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ADMINISTRATIVE PROCEEDING
FILE NOS. 3-3640 & 3-3988

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FILED
JUN 26 1974
SECURITIES & EXCHANGE COMMISSION

In the Matter of

DELMARVA POWER & LIGHT COMPANY
DELMARVA POWER & LIGHT COMPANY OF MARYLAND
DELMARVA POWER & LIGHT COMPANY OF VIRGINIA

(59-114 and 31-736)

(Public Utility Holding Company Act of 1935)

INITIAL DECISION

Washington, D.C.
June 26, 1974

Warren E. Blair
Chief Administrative Law Judge

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(Public Utility Holding Company Act of 1935)	:	
	:	

APPEARANCES: David F. Anderson and Richard L. McMahon, of Potter Anderson & Corroon, for Delmarva Power & Light Company, Delmarva Power & Light Company of Maryland, and Delmarva Power & Light Company of Virginia.

Robert W. Ball, for the Delaware Public Service Commission.

Aaron Levy, Grant G. Guthrie, and Sheldon L. Bierman, for the Division of Corporate Regulation of the Commission.

BEFORE: Warren E. Blair, Chief Administrative Law Judge

These proceedings were instituted by an order of the Commission dated April 5, 1972 pursuant to Section 11(b)(1) of the Public Utility Holding Company Act of 1935 ("Act"),[1/] naming Delmarva Power & Light Company ("Delmarva") and its two wholly owned subsidiaries, Delmarva Power & Light Company of Maryland ("Del-Md") and Delmarva Power & Light Company of Virginia ("Del-Va"), as respondents.[2/] Based upon advice received from its Division of Corporate Regulation ("Division") the Commission ordered a hearing to be held for the purpose of considering:

(a) whether the electric utility assets of the Delmarva Power Power & Light Company holding company system constitute a single integrated electric utility system or more than one such system;

(b) whether the gas utility operations of the Delmarva Power & Light Company holding company system constitute a single integrated gas utility system or more than one such system;

(c) the nature, extent and location of the "single integrated public-utility system" of the Delmarva Power & Light Company holding company system;

(d) whether, along with the Delmarva Power & Light Company holding company system's "single integrated public-utility system," any of its additional electric or gas utility systems may be retained under common control under the provisions of Section 11(b)(1) of the Act, specifically Clauses (A), (B), and (C) thereof; and

(e) what action is necessary to be taken by the Delmarva Power & Light Company holding company system to limit the operations of the system to those of a single integrated public-utility system, together with such additional utility systems, and such other businesses, if any, as are retainable under the standards of Section 11(b)(1) of the Act.

Respondents filed a joint answer asserting that they were exempt from the provisions of Section 11(b) of the Act and, alternatively, that (1) their

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1/ Holding Company Act Release No. 17530 (1972), Administrative Proceeding File No. 3-3640.

2/ Collectively, Delmarva, Del-Md, and Del-Va comprise the Delmarva System ("System").

electric, gas, and steam-electric operations constitute one single integrated public utility system, or (2) that respondents' electric and steam-electric operations constitute a single integrated electric utility system which is respondents' primary utility system and that the gas operations of Delmarva constitute a single integrated gas utility system retainable under the provisions of Section 11(b)(1) of the Act.

In addition, Delmarva filed an application pursuant to Section 3(a)(2) of the Act seeking exemption from all of the provisions of the Act except Section 9(a)(2). On November 2, 1972 the Commission ordered a hearing on that application, directing that particular attention be given to the following matters:

> (a) whether Delmarva meets the requirements for an exemption specified in Section 3(a)(2) of the Act;
>
> (b) whether Delmarva should be granted such exemption without first complying with Section 11(b)(1);
>
> (c) whether the granting of any exemption under Section 3(a)(2) should be subject to terms and conditions, including compliance with Section 11(b)(1).

Noting also the existence of common questions of law and fact in the two proceedings, the Commission further ordered that the Section 11(b)(1) proceeding and the proceeding instituted with respect to Delmarva's application under Section 3(a)(2) be consolidated.[3/]

Interested persons desiring to be heard or proposing to intervene in either of the proceedings were given an opportunity to do so. In each of the proceedings the Delaware Public Service Commission ("Delaware PSC") filed its appearance and, under the provisions of Section 19 of the Act and Rule 9(a) of the Rules of Practice, became an intervening party. No other person requested to be heard or sought to intervene as a party to these proceedings.

3/ Holding Company Act Release No. 17748 (1972), Administrative Proceeding File No. 3-3988.

Respondents and the Division appeared and participated in the hearing through counsel. The Delaware PSC also appeared through counsel but limited itself to a brief participation in the hearing.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by the parties, except that the filing by the Division consisted of a brief without an accompanying counterstatement of its proposed findings. The findings herein are based upon the record and upon observation of the witnesses.

Applicant-Respondents

Delmarva (formerly Delaware Power & Light Company), a Delaware corporation with its principal offices in Delaware, is engaged in electric, gas, and steam-electric operations in Delaware. Delmarva is also a holding company registered as such under Section 5 of the Act with one of its two wholly-owned subsidiaries, Del-Md, engaging exclusively in the generation, transmission, and distribution of electricity within the State of Maryland, and the other, Del-Va, engaged exclusively in the same type of operation in the State of Virginia. In all respects other than incorporation, the System is owned, financed, and operated as a single enterprise.

The electric utility operations of Delmarva in Delaware are conducted through northern and southern divisions, the dividing boundary being the New Castle-Kent County Line, and gas is distributed by the company in northern New Castle County, the most northern of the three Delaware counties. Incidental to its electric and gas business, Delmarva also supplies electricity

and steam to a Tidewater Oil Company refinery located in Delaware City, Delaware.[4/] Additionally, Delmarva is a joint owner of electric generation and transmission facilities in Pennsylvania and New Jersey and has qualified to do business in those States.

