*id*. at 50-85, ¶¶ 111-195).

10. On November 1, 2006, DP&L issued a revised RFP for supplying SOS to incorporate the criteria required by Order Nos. 7066 and 7081. The revised RFP provided more flexibility in the RFP

[3] For a detailed discussion of the procedural history of this docket prior to the issuance of the Commission's and Energy Office's decision regarding the RFP, see pages 9-18 of Order No. 7066 (Oct. 31, 2006).

requirements to encourage a greater number of bid submissions. Accordingly, the Commission approved the RFP.

11. After DP&L hosted a pre-bid conference on November 15, 2006, four companies – Bluewater Wind LLC ("Bluewater"), Conectiv, NRG Energy Inc. ("NRG"), and SCS Energy - notified DP&L of their intent to bid.[4]

12. On December 21, 2006, Conectiv submitted a primary and alternate bid for a 180 MW combined cycle gas turbine ("CCGT") located at its Hay Road site in Edgemoor, Delaware. The following day, Bluewater submitted twelve variations of a bid proposal that included both 20- and 25- year terms and (a) a 600 MW capacity plant with a 400 MW energy limit or (b) a 400 MW capacity plant with a 400 MW energy limit. That same day, NRG submitted a proposal to sell energy and unforced capacity credits from 400 MW of a 600 MW coal-fired integrated gasification combined cycle ("IGCC") facility to be constructed at its Indian River site.

13. On February 21, 2007, DP&L and the IC filed bid evaluation reports. Both DP&L and the IC ranked the bids as follows: (a) Conectiv; (b) Bluewater; and (c) NRG. DP&L concluded that none of the bids achieved the EURCSA's objective because each bid was above the market forecast and produced minimal price stability. DP&L asserted that the EURCSA's objectives could be satisfied with demand side management ("DSM") programs and energy purchases on the regional market. The IC scored each bid pursuant to the favorable

[4]Although SCS Energy Inc submitted a notice of intent to bid, it did not ultimately do so.

characteristics, project viability, and economics supercategories. With respect to price and price stability, the IC concluded that all three of the bids were above market. However, Conectiv's bid was only $1.28/Mwh above market projection, while Bluewater's and NRG's bids were $12.01 and $15.17 MWh higher than market forecast, respectively.

14. On February 27, 2007, the Commission heard oral argument on DP&L's and the IC's evaluations. The Commission established a procedural schedule for further review of the bids and a deadline of March 23, 2007 for public comment.[5] Pursuant to this schedule, public comment sessions were held in each of the three counties on March 6, 7, and 12, 2007. The Commission also directed the IC to review DP&L's Integrated Resources Plan ("IRP") to determine whether the IRP would affect the RFP process.

15. On April 4, 2007, the IC filed its "Interim Report on Delmarva Power IRP in Relations to RFP" (the "Interim Report") in which it analyzed whether the State Agencies should direct DP&L to negotiate a long-term power purchase agreement ("PPA") with any of the bidders in the RFP process. The IC considered DSM, transmission capacity, system reliability, shifting energy prices, renewable energy resources, and regulatory issues associated with long-term PPAs. The IC concluded that the State Agencies should (a) defer the RFP decision until PJM concluded a study on reliability issues associated with the retirement of Indian River Units 1 and 2, and (b) direct DP&L to conduct a "market test" through either an all-source RFP for long-term

[5]This public comment period was extended to April 6, 2007 to allow the public to review items originally designated as confidential by the bidders

power supply that would not be limited to new generation within Delaware or a renewables-only RFP. As for the relationship between the IRP and RFP, the IC concluded that the concepts proposed in the IRP would not significantly affect the bid evaluations. The IC did not change the ranking of the bids or recommend that the State Agencies direct DP&L to sign a PPA with any of the bidders absent a market test. Public comment sessions on the Interim Report were held in the three counties on April 10-12, 2007.

16. In April 2007, Delaware Public Service Commission Staff (the “Staff”) solicited both PJM and PowerWorld, Inc. to analyze four generation contingency scenarios and assess how each would affect overall PJM system reliability. On April 27, 2007, PowerWorld filed its report, in which it concluded that although the retirement of Indian River Units 1 and 2 did not create insurmountable reliability issues in Delaware, each scenario introduced new contingency violations that would have to be addressed operationally regardless of which generation option was in place. PJM reported similar results in its oral discussion with Staff.

