REPORT TO THE DELAWARE PUBLIC SERVICE COMMISSION REGARDING THE PURCHASE OF FULL REQUIREMENTS WHOLESALE SERVICE FOR FIXED PRICE STANDARD OFFER SERVICE CUSTOMERS

A. OVERALL CONCLUSIONS AND RECOMMENDATIONS

This report is prepared pursuant to Order No. 6598 and the July 18, 2005 Phase 2 settlement filed with the Delaware Public Service Commission of (Commission) in Docket No. 04-391. The settlement allowed for the Commission to retain the services of a third party technical consultant to assist in the monitoring and review of the Request for Proposal (RFP) process to be utilized by Delmarva Power & Light (Delmarva) for the purchase of Full Requirements Wholesale Service for Fixed Price Standard Offer Service (FP-SOS) customers in Delaware. Vantage Consulting, Inc. (Vantage) was selected by the Commission to assist with the monitoring and review of this process. This report addresses the first year for the purchase of Full Requirements Wholesale Service for Fixed Price Standard Offer Service customers in Delaware. There are a number of general conclusions that will be discussed in detail in the following report. The overall results and impacts are presented in this section of the report.

General Findings

Each of the findings, designated F1-F3 summarize our overall conclusions. These findings are followed by one recommendation to streamline the next year's process.

F1 The prices bid reflect the general condition and prices of the market at the time of the RFP Process.

Rates, after almost six years of being frozen, will increase significantly. However, the bid prices are reflective of the current market conditions for various energy supplies and resultant electricity costs within the PJM RTO.

F2 The process used for the RFP solicitation was well developed and had no serious flaws.

Vantage believes that the pre-bid conference, the bidder qualifying process and the bidding process utilized by Delmarva resulted in competitively priced bids reflecting the general energy market conditions. The processes were efficiently managed and complied in all respects with the standards developed in the settlement process in Docket No. 04-391 and restated in the RFP.

F3 The number of bidders for most rate groups was adequate.

Fifteen firms were qualified to bid and eleven firms submitted bids. Six of the firms which bid won at least one block. This level of activity is consistent with other jurisdictions in which similar RFP or auctions are taking place.

Recommendations

R1 Modify the process to require all bidders to provide bid assurance collateral by close of business on the day before the bids are due.

With regard to the bidding process, we are recommending one modification. As discussed below, during Tranche 1, two problems arose. Both of these problems were related to the bid assurance collateral. In one instance, the bidder did not provide the required bid assurance collateral by the 5:00 P.M. deadline on the bid day. In the other instance, the bidder inadvertently submitted more bids than it had provided bid assurance collateral to support. We believe these concerns could be eliminated if the process was amended to require the submission of the bid assurance collateral by close of business on the day preceding the bid day. In this way, the PHI Energy Procurement System could monitor the bids as they are submitted for compliance with the bidder's bid assurance collateral.

B. BIDDING PROCESS

Vantage's primary role was to monitor and review the bidding process as detailed in the settlement agreement in Docket No. 04-391. The following parts of this section of the report describe the standards we established , the bidding process and our observations and comments regarding the process.

OVERSIGHT STANDARDS

In order to adequately assess the process and render our opinion on whether it was successful, we first established a number of evaluative criteria that define what expectations we had for the process. Our final conclusions were then based on these criteria. The evaluative criteria we established and general conclusions were:

Evaluative Criteria	Conclusion
The process used for conducting the RFP process should be well defined and have been used before successfully.	The general process utilized in Delaware is very similar to other states, including Maryland, the District of Columbia and Maine. The process was initiated in Maine and in Maryland two years ago, and in the District of Columbia a year ago and has worked in all of these states without any structural problems.
An invitation to participate should be provided to all potential bidders in all available formats.	Delmarva notified prospective bidders, including contacting all bidders that are active in PJM or had bid in previous RFP events in neighboring jurisdictions.
Instructions on how to take part should be	Delmarva posted all directions on a web site.

clear with opportunities for questions.	In addition, a one day training session was held.
A reasonable number of bidders should show interest in qualifying.	Over thirty potential bidders expressed an interest in the RFP Process.
The actual RFP bid receipt and evaluation process should be monitored to assure that all communications, access to data and evaluations are done with no possibility of collusion.	Vantage consultants monitored the process from the receipt of the bids through the approval of the contracts. No Delmarva personnel were allowed to make contact with any bidders without Vantage consultants monitoring the calls and computer communications
Evaluation of bids, rankings, and impact on rates should be evaluated independently.	Vantage conducted its own assessment of the bids received, performed its own ranking and then evaluated the impact of bids on rates independently of any evaluations conducted by Delmarva.
Enough bidders should qualify and actually bid to assure that the number of bids are adequate and the number of successful bidders is diverse.	Fifteen bidders completed the qualification process and eleven submitted bids. A total of 109 bids were received for 33 blocks in the three tranches. Six different firms were successful and no firm garnered over 40% of the total load.

OVERVIEW OF THE PROCESS

In accordance with the settlement, Delmarva prepared a bid plan which identified the service types, the term of the contract, and the number of blocks to be bid in each round or tranche of the bidding process. The bid plan was posted on Delmarva's RFP web site and made readily available to all interested bidders. Each block consisted of approximately 50 megawatts of power. Due to varying load characteristics, the bids differed for the service types. Four different service types were employed for the Delmarva bid process. They were: Residential and Small Commercial & Industrial; Medium General Service – Secondary; Large General Service – Secondary; and General Service – Primary.