Delmarva owns all of the debt securities as well as the stock of its subsidiaries, and its own common and preferred stocks are held by members of the general public with no dominant holders. Financial requirements of Del-Md and Del-Va are met by the sale of additional common stock and notes by those subsidiaries to Delmarva.

The management of Delmarva has responsibility over all of the System's operations and exercises its control through two divisions. Electric, gas, and refinery service north of the New Castle-Kent County Line, together with the New Jersey and Pennsylvania facilities, are managed from Wilmington, Delaware, and everything south of that line, which includes the electric operations in Maryland and Virginia and the two southernmost counties of Delaware, is administered from a regional office in Salisbury, Maryland.

The electric service area of the System, located in the Delmarva Peninsula, covers approximately 5,700 square miles and has an estimated population of over 800,000. The System's gas operations are conducted only by Delmarva and are limited to New Castle County in Delaware which has a population of 382,000 in an area of about 275 square miles.

On a consolidated basis the System's gross utility plant was $732,809,739 as of December 31, 1972 and gross revenues for the calendar year 1972 amounted to $131,340,040 from electric service, $20,818,871 from gas utility

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4/ The facilities and operations relating to the refinery service are accounted for as a separate business by Delmarva; profit from that operation is shown separately on Delmarva's statements, and no allocation of that profit is made to gas or electric business on Delmarva's books.

service, and $6,685,064 from service to the refinery. As of the end of 1972 the System was serving approximately 227,000 electric and 74,500 gas customers.

The electric and gas utility operations of Delmarva are subject to the jurisdiction of the Delaware PSC, and Del-Md and Del-Va are subject to regulation by the public utility regulatory authorities in their respective states. Delmarva's wholesale electric and interconnection agreements come under the jurisdiction of the Federal Power Commission.[5/]

Section 3(a)(2)

Under Section 3(a) of the Act the Commission is empowered to exempt any of five specified types of holding companies from any or all of the provisions of the Act, and is directed to grant such exemption "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers. . . ." Section 3(a)(2), under which Delmarva seeks to obtain exemption from all provisions of the Act except Section 9(a)(2), authorizes an exemption if:

> . . . such holding company is predominantly a public-utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto. . . .

While it appears from the record that Delmarva is a holding company meeting the description in Section 3(a)(2), the standards of the "unless and except" clause of Section 3(a) require consideration of the need for divestiture of the Delmarva gas properties.

Since Delmarva's operations as an operating public utility company are confined to Delaware, where it is incorporated, and to the contiguous

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5/ Delmarva's electric operations are interconnected and are in electromagnetic synchronization as part of the Pennsylvania-New-Jersey-Maryland ("PJM") power pool.

States of Pennsylvania and New Jersey, the initial question is whether, within the meaning of Section 3(a)(2), Delmarva is predominantly a public-utility company. The Division contends that Delmarva is neither a "public-utility company," as that term is defined by the Act, nor "predominantly" such a company.

As to the first contention, the Division argues that a "public-utility company" as defined by Section 2(a)(5) of the Act[6/] is either an electric company or a gas company but not both, as is the case with Delmarva, and urges that a liberal interpretation be adopted because exemptions should be narrowly applied and because the suggested construction is consistent with the policy of the Act. If this were a case of first impression there would be merit in the approach adopted by the Division, but is is not and is therefore rejected. As the Division candidly admits, the Commission has in a number of cases in the past regarded a combination gas and electric company as a public-utility company for purposes of Section 3(a)(2).[7/] While it may be argued, as the Division does, that the question now being raised has not been expressly considered before, the Commission leaves little doubt by its language in the Northern States Power matter that the definition of "public-utility company" under Section 2(a)(5) should be construed as including one with combined electric and gas operations.[8/] Although the

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6/ As set forth in the Act, the definition reads:

Section 2(a) When used in this title, unless the context otherwise requires --

. . . .

(5) "Public-utility company" means an electric utility company or a gas utility company.

7/ See, e.g., Union Electric Co., 40 S.E.C. 1072 (1962); Northern States Power Company, 36 S.E.C. 1 (1954).

8/ Id. at 7-8.

Commission's references therein to other cases in which it had granted Section 3(a)(1) and 3(a)(2) exemptions to combined companies and its conclusion that "the mere existence of the combined gas and electric operations does not of itself require denial of an exemption," were in the context of its consideration of the impact that the standards of Section 11(b)(1) had upon the "unless and except" clause of Section 3(a), it cannot be supposed that the Commission either ignored or overlooked the Act's definition of a public-utility company in reaching its decision in Northern States Power or in deciding the earlier cases cited therein.

With respect to the question of whether Delmarva is "predominantly" a public-utility company, the Division argues that Delmarva does not meet the criteria established for the purpose of determining if a company falls within the meaning of that term. The position taken by the Division in this regard is not supported by the record.

In the absence of a specific standard or test being prescribed in the Act for measuring the breadth of the word "predominantly," it has been interpreted by the Commission in the light of the ordinary meaning of the word "predominant,"[9/] with a number of factors existing in the relationship of the parent and its subsidiaries being used to determine the availability of the exemption. In comparing the utility operations of the holding company with those of its utility subsidiaries, the most significance has generally been given to gross revenues.[10/]

9/ Northern States Power Company, supra, at 4.

10/ Id.

Table I below, based upon data in the record, [11/] compares Delmarva's utility operations with those of its subsidiaries as of June 30, 1972 or for the twelve months ending that date:

TABLE I

	Delmarva and Refinery	Subsidiaries	Percent of Subsidiaries to Delmarva
Gross utility operating revenues*	$114,254,574	$ 29,452,420	25.78
Net utility operating revenues*#	28,117,909	4,543,880	16.16
Sales of electricity - MKwh*	4,646,844	1,361,806	29.31
Sales of gas-MCF	15,884,350	--	--
Gross utility plant (original cost)	$556,886,926	$129,939,421	23.33
Net utility plant (original cost)	$445,299,194	$ 99,528,839	22.35
Average number of electric customers	150,342	70,103	46.63
Average number of gas customers	74,123	--	--

*/ After elimination of intercompany transactions.
#/ Before Federal and State income taxes.