17. On May 3, 2007, Staff issued the “PSC Staff Review and Recommendations on Generation Bid Proposals” (“the Staff Report”), in which it recommended that the State Agencies adopt a portfolio approach to energy planning and that the State Agencies direct DP&L to negotiate with both Conectiv and Bluewater regarding Staff-proposed modifications to those bids, as described *infra*.

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but which were subsequently released. (Order No. 7148 dated Mar. 20, 2007 at Ordering ¶ 4).

18. On May 8, 2007, the Commission and the Energy Office's, the OMB's, and the Controller General's designated representatives convened to hear oral argument and deliberate in open session on the Staff Report and the parties' positions thereon. This is the Final Findings, Opinion and Order of the Commission in this matter.[6]

III. THE STAFF REPORT AND THE COMMISSION'S DISCUSSION AND FINDINGS

A. The Staff Report

19. Staff observed that the State Agencies had a number of options available to them. First, they could reject all bids as non-conforming (since all of the bids had at least one feature that did not conform to the RFP criteria), over market forecast and not beneficial to DPL's customers. Second, they could select one of more of the bids and direct DP&L to negotiate a PPA that addressed the non-conforming issues and any other concerns. Under this approach, bids would not be final until negotiations had been completed to the satisfaction of all parties and were submitted to the State Agencies for approval. Third, the State Agencies could defer any decision until the completion of the IRP review in Docket No. 07-20. Fourth, they could suggest that the General Assembly consider alternative legislation addressing some of the risks associated with customer migration, pricing, generator locations, contract length and other issues. Finally, they could adopt a re-regulated approach and direct

[6]Philip J. Cherry of the Energy Office, Robert Scoglietti of OMB, and Jennifer Cohan of the Controller all stated on the record that they were not in a position to vote on the Staff Report. *See* Transcript of the May 8, 2007 hearing in Dockets Nos. 06-241 and 07-20 at 1772-75 (hereafter cited as "5/8/07 Transcript at 1772-5").

DP&L to build the appropriate generation as determined in the IRP review. (Staff Report at 58-59).

20. Staff recommended that the State Agencies adopt a portfolio approach to energy planning, which would involve the addition of new generation assets in southern Delaware, development of DSM and energy efficiency programs, renewable distributed generation, short- and long-term bilateral contracts, and market purchases. As for the bids received in response to the RFP, Staff recommended that the State Agencies direct DP&L to negotiate with both Bluewater and Conectiv for a hybrid energy supply that would combine a 200-300 MW offshore wind farm with a 150-200 MW synchronous condenser CCGT in Sussex County. In addition to this new supply-side generation, Staff further recommended that the portfolio approach also include DSM and energy efficiency programs, market contracts and spot market purchases. *Id.* at 63-64. Staff estimated that its recommended hybrid model would increase marginal costs by approximately $13-$14 per month, but contended that its recommendation was based on the need for increased reactive support for the new generation, the public comment in favor of wind power, the positive impact on price stability and the effect on system reliability (including locational marginal pricing). Finally, Staff maintained that the State Agencies should not make their ultimate decisions solely on the basis of price, since the EURCSA had identified other criteria that should be included in the State Agencies' examination. (*Id*. at 64-65).

21. In reaching this recommendation, Staff considered both the SOS load requirements and its impact on Delaware's energy future.

Staff noted that PJM forecasted DP&L's average load growth at 1.9%, which translated to a 2013 average load of 570 MW (400 MW after the reduction of 30% that the EURCSA requires be fulfilled through market purchases). Staff was concerned that PJM's average growth rates were not indicative of growth in Delaware, and calculated that a 2.1% growth rate was more historically accurate and more realistic going forward. Thus, using a 2.1% growth rate, DP&L's average residential and small commercial load would be 575 MW, or 405 MW after the 30% reduction for market purchases. (*Id*. at 45.)

22. Staff also considered that several leading energy groups and consultants, such as Synapse Energy Economics, the North Eastern Reliability Council, the National Regulatory Research Institute, and the Governor's Cabinet Committee on Energy had advocated a portfolio approach to supply procurement. Furthermore, Staff identified serious risks in relying on existing PJM markets, including escalating capacity costs and rising energy costs resulting from transmission congestion and generator market power. Given the regional effects of procuring energy supply in Delaware, Staff concluded that the EURCSA required more than simply unilateral action on DP&L's part. In this regard, Staff noted that no jurisdiction had yet demonstrated a level of conservation that would eliminate the need for additional new generation, and that sole reliance on DSM to meet supply needs posed significant system reliability risks. In addition, Staff analyzed the bid evaluations to determine whether any of the proposals were an appropriate match for Delaware's energy needs. Staff also considered DP&L's concerns about financial risk, including customer migration,

rate increases and increased capacity costs. Finally, Staff assessed the effect of future energy supply procurement on system reliability, especially with respect to projects that would provide reactive power on the Delmarva Peninsula. *Id*. at 51-54.