THE QUALIFYING PROCESS

Prior to qualifying any potential bidders, Delmarva conducted a pre-bid conference. The pre-bid conference was held on November 3, 2005. At the conference, Delmarva personnel walked the potential bidders through the qualifying, bidding and contracting process to be used in Delaware. Since many of the potential bidders had also attended a similar presentation for the Maryland process the week before, there were not many questions.

However, there were some clarifying questions which Delmarva representatives answered regarding the differences between the Delaware and Maryland processes. In our view, all of the attendees left with a clear understanding of what was expected of them for the qualifying and bidding processes.

The qualifying and bidding processes in Delaware were managed through the PHI Energy Procurement System on the Delmarva RFP web site. Use of this system made available, in one location, all of the necessary forms for becoming qualified to bid in Delaware. The forms available on the system for qualifying included: a Confidentiality Agreement; PJM Qualification Certification Form; FERC Authorization Certification Form; Credit Application; and Bid Assurance Letter of Credit. Bidders submitted all of the required qualifying documents through the Delmarva RFP web site. All bidders that qualified were notified through the web site. Any deficiencies were noted and sufficient time was allowed to remedy those deficiencies. This efficient system resulted in a total of 15 bidders being qualified to provide bids, subject to meeting the bid assurance standard of $300,000 per bid block. Vantage reviewed the information as it was posted on the RFP web site. It is our opinion that all potential bidders were treated equitably in the qualifying process. Further, the resulting pool of qualified bidders provided sufficient competition for a robust bidding process.

THE BIDDING PROCESS AND EVALUATION

The bidding process was conducted at secure locations and contact with bidders was limited only to clarification of the timely submittal of bid assurance collateral in the form of cash or a line of credit or to address problems with non-conforming bids. Like the qualifying process, the bidding process was also managed through the PHI Energy Procurement System located on the Delmarva RFP web site. Bid Form Spreadsheets were developed and made available on the system. A specific Bid Form Spreadsheet was available for each service type in each tranche. It was necessary for the bidder to submit its bid on the appropriate spreadsheet for the system to recognize the bid as a conforming bid. In addition to the Bid Form Spreadsheet, load data for the service types and a Retail Pricing Model were also provided to assist the bidders with the preparation of their bids. When the system accepted a conforming bid, it would immediately attach a tag number to the bid to be used in further processing. As the bids were logged in they were sorted based on service type and ranked based on the Discounted Average Term Price. The Discounted Average Term Price was the sole basis for ranking bids and was calculated by Delmarva using a discount rate equal to two percent over the Prime Rate published in The Wall Street Journal. The Discount Average Term Price needed to be calculated to account for differences in the terms of the blocks. By using a discount price for evaluation purposes, the time value of money is considered. Assumed within the mid-year discounting convention are cash flows occurring in the middle of each Price Period Within Contract Term and the Load Weighted Average Energy Prices, which are discounted back to the start of the term. At precisely 5:00 P.M., the system no longer accept any bids. Immediately after the system closed for submitting any more bids, Delmarva personnel verified the bids and the rankings.

NOTIFICATION TO BIDDERS

On the following business day, bidders were notified if their bids were successful. Strict confidentiality was maintained throughout the process as bidders were only informed about the status of their bids. No information was conveyed about which bids won or the prices of those bids. Winning bidders received, by facsimile, a partially executed agreement and by overnight courier, three partially executed agreements. By 2:00 P.M. of the next day, the bidder returned to Delmarva, by facsimile, a fully executed copy of the full-service requirement agreement followed by overnight courier delivery of two fully executed copies.

COMMISSION APPROVAL

Delmarva then submitted a copy of each successful bid to the Commission for review and approval. The protocol adopted by the Commission state, that if the Commission took no action, the bids would be considered approved by the Friday of the week the bids were submitted. However, the Commission explicitly, by unanimous vote, approved the submittal of the winning bids by Delmarva in advance of the deadline

CONFIDENTIALITY

The most critical feature of a competitive bidding process is that there be an adequate number of bidders. In our opinion, the release of the confidential data would seriously jeopardize this critical component of the process. If bidders believe that their bid information is going to be released and become publicly available to other bidders, many, if not most, of the bidders will decline to bid in the Delaware process in the future. This is because the release of the confidential data will reveal to other bidders the information that distinguishes the bidding technique of one bidder from another. Given that all kilowatt-hours are the same, the only way a bidder can distinguish itself from other bidders is through its pricing of the energy. If a bidder cannot protect this unique aspect of its bid, then we believe that it will likely decline to bid in the future.

Further, releasing a list of all bidders, winners and losers, the prices they bid for both summer and winter power, and the discounted price of their bid is of marginal value to anyone except other bidders since these bids have to be converted to electricity rates to be of any substantive value and the resulting rates are already available. Accordingly, there appears to be little value for entities other than bidders to be gleaned from dissemination of this confidential information.

Prior to the release of any confidential data, it is our opinion that the potential consequences should be carefully considered. For instance, if inadequate bids are submitted in the future, then Delmarva Power & Light will be forced to fill the void with spot market purchases. Depending on their timing into this market, the consequences could be rather dire. Another alternative would be to end the bidding process and require Delmarva to meet the needs of the electricity consumers in Delaware. However, one must remember that Delmarva no longer possesses generating resources. Therefore, the only way for Delmarva to satisfy the electricity needs of its consumers is to purchase power. Instead of purchasing solely on the spot market, Delmarva could develop a portfolio of contracts including spot, short,

intermediate and long term contracts. This alternative would create other problems, such as whether the resulting prices reflected from such approach were consistent with the statutory requirement that prices be "based on or representative of regional wholesale electric market prices " Moreover, this approach would appear to be a regulatory approach without the necessary attendant oversight.