11/ Applicant-Respondent Exhibit I-10.

The gross operating revenue ratio of 25.78% is less than the 27% ratio that the Commission found acceptable in granting an exemption under Section 3(a)(2) to the Wisconsin Electric Power Company and its subsidiary companies. Further, it appears that all of the other tabulated operations ratios are less than those found in the Wisconsin Electric Power[12/] case except with respect to sales of electricity and average number of electric customers. Those exceptions are not sufficient reason under all the circumstances, including the fact that Delmarva generated 91.7% of the approximately six billion kilowatt-hours of electricity generated in the System in 1971 and the importance attributed to the gross revenue ratio, for concluding that Delmarva is not "predominantly" a public-utility company within the meaning of Section 3(a)(2).

The Division's view that the appropriate statistical comparisons between Delmarva and its subsidiaries cannot include the results of Delmarva's gas operations is based upon its conviction that Delmarva "must meet the test of predominance prescribed by subparagraph (2) of Section 3(a) unaided by a dispensation to comply with Section 11(b)(1)."[13/] The argument made is that exemptions are not alternates or substitutes for Section 11(b)(1)[14/] compliance.

While it is true, as the Division states, that the Commission has not said it will not require a registered holding company to comply with Section

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12/ Wisconsin Electric Power Company, Holding Company Act Release No. 12855 (1955).

13/ Division's Brief at 77-78.

14/ Section 11(b)(1) of the Act requires that each registered holding company system be limited to "a single integrated public-utility system," and such additional public utility systems as are found by the Commission to meet the standards of Clauses A, B and C thereof.

11(b)(1) in order to enable that company to obtain a Section 3(a)(2) exemption to which it would otherwise not be entitled, the Commission did deem it appropriate to dismiss a pending Section 11(b)(1) proceeding with respect to Wisconsin Electric Power Company after determining to grant that company's application for a Section 3(a)(2) exemption [15/] for it and each of its subsidiaries. In view of the fact that the filing of the application was subsequent to the institution of the Section 11(b)(1) proceedings and that those proceedings were dismissed without a determination whether the Wisconsin Electric Power system, which included gas and electric as well as non-utility operations, was in conformity with the standards of Section 11(b)(1), the granting of a Section 3(a)(2) exemption to the Wisconsin Power Electric Company and its subsidiaries must be taken to mean that the availability of a Section 3(a)(2) exemption is to be considered independent of whether the operations of an applicant for exemption should be limited pursuant to Section 11(b)(1). It follows therefore that Delmarva's gas operations as well as its other business are to be taken into account in making comparisons with the operations of its subsidiaries.

The Division also takes exception to Delmarva's relying upon its corporate ownership of 91.7% of the System's power production as a consideration in determining "predominance," and contends that the 46.63% ratio between the electric customers of Delmarva and those of its subsidiaries most accurately measures the importance of Delmarva as a holding company under the Act. The

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15/ Wisconsin Electric Power Company, Holding Company Act Release Nos. 12855 and 12917 (1955). See also Northern States Power Company, supra, in which hearings on a Section 3(a)(2) exemption application were initially consolidated with those in an earlier instituted Section 11(b)(1) proceeding directed to Northern States, and where thereafter the exemption proceedings were separated for disposition prior to the close of hearings on the Section 11(b)(1) matter and a Section 3(a)(2) exemption granted.

fact that Delmarva has that 91.7% ownership does not, in and of itself, weigh the scales in favor of Delmarva, but there is no question that such power generation is a part of Delmarva's over-all operation. As such there is no reason to exclude the fact of that operation from consideration even though appropriately the intercompany sales of that production are not taken into account. The 46.63% ratio of electric customers that the Division highlights does indeed raise a question of the relative status of Delmarva as an operating company vis-a-vis its position as a holding company. The most significant factor, however, is the gross revenues ratio,[16] and that ratio militates against a finding that Delmarva is primarily a holding company.

Turning to the "unless and except" clause of Section 3(a), it is Delmarva's position that the Division has not shown that the combined operations of Delmarva are detrimental to the public interest. The arguments in support of that position are not entirely persuasive, and contrary to Delmarva's assertion that the System has achieved the goals of the Act, it is concluded that the record raises a question, but is inadequate for the purpose of determining, whether the retention of the gas properties is inimical to the public interest.

As has been noted, the Commission in its early years granted exemptions under Section 3(a) where doing so enabled a holding company to retain gas and electric utility operations under common ownership or control. But more recently the Commission, with the guidance of the Supreme Court's

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16/ Id.

decision in the NEES case,[17/] has given further consideration to the impact that the anti-competitive aspects of combined gas and electric operations has upon the public interest or the interest of consumers. In Illinois Power Company,[18/] which is applicable here, the electric and gas utility company applicant had a Section 3(a)(1) exemption, and sought approval of a proposed acquisition of the outstanding common stock of Central Illinois Public Service Company, another exempt holding company having combined electric and gas operations. In denying continuation of Illinois Power's Section 3(a)(1) exemption unless provision was made for divestment of the gas properties, the Commission stated:

> The Supreme Court's emphasis [in the NEES case] on competition between gas and electric operations is in our opinion highly pertinent in determining under the "unless and except clause of Section 3(a) whether a Section 3(a)(1) exemption would not be detrimental to the public interest or the interest of consumers . . . . We have in the past pointed out that it is "highly unrealistic" to expect "vital competition" between the two types of service when controlled by the same interest.
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> [Citing The North American Company, 18 S.E.C. 611, 621 (1945). 32 S.E.C. 169, 179-80 (1950).]