23. Procedurally, Staff recommended that the State Agencies provide DP&L with the option to serve as resource manager of the hybrid energy supply portfolio. If DP&L refused this option, then Staff recommended that Delaware contract with an independent third party for such resource management at DP&L's expense. *Id*. at 70-71. Staff further recommended that the State Agencies maintain continued oversight of the negotiation and resource management processes, and that DP&L provide at least weekly updates on the progress of negotiations. *Id*. at 67.

B. Comments[7]

1. DP&L/NRG

24. None of the bidders, of course, had proposed any bid similar to Staff's recommended hybrid model. Both DP&L and NRG Energy, Inc. ("NRG") asserted that Staff's proposal did not comply with the EURCSA, which required the State Agencies to consider the bids as submitted and without modification. (5/8/07 Transcript at 1644, 1704-05, 1709). Thus, at the outset, the State Agencies must consider whether the EURCSA allows us to consider (and accept or reject) projects only as they were submitted by their proponents.

[7]We are aware that not all of these comments were made in response to the Staff Report *per se*. Nevertheless, we include a discussion of them because some of them are pertinent to Staff's recommendations and our decision thereon.

2. <u>DP&L</u>

25. In addition to its legal argument, DP&L cited several other reasons why Staff's recommendation should be rejected. First, DP&L argued that accepting any of the bids would result in "significant and irrevocable" cost increases to DP&L customers for 25 years. (Delmarva Power & Light Company's Comments on the Independent Consultant's Interim Report and Presentation to the Delaware Public Service Commission and State Agencies on Delmarva's Integrated Resource Plan, dated May 3, 2007, at 12) (hereafter "DP&L Comments on 5/8/07 Transcript at1651"). DP&L's consultant forecasted that the Bluewater and NRG bids would cost DP&L customers from $2-$5 billion more than what they would otherwise pay, and that the State Agencies' IC predicted that they would impose costs of $1.8-$3.4 billion over what customers would otherwise pay. *Id.*[8] Accepting the Bluewater or NRG bids would commit SOS customers to a 25-year contract that would require them to pay, on average, $22-$55 (DP&L estimate) or $20-$37 (IC estimate) more per month than forecasted market prices. *Id*. at 13. Moreover, the IC's "apples to apples" comparison of the bids over different lengths of time, using an average SOS customer using 1000 kWh per month, resulted in a $1, $12, and $15 incremental cost for the Conectiv, Bluewater and NRG bids, respectively. *Id*. DP&L contended that its estimated $22-$55 monthly increase was more representative of the real financial burden customers would shoulder if the Bluewater or NRG bids were accepted. *Id*. at 12-13. In addition, the above-market

[8]In fact, DP&L contended that Bluewater and NRG never got close to the market cost of power under any of the scenarios that it ran. (*Id*. at 13).

prices would encourage customers to migrate to other suppliers who could provide the same service at the lower market price. *Id*. at 13.

26. Second, DP&L argued that none of the bids would produce price stability at a reasonable cost for Delaware SOS customers. *Id*. at 16. Noting that a long-term contract does not mean long-term fixed prices, DP&L contended that none of the bids would provide price stability because:

- Bluewater's and NRG's bids would create an imbalance between supply and demand for SOS energy procurement and would require DP&L to either purchase or sell excess energy. Any excess costs incurred under either bid would be placed into deferred accounts to be recovered later from SOS customers.

- Conectiv's and NRG's bids contained annual adjustment factors based on various indices that could lead to significant variations in year-to-year pricing;

- Neither Bluewater's nor NRG's bids provided for full requirements service to retail customers, so DP&L will have to procure these requirements from other sources or the open market.

- Conectiv's and NRG's bids contained pass-through provisions for unanticipated costs (*e.g.*, carbon capture and sequestration) that are either not known or not identified at the time the contract is initiated, which costs would be passed through to SOS customers.

- The bids' over-market costs could result in customer migration, requiring readjustments designed to recover the long-term contract costs, which would increase the remaining customers' SOS rates.