C. BID RESULTS

TRANCHE 1 RESULTS

Tranche 1 of the bidding process was conducted on December 12, 2005. In accordance with the established bid plan, 17 blocks were offered. This included nine blocks for the Residential & Small Commercial & Industrial service type to be let in Tranche 1. There were three blocks for a 13 month term, three blocks for a 25 month term, and three blocks for a 37 month term. Two blocks for 13 month term for the Medium General Service – Secondary were to be let. Two blocks for 13 month term for the Large General Service – Secondary were to be let. Finally, four blocks for 13 month term for the General Service – Primary were to be let in Tranche 1.

Although 15 bidders were qualified to bid in Tranche 1, only nine submitted bids. However, one of these bidders did not submit its bid assurance collateral by the 5:00 P.M. deadline and its bids were not considered. This left eight qualified bidders that submitted bids. Five different bidders submitted winning bids. However, as the following table shows, there were only three bids submitted for the General Service – Primary service type. Since four blocks were offered for the General Service – Primary group in Tranche 1, the bid plan for Tranche 2 was modified to allow five blocks to be bid for the General Service – Primary service type. The table below shows the service type and term, the number of blocks offered and the number of bids received.

Tranche 1, Service Type and Term	Blocks Offered	Bids Received
Residential, 13 months	3	19
Residential, 25 months	3	15
Residential, 37 months	3	10
General Service – Primary, 13 months	4	3
Large General Service – Secondary, 13 months	2	3
Medium General Service – Secondary, 13 months	2	4

The bidding in the Residential category was very robust with 44 bids received for the nine blocks offered.

It should also be noted that during the bidding in Tranche 1, one bidder submitted more bids than it had bid assurance collateral to support. As a result, two of this bidder's bids could not be accepted. It was determined that the most equitable solution to this problem was to err on the side of the ratepayers and disallow the bidder's two highest bids.

TRANCHE 2

Tranche 2 of the bidding process was conducted on January 9, 2006. Sixteen blocks were offered. This included nine blocks for the Residential & Small Commercial & Industrial service type to be let in Tranche 2. There were three blocks for a 13 month term, three blocks for a 25 month term, and three blocks for a 37 month term. Two blocks for 13 month term for the Medium General Service – Secondary were to be let. Finally, five blocks for 13 month term for the General Service – Primary were to be let in Tranche 2.

As in Tranche 1, 15 bidders were qualified to bid in Tranche 2. Ten submitted bids. Four different bidders submitted winning bids. However, once again there were insufficient bids received for the General Service – Primary. As the following table shows, there were only four bids submitted for the General Service – Primary service type. Since five blocks were offered for the General Service – Primary group in Tranche 2, another round of bidding, Tranche 3, would be required to fill the remaining block. The table below shows the service type and term, the number of blocks offered and the number of bids received in Tranche 2.

Tranche 2, Service Type and Term	Blocks Offered	Bids Received
Residential, 13 months	3	24
Residential, 25 months	3	10
Residential, 37 months	3	9
General Service – Primary, 13 months	5	4
Medium General Service – Secondary, 13 months	2	5

As in Tranche 1, the bidding in the Residential category was again very robust with 43 bids for the nine blocks.

TRANCHE 3

Tranche 3 was necessitated by the insufficient number of bids received for the General Service – Primary category. Accordingly, Tranche 3 was conducted on January 23, 2006 to offer for bid the one remaining block for the General Service – Primary. Three bidders provided the necessary bid assurance collateral of $300,000 to bid on the one block. However, only two bidders submitted bids. The winning bid was clearly below the other bid. In fact, if the winning bid had been offered in Tranche 2 it would have been the second lowest bid offered for General Service – Primary. Since this bid was in line with the Tranche

2 bids that were already considered acceptable, this final bid was also considered acceptable.

D. REGIONAL AND INDUSTRY PERSPECTIVE

The impacts of increased energy prices that are being felt by Delmarva customers in Delaware appear to be similar to changes in other jurisdictions. For instance, Maryland and the District of Columbia held RFP processes similar to that in Delaware recently and results will be announced in the near future. The Baltimore Sun recently noted "Electric bills could go up anywhere from 40 percent to 80 percent for BGE customers as the effects of utility deregulation are felt for the first time since legislation restructuring the industry was passed in 1999." (Baltimore Sun 2/20/06)

There are several factors that have had an upward pressure on market electricity prices in the Mid-Atlantic region since Delmarva's customers rates were frozen in 1999. The most significant factor causing the increase in market electricity rates has been the increase in the cost of fuels that are used to generate electricity. This factor is discussed in more detail below. The other factors that have caused market electricity prices to increase can be described generally as PJM market rules.

PJM IMPACTS ON ENERGY PRICES

PJM, Interconnection, Inc. is the non-profit organization that plans and operates the regional transmission grid that brings electricity from generators located throughout the region to the local delivery systems. PJM also operates the essential markets in the region that allow electricity to be purchased and sold. These markets include energy, capacity and ancillary services.

As part of our assessment of the energy prices bid during this process and resultant rate increases, Vantage consultants tried to determine what impact the PJM policies might have. Interviews and analysis show that PJM has instituted a number of rules to ensure a reliable market and to generate market signals for new and more efficient generating plants in the future. A description of three aspects of the PJM market rules that are providing upward pressure on market electricity prices – and which in turn cause higher retail prices - follows:

The first market rule affects the energy price. Every generating unit that is dispatched in PJM receives the market clearing price. Natural gas was the marginal fuel in 34% of the hours in 2004 in PJM. Natural gas has increased in price 2.5 times faster than coal and even more dramatically than the price of nuclear fuel. Because of this market rule, in over 1/3 of the hours in 2004, the typically low-priced energy from baseload generating units burning coal and nuclear fuel were priced at the much higher natural gas price. This varies dramatically from the pricing rules in place prior to restructuring when generating units were dispatched and priced based on their own marginal fuel prices.