It is clear therefore that Commission pronouncements and interpretations regarding the "unless and except" clause of Section 3(a) which preceded the Illinois Power decision must be modified to accommodate the added emphasis that the Supreme Court and the Commission have placed upon encouragement of true competition by separation of gas and electric businesses. This

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17/ New England Electric System, 41 S.E.C. 888 (1964), affm'd initially, SEC v. New England Electric System, 384 U.S. 176 (1966), rev'g 346 F.2d 399 (1st Cir. 1965), again affm'd, SEC v. New England Electric System, 390 U.S. 207 (1968), rev'g 376 F.2d 107 (1st Cir. 1967).

18/ Holding Company Act Release No. 16574 (1970).

is not to suggest that the Illinois Power case is to be construed as mandating the elimination of combined gas and electric operations in every case and under all circumstances before a Section 3(a) exemption may be granted, but it unquestionably directs that the policy of favoring competition between gas and electric businesses be treated as the foremost of the considerations coming into play in determining whether a Section 3(a) exemption would be detrimental to the public interest or the interest of consumers.[19/]

While there is not here, as there was in the Illinois Power case, an issue of whether to permit a consolidation of combined operations, an issue is present similar to that in Illinois Power of whether to permit enlargement of combined operations. Delmarva, which until April 20, 1966 had the name Delaware Power & Light Company, is the survivor of a merger that took place in October, 1943 with Eastern Shore Public Service Company pursuant to an order of this Commission dated October 14, 1943. As of December 31, 1944 Delmarva's property, plant and equipment on a consolidated basis was $43,520,918 and its own operating plant totaled $30,770,518. Gross revenues on a consolidated basis were $12,703,671 with $10,551,145 attributable to electric operations, $1,823,985 to gas, and $328,541 to the ice and refrigeration service which Delmarva sold in Delaware. The electric and gas revenues were derived from sales of 501,398 MKwh of electricity and 2,065,992 MCF of gas to customers who respectively numbered 94,984 and 41,874 at the end of that year.[20/]

19/ Cf. Union Electric Company, Holding Company Act Release No. 18368, 11-14 (1974).

20/ Statistics for year 1944 taken from Moody's = Public Utilities, 1949, 1264-67.

Table II below indicates the growth of the Delmarva System between 1944 and 1972:

TABLE II

For the Year Ending December 31

	1972 21/	% of Total	1944	% of Total	% Increase Since 1944
Operating Revenues:					
Electric	$ 131,340,040	82.7	$10,551,145	83.2	1144%
Gas	20,818,871	13.1	1,823,985	14.6	1041%
Refinery	6,685,064	4.2	--	--	--
Ice & Refrigeration	--	--	328,541	2.2	--
Total	$ 158,843,975	100.0	$12,703,671	100.0	1150%
Sales of Electricity - MKwh	6,240,562		501,398		1145%
Sales of Gas - MCF	16,461,557		2,065,992		697%
Customers - as at Dec. 31					
Electric	227,816		94,984		140%
Gas	74,515		41,874		78%

21/ Moody's Public Utility Manual, 1973, at 1244-48.

Delmarva is no longer the small utility system it was in 1944. It has enjoyed growth in plant, sales, and revenues with the increased industrial, commercial and residential growth in its service area. But it appears that the growth in Delmarva's gas operations has not kept pace with its electric business either in the percentage increases in operating revenues, sales, or numbers or customers. Such disparity in those areas may well be attributable to the fact that Delmarva takes the position that its gas and electric operations are not two but a single business and that no favoritism is shown toward either operation. Under such policy, it is clear that the "vital competition" sought-for under the Act could not have occurred during the past years and cannot be expected in the future.[22/] Further, the record reflects that despite its refusal to accept new gas customers since 1970 and the curtailment of gas service ordered by the Delaware PSC in 1971 and continued in 1972, Delmarva anticipates substantial growth during the next 10 years, with a slower rate of growth forecast for gas than for its electric operations. Under the circumstances, if the public interest or the interest of consumers requires competition to be encouraged between energy sources available in Delmarva's service area, it would not be consonant with the purposes of the Act to grant a Section 3(a)(2) exemption to Delmarva unless granting of the exemption were conditioned upon divestment of Delmarva's gas properties.

Of course, one of the consequences of a divestiture of Delmarva's gas business would be to increase the relative size of the subsidiaries in

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22/ Cf. Union Electric Company, Holding Company Act Release No. 18368, at 20 (1974).

comparison to Delmarva. Using data available as of June 30, 1972 or for the twelve months ending that date, a comparison of Delmarva's operations absent gas with the operations of its subsidiaries is shown in Table III below:

TABLE III

	Delmarva and Refinery	Subsidiaries	Percent of Subsidiaries to Delmarva and refinery
Gross utility operating revenues*	$ 94,515,500	$29,452,420	31.16
Net utility operating revenues*#	$ 24,202,746	$ 4,543,880	18.77
Sales of electricity - MKwh*	4,646,844	1,361,806	29.31
Gross utility plant (original cost)	$ 503,346,133	$129,939,421	25.82
Net utility plant (original cost)	$ 403,165,524	$ 99,528,839	24.69
Average number of electric customers	150,342	70,103	46.63

*/ After elimination of intercompany transactions.
#/ Before Federal and State income taxes.