- The large contracts represented by the Bluewater and NRG bids do not provide a good match with SOS customers' hourly electricity demand, and this mismatch will require the excess generation to be sold into the market at a loss, which losses will be passed on to SOS customers.

- Bluewater’s bid requires DP&L to purchase up to 400 MW of wind power but does not mean there are no variable retail charges to SOS customers; wind power has expensive up-front construction costs and a fuel price risk that is embedded in the cost of replacement power when wind is unavailable. Bluewater’s bid also includes regular annual price increases.

DP&L Comments at 16-17.

27. Third, DP&L argued that multiple case scenario analyses did not change the rankings of the bids from the original evaluation. *Id*. at 18-19. Thus, even using assumptions that varied widely from DP&L’s reference case assumptions did not change the rankings of the bids. *Id*. at 19 and Appendix A.

28. Fourth, DP&L asserted that it “faithfully” followed the EURCSA and the prescribed scoring approach in preparing its RFP evaluations, so the bids should not be ranked differently according to new or different criteria. *Id*. at 20. Thus, it objected to the IC’s suggestion that the State Agencies could change the bid rankings by re-weighting the supercategories. DP&L contended that applying additional criteria after the fact provided no meaningful information and would undermine the credibility and integrity of the evaluation process. *Id*. at 21.

29. Sixth, DP&L asserted that none of the proposed projects was needed to provide reliability for DP&L’s SOS customers. It claims to have fully considered unit retirements, new transmission capacity, the implementation of the Reliability Pricing Model, PJM’s role in the planning process, and short-term supply and demand imbalances in

preparing and developing its IRP, and none of these considerations showed any need for additional reliability. *Id*. at 21-27.[9]

30. Seventh, DP&L contended that long-term contracts did not integrate easily or well with full requirements service and, therefore, additional costs would be required to manage such contracts. *Id*. at 31. DP&L noted that its rolling 3-year SOS procurement process secured full requirements energy and capacity for SOS customers without additional charges for risk management services. DP&L asserted that risk management services would be needed for long-term contracts because they expose customers to costs associated with the spot market, congestion and environmental compliance, and deferred costs arising from put-of-market energy procurement accruing to retail rates. If DP&L were to follow any of the IC's recommendations, it claimed that it would essentially become a power trading organization, and that either of the options for dealing with this would be expensive for DP&L's customers. *Id*. at 31-33.

31. Eighth, DP&L argues that it was inequitable for SOS customers to be responsible for paying for a contract with Bluewater if the sole justification for it was environmental concerns, because all Delawareans would be benefiting from that power and thus would be getting a "free ride" from the SOS customers. Delmarva contended that customers desiring green energy could contract with Delaware-licensed suppliers providing such energy. *Id*. at 33.

[9]DP&L next argued that the IC's proposed market test was unnecessary for the State Agencies to reject the bids. (DP&L Comments at 28-31). This argument does not appear to pertain to the Staff Report since Staff did not recommend a market test.

32. Finally, DP&L contended that customer migration was a real threat and represented significant exposure for DP&L's SOS customers if DP&L were forced to accept a long-term contract. DP&L acknowledged that customer migration in the residential and small commercial customer classes as a result of deregulation had been insignificant, but contended that SOS rates have never been considerably higher than the competitive rate offered by other suppliers. *Id*. at 34. But if the SOS rate becomes higher than the market rate, residential and small commercial customers have an incentive to switch to other suppliers. *Id*. at 35.

3. <u>The DPA</u>

33. The Division of the Public Advocate ("DPA") contended that the EURCSA did not intend to place DP&L's SOS customers in a worse situation than they were in when the EURCSA was enacted. Therefore, the DPA took the position that "[t]he contract awarded in this proceeding must be manifestly better than the current SOS procurement strategy. … [T]he execution of any of these power purchase agreements must leave most customers better off without leaving any customers worse-off." Responsive Comments to the Independent Consultant's Report dated May 2, 2007 at 6-7 (hereafter "DPA Comments at __"). The DPA argued that the State Agencies must consider each bid received against the existing SOS procurement process with regard to rate stability and consumer protection. *Id.* at 7. The DPA further argued that construction of new generation in Delaware should be considered pursuant to the IRP, rather than the RFP, because the current SOS

procurement process continues to be in the public interest and has produced “below market” rates for the past two years. *Id.* at 14.