The second market rule that has increased prices in PJM is the PJM proposal to change the way the rates in the capacity market will be determined. Its proposed Reliability Pricing

Model (RPM), according to estimates, will increase the rates capacity resources will receive in the region, especially those located in certain locations where transmission constraints exist, such as the Delmarva Peninsula. While this proposal has not yet been approved by the Federal Energy Regulatory Commission (FERC), the possibility of its enactment and the attended costs associated with the proposal are risks likely reflected in the bids presented in this process.

The third market rule is Locational Marginal Pricing. This rule increases energy rates in areas of PJM where transmission constraints exist. Shortly after restructuring took place, this transmission congestion was a significant factor in the Delmarva region. Prior to the end of the initial transition period, Delaware PSC Staff had been informed by some wholesale suppliers that they would significantly mark-up the price of power to Delmarva to account for the economic effects of transmission congestion on the Peninsula. Certain wholesale customers in Delaware also complained that they were already paying a substantial mark-up for electricity due to congestion. For this reason and some service related issues, it was agreed as part of the settlement of the Conectiv-PEPCO Merger in Docket 01-194, to extend the rate caps that had been scheduled to end in 2002 and 2003. The extension of rate caps was designed in part to allow time to reduce transmission congestion on the Peninsula . Importantly, as part of the merger settlement approved by the Commission, the Company agreed to limits on the number of hours of congestion allowed in its service territory during the rate freeze extension. These limits required Delmarva to dramatically reduce the level of congestion by the end of the freeze.

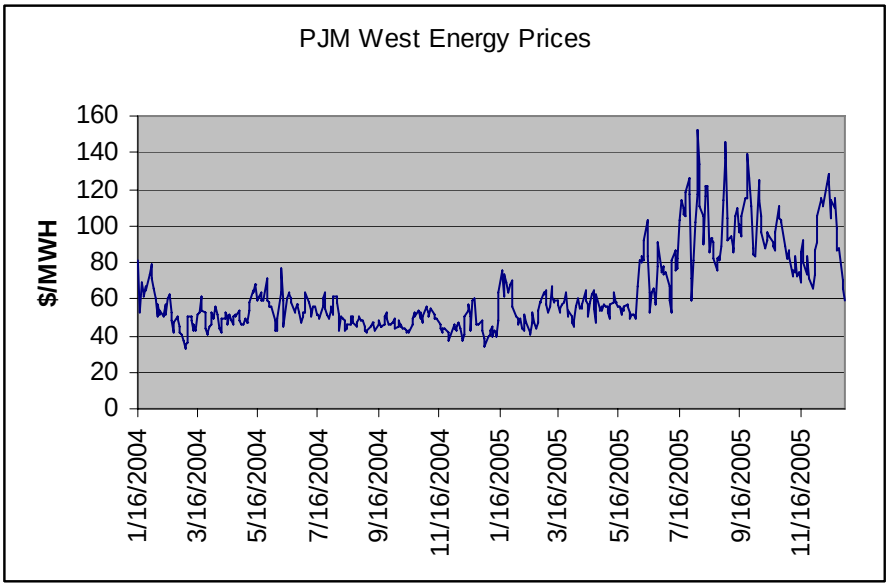
The Delaware Public Service Commission actively confronted PJM and the FERC to make sure that these entities were aware of the impact of transmission congestion on energy rates in Delaware. As a result of those efforts, PJM changed its Regional Transmission Expansion Planning Process (RTEPP) to begin considering the economic impacts of congestion in the transmission planning process. Previously, reliability had been the only consideration.

The merger resolution and the Commission's efforts with FERC and PJM helped contribute to a considerable reduction in transmission congestion in Delaware. Nevertheless, transmission congestion remains a concern that continues to exist because of Delaware's load growth and the lack of robustness of the transmission system on the Delmarva Peninsula. Had the issue of transmission congestion not been addressed prior to end of the rate freeze, there would be no doubt that prices would be even higher than the market rates obtained through the recently concluded SOS bidding process in Delaware.

ENERGY AND FUEL PRICE GRAPHS

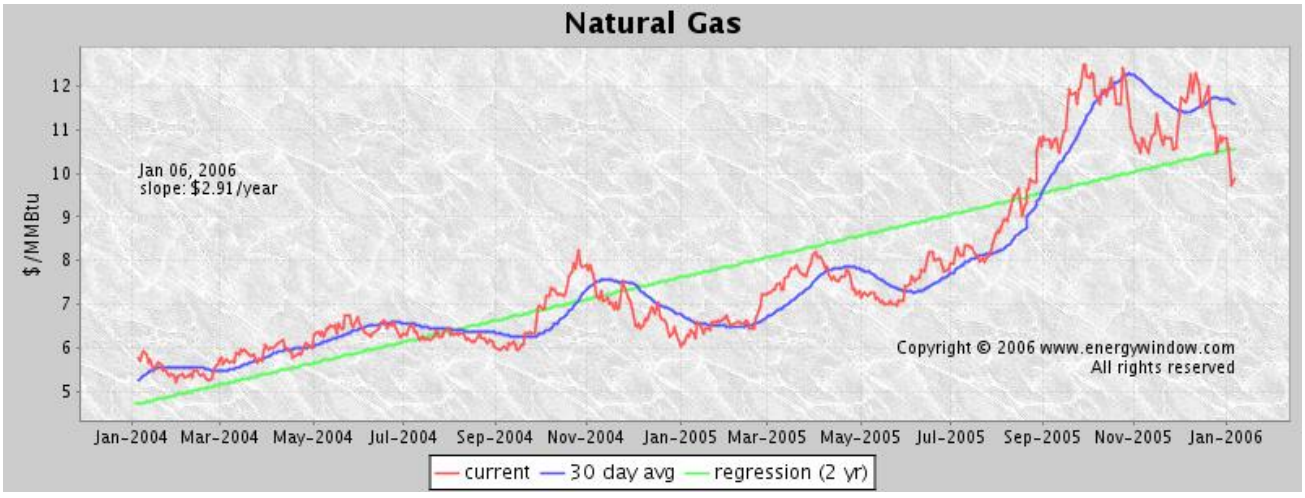
In preparing this report, we illustrate the trends in electricity and energy prices that are affecting SOS and other retail prices in Delaware. The Graph of PJM Electricity Costs for 2004-2005 shows that the cost per mega-watt hour has almost doubled within the last two years. The PJM West Energy Price is the point of entry where trading prices are established, just as Henry Hub is the location for eastern natural gas prices.