The gross operating revenue ratio of 31.16% which would exist without Delmarva's gas operations is higher than that in any other case excepting Connecticut Yankee Atomic Power Company 23/ where the corresponding ratio was 35.3%. At the same time it is considerably below the 35.9%, 24/ the lowest of the gross operating revenue ratios found in cases where a Section 3(a)(2) exemption was denied. Connecticut Yankee cannot be taken as precedent for raising the upper limit of acceptable ratios to 35.3% or less, but it does demonstrate the flexibility of the upper limit of the gross operating ratio, at least to the extent that such ratio does not equal or exceed the 35.9% in Union Electric. 25/ As noted earlier, Delmarva's ownership of 91.7% of the System's power production of over 6 billion Kwh in 1971 is a consideration to take into account in comparing the relative size of Delmarva and its subsidiaries. That ownership plus the planned nuclear generating stations that are to be added during the next ten years which will double Delmarva's capacity and utility plant diminishes the impact of the 31.16% gross revenue ratio to the point where under all the circumstances it may be concluded that even without its gas operations Delmarva will continue to be predominately a public utility company.

On the issue of competition between the gas and electric operations, Delmarva, supported by the Delaware PSC, argues that each of the segregated gas and electric marketing departments "was charged with the duty to present to all potential users the relative virtues and cost of each form of energy," that "[n]ew users received a proposal from each until the gas shortage restricted new gas customers," and that "[t]he results of this competitive

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23/ 41 S.E.C. 705, 712.

24/ Union Electric Company, 5 S.E.C. 252 (1939).

25/ Id.

marketing approach are those which the Act seeks."[26/] While the marketing philosophy adopted by Delmarva may have something to commend it from the standpoint of ensuring that neither of the services is favored, it cannot be deemed "competitive marketing." As indicated by the Illinois Power and recent Union Electric decisions, the competition envisaged by the Act is the aggressive rivalry ordinarily found between independent companies offering competing sources of energy, not the passive, informational "soft-sell" that Delmarva has elected to follow in presenting its gas and electric services to potential customers.

Additionally, it appears from the record that Delmarva's market penetration in 1970 for gas use in house and water heating and cooking in the Wilmington, Delaware area was considerably smaller than that enjoyed by neighboring utilities in comparable service areas,[27/] indicating that Delmarva has not been aggressive in past years in promoting or expanding its gas service. A further area in which Delmarva appears not to have maximized the potential of its gas operations has been the extent of its continued use of gas for its electric generation, a practice which results in crediting the gas department with lesser revenues than if that gas were made available for sale at the higher rates charged gas customers receiving gas on a firm basis. Moreover, Delmarva favors its electric operation over customers on interruptible gas service by cutting off those customers when interruptible gas is unavailable, but continuing to supply gas from winter storage for use of its electric turbine units. In effect, that procedure assures that Delmarva's electric business receives gas on a firm basis without the gas business receiving fair compensation for that type of service. As the Division has noted, if gas now

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26/ Applicant-Respondents' Brief, July 27, 1973, at 47.

27/ Div. Ex. Nos. 21 and 23.

sent to the turbines were routed to firm sales and more of the gas presently consumed as boiler fuel in generating electricity were stored for winter sales to firm customers, gas revenues would be considerably enhanced. Delmarva's response that gas used for electric generation is by definition excess gas for which other customers cannot be found fails to answer the question of why storage facilities were not obtained for the purpose of saving its otherwise excess gas for higher uses. According to the Vice President for Gas Operations, that gas could have been stored "if there was a place to store it." 28/

But the further suggestion of Delmarva that the NEES and Illinois Power cases are not controlling here because neither had the "energy crisis" as a factor to consider raises the same issue that caused the Commission to reserve jurisdiction over the retainability of gas properties in the recent Union Electric Company matter. 29/ There the Commission, in considering the impact of its earlier decision in Illinois Power, stated:

> That [Illinois Power] decision rested, of course, on the premise that separation fosters vigorous competition between gas and electricity. That such competition is good for consumers and in the public interest was deemed axiomatic. We are now told that the so-called energy crisis makes this reasoning untenable. We cannot now determine, upon this record, whether and to what extent this is so. But it is apparent that the energy crisis has assumed dimensions, and has evoked a response from the public and from government at all levels, which did not exist and was not readily foreseeable four years ago when the Illinois Power case was decided, or in September 1972, when the administrative law judge issued his initial decision in this case or even in March 1973 when we heard oral argument. Neither limits on our powers, nor the proper discharge of our responsibilities, permit us to now dispose of this case upon the assumption that none of these developments have occurred or that they are irrelevant. We may read the broad and flexi-

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28/ Tr. 901.

29/ Holding Company Act Release No. 18368 (1974).

> ble language of Section 3(a)'s "unless and except" clause in a way that makes economic and social sense in the light of contemporary realities.
>
> The Act is replete with references to the interests of consumers and to the public interest. Up to now we have considered those interests best served by promoting the "wider . . . use of gas and electric energy." By fostering "variegated competition" between gas and electricity and the attendant promotion of the use of each, we moved toward that end. Valid and constructive though it was in its day, that approach may now be outmoded. In an era confronted by an energy crisis the maximization of energy use seems a questionable public policy objective. In today's world the public interest and the longrun consumer interest seem to call for prudent conservation and rational allocation. [Footnotes omitted]. 30/

Although expressed in a Section 10(c) acquisition context, those views seem equally apropos in determining whether separation of Delmarva's gas and electric operations should be mandated under the "unless and except" clause of Section 3(a) before granting an exemption from the Act's provisions.

The Division, however, does not view the "energy crisis" as a reason to permit Delmarva to continue its combined operations and submits a forceful and detailed argument in support of its position. It correctly points out that the shortage of gas supply does not destroy the viability of Delmarva's gas business, and asserts that the future situation of Delmarva's gas supply and gas revenue is promising. 31/

While conceding that the evidence in the record regarding the supply of gas indicates that the future supply is uncertain, the Division refers

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30/ Id. at 23.