34. The DPA somewhat reluctantly agreed with Staff’s recommendation to direct DP&L to negotiate only with Bluewater, but did not endorse the natural gas backup component of the hybrid model (although the DPA did acknowledge the need for some firm power, load-following PPA to augment any PPA entered into with Bluewater). (5/8/07 Transcript at 1672; DPA Comments at 8, 13-14). The DPA asserted that the Commission should direct DP&L to secure a PPA with Bluewater only and focus on negotiating a competitive price clause. (DPA Comments at 12). If the Bluewater proposal is awarded, the DPA recommended that the State Agencies direct Staff to petition FERC to relieve Delaware customers from capacity payments to generators and open a proceeding to establish a low-income energy rate for eligible households in Delaware. *Id.* at 15.

35. The DPA agreed with Staff that energy efficiency and demand-side renewable energy generation envisioned by the SEU Task Force must complement new generation in Delaware. *Id.* at 11. The DPA emphasized that the decision on the generation bid proposals should be executed without further delay. *Id*. at 16. In support of this recommendation, the DPA noted that no new insight will be gained by delaying a decision implementing the EURCSA because the IRP docket will not be resolved until late summer or early fall. *Id.*

36. The DPA urged the State Agencies to seek legislation requiring Delaware Municipal Electric Customers and Delaware Electric Cooperative Customers to share in renewable premium payments and net

capacity sales for a long-term PPA. *Id.* at 15. In support of this contention, the DPA highlighted the fact that all Delaware customers will reap the environmental benefits of the EURCSA, but only Delmarva customers will be paying. *Id.*

37. The DPA further urged that a PPA with an out-of-state renewable generation source, such an onshore wind farm, was not a substitute for constructing renewable generation in Delaware as required by the EURCSA, reasoning that contracting with an out-of-state wind provider would require Delawareans to pay for environmental benefits reaped by regional citizens. *Id.* at 9. Likewise, the DPA recommended that if the State Agencies directed DP&L to negotiate with Bluewater, then all Delawareans should be required to cover DP&L's stranded costs as a result of customer migration because all Delawareans would be reaping the health and other benefits of cleaner energy. *Id*. at 9-10.

4. Bluewater

38. Bluewater "strongly support[ed]" Staff's recommendation and indicated its willingness to negotiate with DP&L regarding all aspects of its bid. (*Id*. at 1677, 1682, 1686). It observed that its project would provide union jobs during the construction of the wind farm, and that it would likely provide other jobs in the tourism industry. *Id*. at 1679-80. Bluewater confirmed that it had recently entered into a contract with DEMEC (contingent on Bluewater's obtaining a contract with DP&L) whereby DEMEC would take the excess power that DP&L did not want. *Id*. at 1687-88. Bluewater objected to DP&L's suggestion that all bids should be rejected and the RFP process closed down, asserting

that stopping the RFP process now would (1) hinder Delaware's attempt to diversify its energy supply portfolio beyond the regional wholesale market; (2) limit the opportunity to address risk within the confines of the EURCSA and deregulation; (3) waste millions of dollars already spent in the process; and (4) prevent an informed decision on the generation bids, which is only possible after negotiation. (5/8/07 Transcript at 1695, 1696).

5. Conectiv

39. Conectiv stated that it had not studied Staff's hybrid proposal, but that it looked forward to working with the Commission and DP&L going forward. *Id*. at 1698. In response to questions from the Commission, Conectiv stated that it was not opposed to negotiating with DP&L regarding siting the proposed CCGT at a different location, fuel access, water supply and electric transmission, and that it would not be opposed to trying to "follow the same path" with respect to covering the cost of carbon dioxide for a scaled-down project. *Id.* at 1698-1700.

6. NRG

40. As noted, NRG argued that Staff's recommendation regarding the hybrid energy supply exceeded the scope of the EURCSA, which it contended required the State Agencies to choose from the bids that were actually submitted. (5/8/07 Transcript at 1704, 1709).

41. NRG also opposed DP&L's recommendation to reject all bids, arguing that it was clear that DP&L "wishe[s] to end this process as quickly as possible." (Supplemental Comments of NRG Energy, Inc. On Reports of Evaluation of Bids Received in Response to Request for

Proposals for Competitive Power Supply by Delmarva Power & Light Company dated April 6, 2007 at 2) (hereafter "NRG Supplement at __"). First, NRG contended that more wholesale market prices do not limit volatility; rather, NRG pointed out that the price increase that led to the EURCSA was the result of reliance on a wholesale market purchasing system. *Id*. at 3-4. NRG noted that wholesale market purchases do not have associated and enforceable environmental criteria, which is inconsistent with the EURCSA. *Id*. at 4. Finally, NRG alleged that selection of Bluewater's bid would increase the reliance on market purchases because of the unpredictability of wind. *Id*. at 5.