PJM ELECTRICITY COSTS FOR 2004-2005



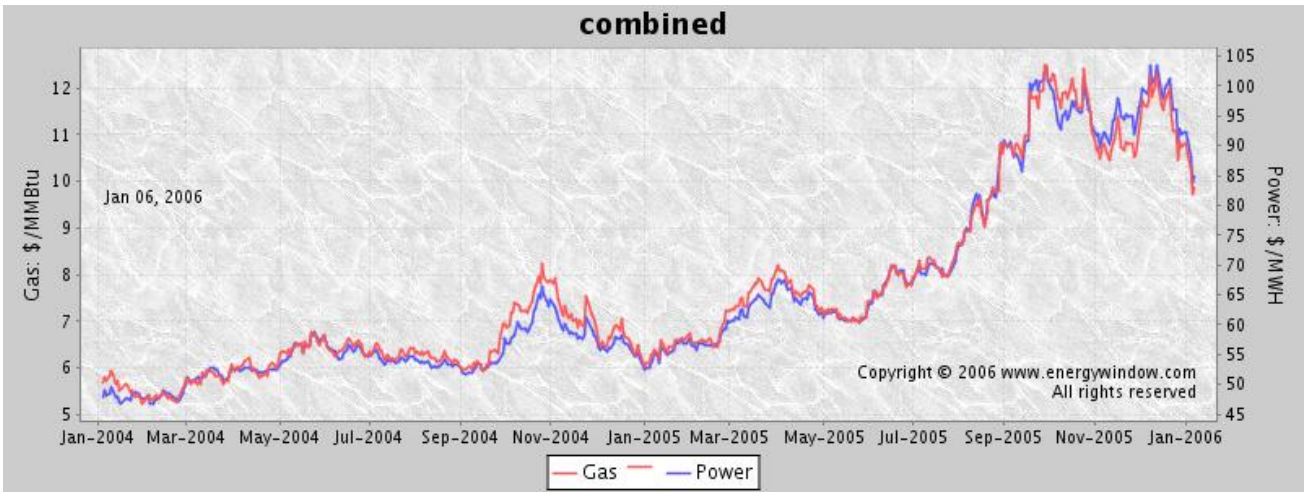
IMPACT OF NATURAL GAS PRICE INCREASES

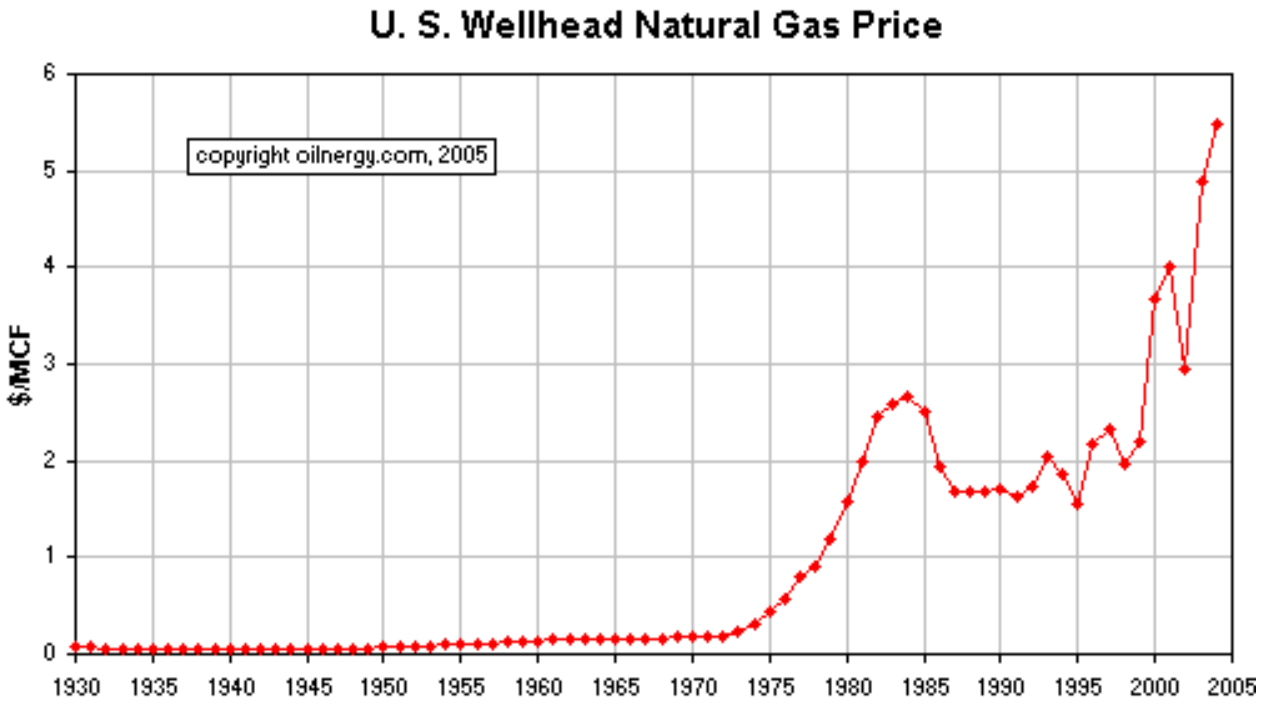
The graph below shows that electricity prices track very close to natural gas prices. Gas prices are shown on the left axis in $/MMBtu and electric prices are on the right in $/MWHR. The next graph illustrates the increasing price of natural gas over the last seventy-five years.