31/ In January, 1973 Delmarva forecast that its gas sales in 1981 would be 40% greater than the amount actually sold in 1972, estimating that 23,143 MMCF of gas would be sold in 1981, up 6,681 MMCF over the 16,462 MMCF sold in 1972, and that gas operating revenue would increase 131% from $20,819,000 in 1972 to $48,159,000 in 1981 (Div. Ex. 7, at 2).

to evidence that the needed quantities of gas are in the ground. It further refers to the various ways in which skillful management of gas storage would provide reliable service to the public, meet increased firm gas demand, and minimize costs to the utility. Mention is also made of the various alternatives to the curtailed pipeline gas supplies, including participation in exploration and development of producing properties, and the purchase or production of synthetic natural gas and liquified natural gas.

Additionally the Division takes exception to the testimony of R. Bruce Foster, the expert witness on nationwide gas supply presented by Delmarva, asserting that Mr. Foster, a planning analyst with the Institute for Gas Technology, an industrial research institute for the gas industry, erroneously accepted the estimates of proven and unproven gas reserves published by the Potential Gas Committee, an industry organization. The validity of any estimate of gas reserves must, in the Division's opinion, be reviewed in the light of the wide variations in published estimates of those reserves as reflected by the fact that a recent U.S. Geological Survey estimate of gas reserves was over five times as large as that reached by the Potential Gas Committee.[32/] Also questioned was the reliability of Mr. Foster's estimates of "proven" and "contracted for" reserves which he based upon data of the American Gas Association ("AGA"). These were deemed suspect by the Division because of the unverified nature of the AGA figures, the differences between AGA reports and the larger dedicated reserves under contract to interstate

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32/ Div. Ex. 154, at 3.

pipelines as reported to the Federal Power Commission, and the fact that some proven reserves are not being exploited. Another facet of the Division's argument is bottomed on the premise that regardless of the national situation, the record is void of any evidence demonstrating the impact of that shortage upon Delmarva or upon Transcontinental Gas Pipeline Company, the source of Delmarva's natural gas.

The weakness of the Division's position in regard to the "energy crisis" lies in its reliance upon the record proof that a separated company would be able to obtain sufficient gas to survive and upon the absence of evidence that a natural gas shortage exists, definite in amount, extent or duration. Overlooked, however, is the fact that the record does not establish that either at the present time or in the foreseeable future "the public interest and the long-run consumer interest" would be served by the competition that would be engendered by a divestiture of Delmarva's gas properties. The Delaware PSC, pointing to its gas curtailment order, insists that the opposite is true, that a divestment of the gas properties would not result in greater competition and would not be in the public interest or in the interest of Delmarva consumers. Delmarva agrees with the Delaware PSC.

The problem clearly resolves itself into one identical to that which confronted the Commission in the last cited Union Electric Company decision where because the dimensions of the energy crisis were not established in the record, a determination of whether gas properties should be divested as a condition of granting the application there in question could not be made. Inasmuch as the energy situation has not clarified in the brief period that

has elapsed since April 10, 1974, the date of the last Union Electric Company decision, it appears meet to adopt the same approach here that the Commission viewed desirable then by granting the Section 3(a)(2) exemption, but reserving jurisdiction to pass upon the retainability of Delmarva's gas properties at some appropriate future time.

Divestiture under Rule 11(b)(1)

Under Section 11(b)(1) of the Act a holding company system is required to be limited to "a single integrated public-utility system" together with such additional systems as meet the standards of the (A), (B), and (C) clauses of that section.[33/]

Delmarva urges that the Commission abandon its long-established position that a combined gas and electric system can not constitute "a single integrated public-utility system," and find that the gas and electric properties of the Delmarva System together are a single integrated public-utility system. The only argument advanced for seeking that radical departure from precedent is the view that changed energy circumstances require energy sources to be coordinated.[34/] But the circumstance of a

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33/ Clauses A, B,and C provide for retention of one or more additional public-utility systems if the Commission finds:

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

34/ Delmarva cites the 1972 Report of the Ad Hoc Committee on Non-Utility Investments, National Association of Regulatory Utility Commissioners (Delaware Exhibit B).

changed energy picture, especially one that has not yet stabilized, cannot afford a basis for casting aside a rule predicated upon carefully reasoned interpretation of unchanged statutory language. 35/ It is therefore concluded that the combined gas and electric properties of the Delmarva system cannot be considered "a single integrated public-utility system." Since the System's electric properties, which form an integrated electric utility system within the meaning of Section 2(a)(29)(A) of the Act, 36/ have been designated as its principal system, it follows that Delmarva cannot without the requested Section 3(a)(2) exemption retain its gas properties, which constitute a single integrated gas utility system within the meaning of Section 2(a)(29)(B), 37/ unless the standards in the conjunctive "ABC" clauses of Section 11(b)(1) are met.

The gas properties of Delmarva being located entirely within the State of Delaware, the geographical limitations imposed by Clause B are clearly satisfied. Further, those properties, concentrated as they are

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35/ For the rationale underlying the conclusion that a "single integrated system" within the meaning of Section 11(b)(1) may not include a combination of gas and electric properties, see: Union Electric Company, Holding Company Act Release No. 18368, at 10 (1974); The United Gas Improvement Company, 9 S.E.C. 52, 77-83 (1941); Columbia Gas & Electric Corp., 8 S.E.C. 443, 462 (1941).

36/ As defined by Section 2(a)(29)(A) an integrated electric utility system is:

> . . . a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation . . .

37/ Section 2(a)(29)(B) defines an integrated gas utility (continued)

in the northern portion of Delaware's New Castle County, are not of such size as to raise issues under Clause C.[38/] However, the record does not establish that Delmarva's gas system cannot be operated as an independent system without the loss of substantial economies. The requisite findings under Clause A therefore cannot be made.[39/]

For proof that an independent gas system would be unable to operate the Delmarva gas properties without loss of substantial economies, Delmarva elected to rely primarily upon a study made by Earl Krapf, one of its employees, to establish the extent of the loss to be anticipated from independent operations. Additionally, Delmarva and the Delaware PSC contend that substantially greater annual financing costs, as testified to by their witnesses, are to be anticipated in an independent gas operation and those costs must also be taken into consideration in determining the probable economic loss.