42. Even though NRG expressed substantial concerns with Staff's recommendations, it assured the State Agencies that it was eager to negotiate a competitive solution for wind backup with DP&L. (5/8/07 Transcript at 1711-13). Consequently, NRG urged the State Agencies to instruct DP&L to negotiate with all three bidders for the backup component of the hybrid model. *Id*.

7. Alan Muller/Green Delaware

43. Mr. Muller stated that he was "in broad general agreement with the conclusions" of the Staff Report. Comments of Alan Muller on Interim Report at 5 (hereafter "Muller Comments at 1747"). He agreed that Delaware needed additional generation in Delaware because of "the need to offset the operation of the existing, very dirty and damaging capacity now being operated in Delaware." Mr. Muller suspected that PJM's Reliability Pricing Model benefited the operators of "old, dirty units" the most. He agreed that DP&L should negotiate with Bluewater

but questioned the "wisdom" of reducing the Bluewater project from 600 MW to 200-300 MW in light of economies of scale and the fact that all of its possible output would replace "unhealthy existing generation." Because health and other benefits are proportional to the size of the wind farm, Mr. Muller believed that reducing the size of the wind farm reduced public benefits "without any countervailing justification." He agreed that wind should be paired with gas to provide a dispatchable product, but opined that there was no shortage of gas capacity, noting that FPL had recently constructed a 700 MW gas-burning facility just north of the Delaware state line. Thus, he questioned the recommendation to include a CCGT in the negotiations. Nevertheless, if it was included, locating it in Southern Delaware was sensible, as well as the proposal to include a synchronous condenser unit to provide reactive power. *Id*.

8. **Dr. Jeremy Firestone**

44. Dr. Firestone agreed with the IC that DSM, potential retirement of existing supply, potential transmission upgrades and a long-term fundamental shift in natural gas prices must be considered in determining whether new generation is necessary. (Additional Point-Counterpoint on the Independent Consultant's Evaluation dated April 6, 2007 at 1). He further agreed that a utility-scale renewable energy project would offer DP&L's customers an important hedge against the risk of future fuel shock and the "near certainty" of carbon charges. *Id*.

45. Dr. Firestone disagreed with the IC, however, on several points. First, he did not agree that it would be appropriate to

consider an out-of-state wind farm because the EURCSA clearly specified that the generation be located "within Delaware." Dr. Firestone also contested the IC's conclusion that it may be in Delaware's best interest for DP&L to enter into a long-term contract for out-of-state power, questioning how it could be in Delaware's best interest to export jobs to some other state. *Id*. at 2. Dr. Firestone next opposed the IC's recommended market test, stating that a test could only be run of a highly distorted market and little would be gained in any event. *Id.*

46. Dr. Firestone also contended that there was no context provided for the IC's evaluation of the Bluewater bid as being $493 million above market over its 25-year life. Dr. Firestone explained that, on average, customers' bills would increase by just over $5 per month, and that this was a conservative estimate because it assumed that all costs would be borne by residential customers only. *Id*. Dr. Firestone also objected to the assumption that only residential and small commercial customers receive SOS, pointing out that SOS is available to customers in the MGS-S, LGS-S, GS-P and GS-T customer classes. *Id*. at 3.

47. Dr. Firestone took issue with what he called "phantom increases in Bluewater's fixed-price bids," noting that Bluewater's bid only increased in accordance with a fixed inflation index. He assumed that the IC had increased the price of the Bluewater bid because it assumed that some other portion of DP&L's supply would increase with higher natural gas rates, increased load growth and other requirements and that Bluewater should be penalized for this.

Assuming *arguendo* that more capacity was needed, that did not mean that the price that DP&L would pay for Bluewater capacity would increase, but rather only that Bluewater contract cannot in and of itself insulate ratepayers from all future market moves. *Id*. at 4.

48. Dr. Firestone concluded that not accepting Bluewater's bid would "expose DP&L's SOS customers to greater risks than any risks of stranded costs." *Id*. at 5. In Dr. Firestone's opinion, the Bluewater bid fulfilled all the criteria of the EURCSA, and he urged the State Agencies to recommend it. *Id*.