GAS PRICE IMPACT ON ELECTRICITY PRICES

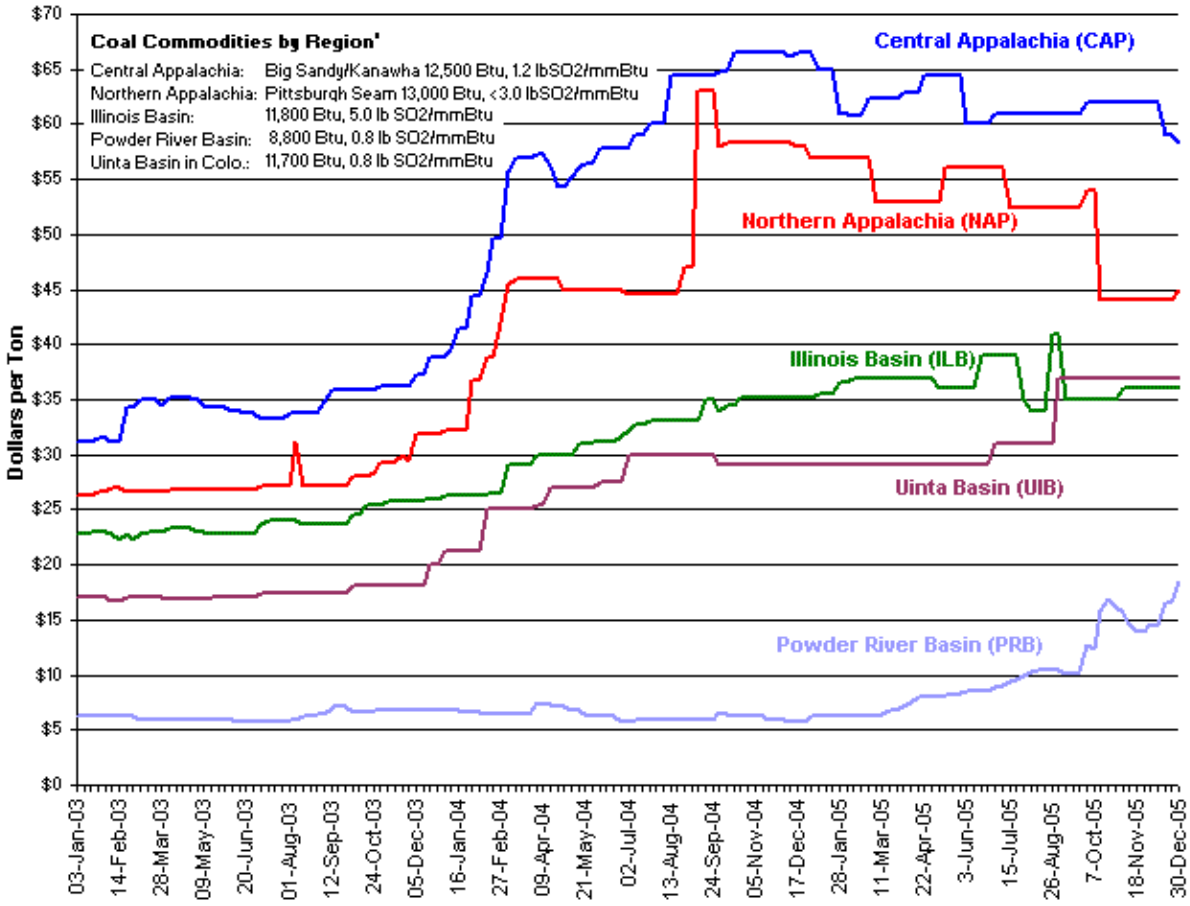
The graph below shows that electricity prices track very close to natural gas prices. The next graph illustrates the increasing price of natural gas over the last seventy-five years. Gas prices are shown on the left axis in $/MMBtu and electric prices are on the right in $/MWHR.