Krapf's study indicates that the loss of economies in operation

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37/ (Continued)
system as follows:

> As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: Provided, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

38/ Cf. Cities Service Power & Light Company, 14 S.E.C. 28, 61-62 n. 56 (1943).

39/ Contrary to Delmarva's assertion that the Division has the burden "to prove that Delmarva's utility system must be separated to meet the requirements of Section 11," the burden of proof with respect to the satisfaction of the standards of the "ABC" clauses rests upon Delmarva and it must by "clear and convincing evidence" meet the burden of demonstrating that substantial economies would be lost were retention of the gas system not permitted. Union Electric Company, Holding Company Act Release No. 18368, at 11 (1974); Philadelphia Company, 28 S.E.C. 35, 53 (1948); American Gas and Electric Company, 21 S.E.C. 575, 596 (1945).

that would have eventuated for the year 1971 had a separate company operated Delmarva's gas properties would amount to $1,528,137, and were the projected additional financing costs of $1,525,000 for the independent company included, the economic loss would climb to $3,053,137. Translated into percentages of actual results of Delmarva's 1971 gas operations, the economic loss forecast by Delmarva and Delaware PSC is the equivalent of 15.8% of gas operating revenues, 21.2% of gas operating revenue deductions before Federal Income Taxes, and 62.4% of net operating revenues before Federal Income Taxes.

Delmarva and the Delaware PSC argue that these loss ratios far exceed those found by the Commission in other cases to be insufficient to indicate a substantial loss of economies, 40/ and emphasize the approval that the Supreme Court has given to the Commission's use of such ratios in the exercise of administrative discretion. 41/ But as noted by the Supreme Court, the loss ratios serve as a "guide," and are not the only considerations in determining whether loss of substantial economies has been established. 42/ As the Commission has held, there are compensating advantages flowing from a segregation of gas and electric businesses and a "showing of increased operational expense is not in and of itself determinative and cannot be regarded as conclusive proof of a 'loss of economies' in the amount of the increased expense." 43/

40/ New England Electric System, 41 S.E.C. 888, 905 (1964).

41/ SEC v. New England Electric System, 390 U.S. 207, 216 (1968).

42/ Philadelphia Company, supra, at 48.

43/ Id. See also Union Electric Company, supra, note 39, where the Commission states that "the 'loss of substantial economies' issue involved much more than mere bookkeeping and that arithmetical computations standing alone were never enough to resolve it."

Here there is no need to undertake the delicate balancing of the advantages to be gained from segregation against the increased costs that are asserted by Delmarva and the Delaware PSC. Consideration of the record makes obvious the fact that the evidence submitted in support of the claimed additional expenses to be incurred by a divestiture of the gas properties is not sufficient to establish the validity of those figures. This is true not only with respect to the operational expenses but also as to the assumed additional financing costs.

At the outset it may be noted that Krapf did not undertake his study without knowledge of his employer's opposition to the divestiture of its gas properties. He learned of that position at a meeting held in July, 1972 at which officers of Delmarva discussed the Commission's order instituting these Section 11(b)(1) proceedings. There was no explicit direction given to Krapf to undertake the loss of economy study which the group deemed necessary as part of Delmarva's preparation nor apparently any consideration given to whether he was qualified to undertake such a study.[44/] In fact, Krapf had never previously prepared a study designed to determine efficiencies of operations of a utility company or diseconomies arising from a severance of the electric and gas businesses of a combination company. His experience in the field of electric and gas utilities has been limited to his 17 years of employment with Delmarva where he now has the position of Research Engineer with duties mostly based on the correlation,

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44/ When asked why he was chosen to make the study, Krapf replied: "Basically because it is the kind of thing that our little office does-- anything to do with statistics seems to fall our way." Tr. 1421.

interpretation and extrapolation of the statistics of gas and electric utility operations. None of this is to suggest that Krapf's study is not to be considered in determining the "loss of economies" issue, but by choosing to rely upon an employee whose first loyalty is to his company and to its management's objectives and who is without experience in the area covered by his study, Delmarva has chosen to materially weaken the probative value of its evidence. Delmarva's insistence that the Philadelphia Company [45/] and the NEES [46/] cases should be taken as holding that an independent loss of economies study by an outside expert can never be accepted reads too much into those cases. They stand for no more than that the acceptability of a study depends upon a number of factors including the qualifications of the person undertaking the study and his methodology and familiarity with the details in his report.

Krapf's approach to the study here in question can at best be characterized as simplistic, one in which he used little of his own judgment and had implicit faith in the objectivity of various office and department managers with whom he consulted. Basically the study was an arithmetical exercise dependent for reliability in its result upon the reliability of the projected increased personnel requirements. As pointed out by the Divison, "[s]imple arithmetic transformed the number of people into costs of salaries and fringe benefits and, through an assumption as to the number of square feet required per person, into costs for rent, maintenance, etc." [47/]

45/ 28 S.E.C. 35 (1948).

46/ 41 S.E.C. 888 (1964).

47/ Division's Brief at 18 (December 4, 1973).

The single largest increase projected by Krapf was in payroll cost for the separated gas company and, as testified by Krapf, special attention was given to isolating the direct payroll charges that would be experienced by the separated companies. A summary of Krapf's conclusions with respect to the existing gas payroll and that of an independent gas operation are reflected in Table IV below.