9. Other Public Comment

49. The members of the public that appeared and spoke at the May 8, 2007 hearing predominantly favored the Bluewater wind project. They expressed concern about the health effects of polluting plants and cited the emission-free nature of wind power as a significant benefit.

III. DISCUSSION

50. First, we address DP&L's and NRG's arguments that Staff's hybrid proposal goes beyond the bounds of the EURCSA and is impermissible thereunder. We disagree with DP&L and NRG that the EURCSA only permits us to consider and accept or reject projects as they were submitted by the bidders. The EURCSA contains no such limitation in its language, and indeed the RFP that the Commission and the Energy Office approved contemplated that negotiations could occur between DP&L and a bidder that would change the proposal from what was initially submitted. That was the entire point of rejecting a provision in the RFP that would make most of the terms of the PPA non-

negotiable. *See* Order No. 7066 at ¶¶ 108-110. Likewise, we do not believe that the General Assembly intended to tie a bidder's hands in this manner. The goal of the EURCSA is to attempt to provide Delmarva's SOS customers with price-stable reliable energy. If a bidder seeks to change its project to make it more price-stable, reliable or otherwise acceptable under the EURCSA standards, we do not see why it should not be permitted to do so. And we see no difference between a bidder changing its proposal on its own initiative or doing so after the Commission Staff (or representatives of the other State Agencies charged with responsibility under the EURCSA) suggests that such changes might be beneficial. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

51. We accept Staff's recommendation that DP&L's SOS requirements be provided from a portfolio of supply that shall include Sustainable Energy Utility concepts (to the extent that they fit). While we understand that we cannot diversify away all risk, we believe that a portfolio approach presents the best way to mitigate risk. Thus, we approve Staff's recommended portfolio approach for energy planning. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

52. This process has made it abundantly clear that Delaware must, as Staff recommends, take control of its own energy future. As one of the commenters at the May 8, 2007 hearing pointed out, the Town of Long Beach, California emerged unscathed from the Enron debacle because it had its own generation. (5/8/07 Transcript at 1751). We

believe it is imperative for new generation to be sited in Delaware to help maintain the reliability of the system and to provide power to DP&L's SOS customers. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

53. We realize that we cannot insulate ratepayers from all market forces in this era of deregulation, but we must do our utmost to ensure that we fulfill the mandate the General Assembly has given us: to supply DP&L's Delaware SOS with reliable energy at reasonably stable rates, taking into consideration the criteria enumerated in the EURCSA. Those criteria, as many of the commenters have observed, do not focus solely on price; rather, there are other public policy considerations that the General Assembly has identified as more important than price. Therefore, we cannot accept DP&L's invitation to reject all of the bids because they exceed what DP&L has calculated to be a levelized 2005 market price. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

54. Similarly, because the EURCSA contains considerations other than price, we do not direct DP&L to negotiate only with Conectiv even though it had the lowest bid. We recognize that it scored highly in many of the individual categories, but it does not utilize a new or innovative technology and it is not nearly as environmentally friendly as other proposed projects. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

55. With our vote here today we bring the potential for clean, renewable and carbon free wind power to Delaware, an important factor

for consideration in EURCSA. While we recognize DP&L's concern that wind generation may not be the lowest cost alternative to its SOS customers, we observe that price is not identified in the EURCSA as a controlling factor of the RFP. We also acknowledge DP&L's contentions with the uncertainties attending Staff's proposed hybrid model and its concern that Staff's proposal will not produce price stability. However, we observe the growing uncertainties with respect to price in the current energy market, including the recent estimated 1227% increase in capacity costs from PJM, the uncertainty regarding transmission, the uncertainty regarding possible retirement of existing generation (for example, Oyster Creek and Basley), the volatility of natural gas prices, and the uncertainty surrounding the cost of carbon. (*See* 5/8/07 Transcript at 1655-56). Thus, we are not convinced that the market is less uncertain than Staff's hybrid proposal. Accordingly, we direct DP&L and Bluewater to negotiate in good faith for a long-term PPA for the provision of wind power. While we support Staff's guidance on the 200-300 MW size, we will allow some, albeit not unlimited, flexibility in the size because we want to give DP&L and Bluewater the greatest flexibility in negotiating an agreement that will be the most beneficial for Delaware. But that flexibility must also be coupled with a recognition that the proposed contract must be sized appropriately for the estimated SOS demand. (Tr. 1790) (All Commissioners voting yea; Energy Office, OMB and Controller General representatives not voting).