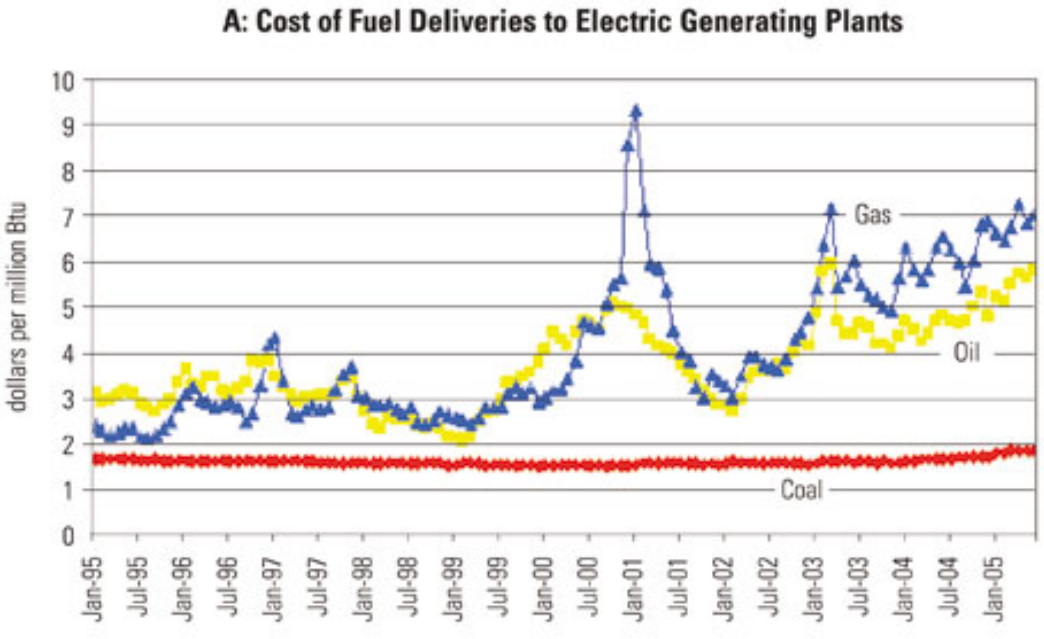
COAL PRICES

It is also important to note that coal prices have risen significantly in recent years. The graph below illustrates the increase in coal prices from different regions of the country. Central and Northern Appalachian coal has doubled in price since 2003. Powder River Basin coal has also increased significantly. While this source is cheaper, the cost of and problems with transportation from Wyoming, result in similarly high costs when used on the east coast.



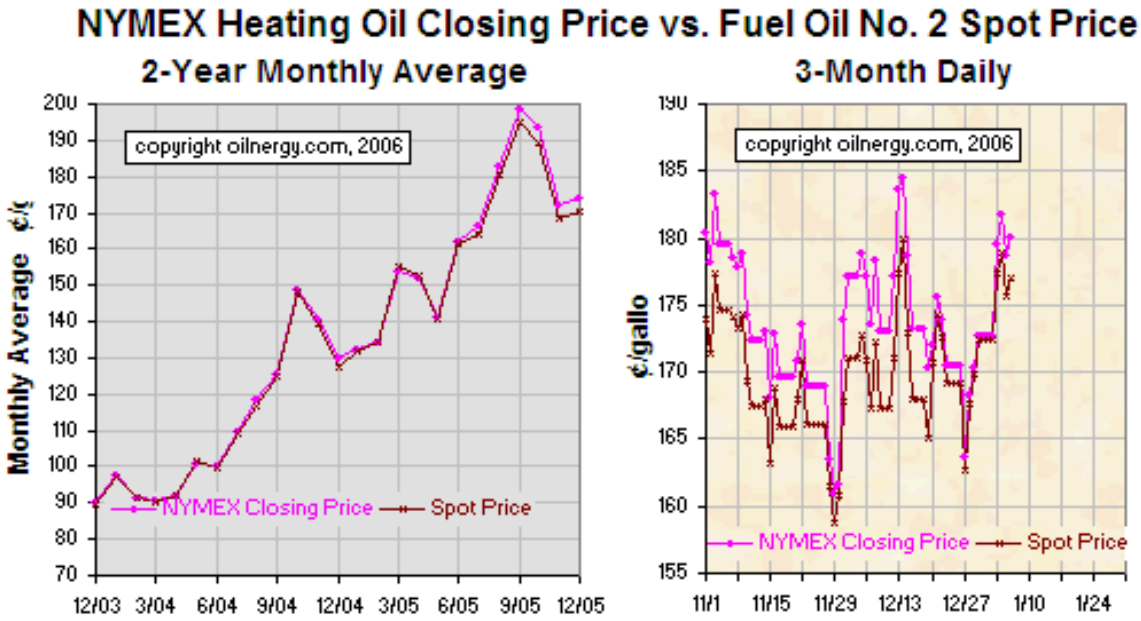
LONG-TERM TRENDS IN FUEL DELIVERED TO GENERATING PLANTS

The graph below helps to illustrate the changes over the last ten years in fuel costs.