56. We also direct DP&L to negotiate with both Conectiv and NRG to provide any backup firm power that may be necessary when wind power

is not available, and that these negotiations be conducted independently, and in the same time frame that DP&L is negotiating with Bluewater. NRG's bid proposal may compare favorably due to NRG's pre-existing location in Sussex County, obviating the need to site a new power plant outside of an existing brownfield (one of the criteria outlined under EURCSA). NRG's existing location may also serve to minimize the costs and sighting issues associated with new supporting transmission. Use of NRG's existing power plant site for gas-fired back-up generation may also incent the conversion of Indian River units 1-4 to cleaner natural gas. We suggest conclusion of negotiations within a 30 to 60 day time frame maximum; however, to the extent that there is continuing progress we can accept some extension in that process. In regard to the procedural aspects of negotiations, we reject Staff's recommendation that DP&L be instructed to negotiate only with Conectiv and that the negotiations between DP&L and Bluewater and DP&L and Conectiv be conducted sequentially. We believe that requiring DP&L to conduct all negotiations (i.e. with Conectiv, Bluewater and NRG) simultaneously, or in propinquity will result in the bidders putting their best bids forward, rather than trying to hedge their bets to see what comes out of the negotiations between DP&L and Bluewater. And while we are in general agreement with Staff's proposal that a gas (or combined cycle) turbine will likely provide the most operational flexibility and cost effectiveness response to staff's stated concerns regarding backup generation, we will not now foreclose an alternative solution to the those concerns. DP&L may assume some level of risk during these negotiations, provided that there is a corresponding price reduction associated with DP&L's assumption of that risk. Otherwise, we find that the financial risks of Staff's hybrid proposal are limited and manageable and satisfy the intent of the EURCSA. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

57. In this regard, we direct DP&L to report back to the State Agencies at least weekly regarding the progress and status of the negotiations. This has the benefit of keeping the State Agencies informed as well as making sure that negotiations are in fact taking place. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

58. DP&L shall be assigned the responsibility of managing supply resources unless it declines to accept such responsibility. Should it decline to do so, it shall notify the State Agencies within 30 days of the date this order is entered. If DP&L declines to accept such responsibility, the State Agencies shall retain an independent third party to serve as supply resource manager, and DP&L shall be responsible for the cost of the third party. We recognize that the negotiations, that we direct by our action herein, will be difficult, especially since one of the critical parties to the negotiations has publicly stated that it will not be directed to negotiate. To ensure that the negotiations move forward in a manner more likely to achieve the results directed by this order, we direct our staff to retain independent third party oversight, at DP&L's expense. This third party will oversee the negotiations process and report back periodically to the Commission and other State Agencies on the status

of the negotiations and evaluate the efforts of all of the parties to negotiate agreements in good faith and in conformance with EURCSA. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

59. In the event that DP&L's negotiations with Bluewater, Conectiv, or NRG are unsuccessful, the Commission will reconvene with the other State Agencies to reconsider whether another generation solution would be appropriate. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

60. While we recognize a shortcoming of the EURCSA, in the exclusion of other states from the process, we must act within its confines. We agree with the bidders' observation that flexibility and competition are crucial components to the upcoming negotiations. For these reasons, we believe that the Staff Report, with these exceptions, best captures the intent underlying the EURCSA. (All Commissioners voting yea; Energy Office, OMB, and Controller General representatives not voting).

IV. ORDER

AND NOW, this 22nd day of May, 2007, **IT IS HEREBY ORDERED**:

1. That the Staff Report (attached to the original hereto as Exhibit "A") is hereby adopted and approved except as specifically addressed to the contrary above.

2. That the Commission and the other State Agencies reserve the jurisdiction and authority to enter such further Orders in this docket as may be deemed necessary or appropriate.

BY ORDER OF THE DELAWARE PUBLIC SERVICE COMMISSION,
THE DELAWARE ENERGY OFFICE,
THE CONTROLLER GENERAL
DIRECTOR OF THE OFFICE OF MANAGEMENT & BUDGET

DELAWARE DEPARTMENT OF NATURAL **RESOURCES AND ENVIRONMENTAL CONTROL**

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CONTROLLER GENERAL

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DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

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PUBLIC SERVICE COMMISSION

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Chair

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Commissioner

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Commissioner

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Commissioner

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Commissioner

ATTEST:

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Secretary