HEATING OIL COST INCRESAES

Heating Oil prices have also risen



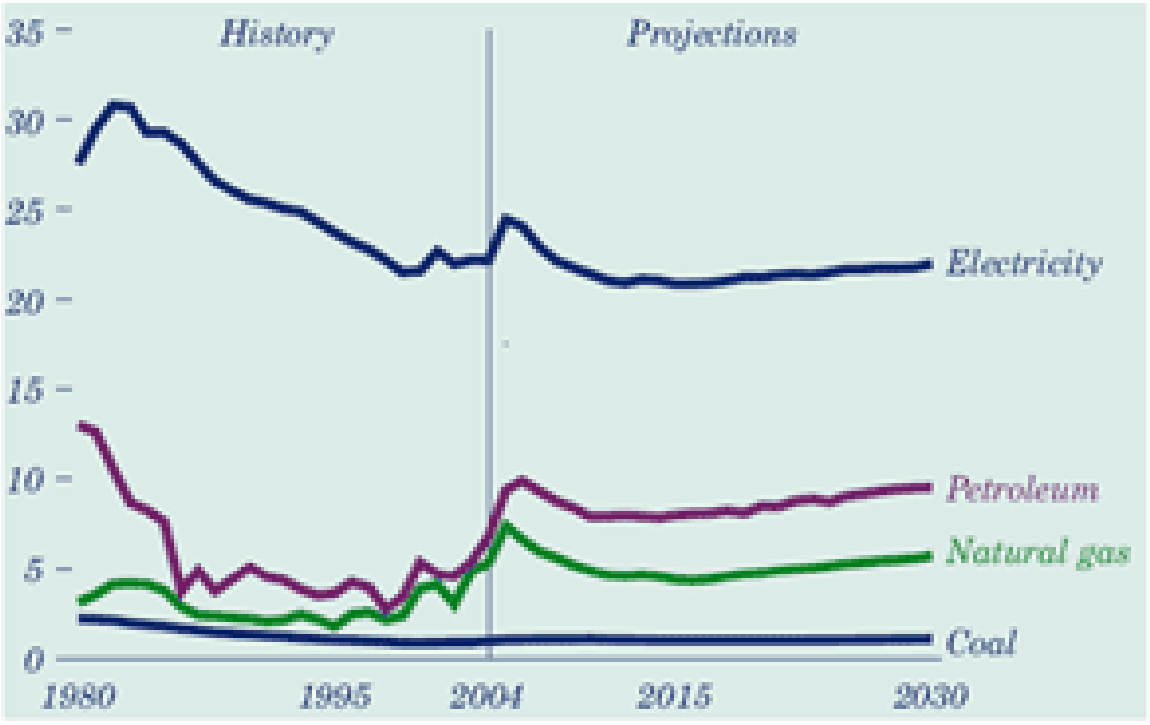
Energy Information Agency (EIA) - Annual Energy Outlook 2006 with Projections to 2030 (Early Release) - Overview

Release date: December 2005

The following graph was released in December 2005 by the EIA and shows electricity prices declining over the next ten years, The associated write-up with this graph states

" Average delivered electricity prices are projected to decline from 7.6 cents per kilowatt-hour (2004 dollars) in 2004 to a low of 7.1 cents per kilowatt-hour in 2015 as a result of declines in natural gas prices and, to a lesser extent, coal prices. After 2015, average real electricity prices are projected to increase, to 7.4 cents per kilowatt-hour in 2025 and 7.5 cents per kilowatt-hour in 2030. In the *AEO2005* reference case, electricity prices were lower in the early years of the projection but reached about the same level in 2025. **The higher near-term electricity prices projected in the *AEO2006* reference case result primarily from higher expected fuel costs for natural-gas- and coal-fired electric power plants**." (Bold added. Prices are national)

Figure 1. Energy prices, 1980-2030 (2004 dollars per million Btu)



E. IMPACT TO RATES

The initial step in assessing the rate impact was to convert the FP-SOS bids into rates. This was accomplished by using the Retail Pricing Model that Delmarva posted on its RFP web site. This model allowed each of the supply-related tariff elements to be determined. It should be noted that for purposes of developing the rates the reasonable allowance for retail margin (RARM) was assumed to be $0.0012.[i] Then, to evaluate the impact of the new rates, Delmarva's billing determinants were needed. In response to a data request from Vantage, Delmarva provided its billing determinants for all of its principal rate categories for the test period April 2004 through March 2005. This is the same test period that Delmarva is utilizing in a pending base rate case. At this time, that rate case has not been resolved. Thus, as a basis for comparison we have calculated the revenues for the principal rate categories under the current tariffs and then re-calculated the revenues that will be generated when the rates from the FP-SOS go into effect on May 1, 2006. To perform these calculations we have relied on the historical billing determinants. The alternative would be to project the billing determinants for May 2006 through April 2007. As a consequence, the percent increases we have calculated are similar to those calculated by others who projected the billing determinants. However, there is considerable variation in the current and proposed revenue calculations for some of the rate classes. For instance, for the Residential rate class we estimate a percentage increase of 56.3% and Delmarva estimates a 57.05% increase. However, because Delmarva projects an approximate 11.3% increase in kwh usage, their revenue estimates exceed those calculated by us. Whereas, for the Residential-Space Heating tariff Delmarva estimates a slight decrease in kwh usage so our estimates and Delmarva's are very similar. The following table provides the results of our calculations.

TARIFF	CURRENT REVENUES $000	PROPOSED REVENUES $000	PERCENT INCREASE %
Residential	$175,556.4	$274,410.9	56.3%
Residential – Space Heating	$ 83,440.6	$136,424.4	63.5%
Residential – Time-of-Use Non-Demand	$ 131.6	$ 211.5	60.7%
Residential – Time-of-Use	$ 3.4	$ 5.2	52.1%
Residential – Time-of-Use Super Off-Peak	$ 1.2	$ 2.0	67.6%
Small General Service – Sec Non-Demand	$ 17,390.5	$ 25,603.7	47.2%
Space Heating Secondary Service	$ 2,562.3	$ 4,321.1	68.6%
Water Heating Secondary Service	$ 63.2	$ 105.2	66.4%
Medium General Service - Secondary	$ 84,735.3	$142,150.6	67.8%
Large General Service - Secondary	$ 35,683.5	$ 71,845.8	101.3%
General Service – Primary	$147,984.3	$322,171.7	117.7%

[i] At the end of 2006 the elements comprising the RARM will be audited and trued-up. The trued-up RARM will be used on a going forward basis.

On average, customers in the various tariff classifications can anticipate an increase in their bill approximating the percentage increases reflected in the right-hand column. However, different usage patterns can affect those percentages. Also, if Delmarva's pending rate case is resolved prior to the FP-SOS rates going into effect, the percentage changes due solely to the FP-SOS bids may be less than reported here.