TABLE IV

	Employees			Payroll Costs		
		Proposed		Average	Gas Operation	
	Present	Electric	Gas	Wage	Present	Proposed
General Accounting	40	36	19	$ 9,985	$ 107,838	$ 189,715
Systems & Data Processing	28	25	15	9,343	96,789	140,145
Customer Accounting	111	95	64	7,993	328,290	511,579
Merchandise Sales	17	11	7	10,333	57,968	72,331
Advertising and Public Relations	7	7	5	10,637	21,594	53,185
Marketing	38	27	12	11,405	125,684	136,861
Service	129	39	97	11,668	1,083,748	1,131,796
Purchasing & Stores	33	28	10	10,613	59,541	106,130
Garage	28	21	17	10,743	117,309	182,631
Meter	52	50	3	11,411	29,668	34,233
Building Maintenance	33	33	10	8,352	74,419	83,520
Safety and Rights-of-way & Claims	9	7	5	11,801	28,676	59,005
Underground Residential Distribution	11	9	5	10,162	41,361	50,810
Executive, Treasury, Research & Personnel	42	38	19	18,891	214,220	358,929
	578	426	288		$2,387,105	$3,110,370

In addition to the $723,765 increase shown in Table IV, Krapf estimated increases in employee-related expenses for the separate gas company as set forth in Table V below.

TABLE V
Gas Operations

	Present	Separate Company	Increase for Separate Gas Company
Pensions	$ 404,393	$475,267	$ 70,874
Employee Benefits	213,806	251,278	37,472
Employee Taxes	107,406	126,230	18,824
Office Rent	-	145,950	145,950
Building Operations & Maintenance	52,602	59,039	6,437
Property Insurance	8,607	20,800	12,193
Depreciation*	22,258	92,040	69,782
Telephone	26,187	34,800	8,613
Transportation (Vehicles)	165,899	245,315	79,416
	$1,001,158	$1,450,719	$449,561

*Depreciation on proposed new construction of building for operating offices and of a garage plus depreciation on proposed additional vehicles, garage equipment, and office furniture.

Krapf's conclusion that a separated gas company would require 288 employees at the increased cost in payroll and employee-related expenses of $1,173,326 as shown in Tables IV and V was predicated upon what he deemed a quality of operations not higher than the level of actual 1971 operations. However, no study of the operations of similarly sized independent gas distribution companies which would have served as a gauge against which Delmarva's gas operations could be measured was undertaken, 48/ and Krapf assumed that the gas properties would be operated independently in the "exact same manner" 49/ that had been followed by Delmarva. The efficiency of Delmarva's operations was not questioned by Krapf despite the fact that the Delaware PSC had voiced serious doubts regarding the company's practices in April, 1972, stating its belief to be that "the Company [Delmarva] management is not doing its utmost in these difficult times to effect every economy in the use of labor, materials and capital . . ." 50/ While Delmarva attempts to counter the thrust of that criticism by pointing out that United Research Company made a comprehensive study in 1968-69 and was making a further study at the time of these hearings, the fact remains that the record here is devoid of a proper efficiency study, the absence of which in the Philadelphia Company case was considered critical in determining the lack of validity of the study there submitted. 51/

Turning to the methodology of Krapf's study, it appears that Krapf considered the managers of the departments performing common gas and electric

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48/ Cf. New England Electric System, 41 S.E.C. 888, 900-01 (1964).

49/ Tr. 1325.

50/ Div. Ex. 26, at 25.

51/ 28 S.E.C. 35, 61 (1948). "A proper study would entail an examination of the entire situation both before and after segregation, including a determination of what present expenses might be eliminated or reduced on segregation by combining functions. . ."

duties to be the best source for determining the number of personnel necessary in separate operations. Those managers were requested to submit estimates of such personnel requirements and the estimates received were reviewed by Krapf with the vice-presidents in charge of the various departments. Only minor adjustments downward were made in the original estimates as a result of the review process. The next step, by which Krapf determined the extent of the increase in payroll over that actually booked in 1971, consisted of the arithmetical tasks of multiplying each department's estimate of required personnel by that department's average payroll per person and adding the results of those computations.[52/]

A study using Krapf's methodology is suspect in the first instance because it assumes not only that existing operations are efficient but that a similar type of operation for a separated gas company would also be efficient. It would seem, however, that from the fact that gas revenues represented only about 14% of Delmarva's 1971 gross revenues, a fair inference may be drawn that an organizational structure different from that used for the combined operations would be found in a separated gas operation. In any event, the burden is upon Delmarva to shown by "clear and convincing evidence" that substantial economies would be lost were retention of the gas properties not permitted,[53/] and that evidence has not been produced to support Krapf's approach.

52/ Illustrative of the lack of independence that tends to discredit the reliability of the entire Krapf study is the use of the average payroll per person instead of actual payroll figures. Krapf explained that in order to do a person-by-person study, confidential payroll records, not readily available to anyone other than top company officers and for which he made no request, would have to be utilized. (Tr. 1491). It is highly unlikely that an independent expert would have scrupled about demanding the records so that a proper estimate could be made of the cost of top management and operating personnel in a separated gas company.

53/ Cf. Philadelphia Company, supra at 53.

Additionally, there is insufficient evidence to establish that the personnel figures submitted by the managers of the combined operations departments are acceptable. With minor exceptions, those managers, whose submissions were only superficially reviewed,[54/] were not presented to testify in support of their judgments. Delmarva's argument that all department heads were available for cross—examination is wholly irrelevant since it is not the Division's obligation to prove that the loss of economies study is deficient but Delmarva's burden to establish its validity. Without the testimony of the managers concerning the judgmental factors that entered into the figures furnished to Krapf, there is no possibility of ascertaining whether the study truly represents the personnel needs of a separated gas operation. This being so, it follows that the payroll costs and the employee-related expenses reflected in Tables IV and V cannot be verified in the present record.

Other examples of unacceptable expense estimates are present in Krapf's projected increased expenses of \$21,984 for advertising, \$77,628 for outside services, \$20,432 for fees and other fiscal expense and \$21,208 for reports to shareholders. These increases in the aggregate of \$141,252 are approximately equal to the \$145,215 actual expenses attributed to the present gas operation in 1971 and suggest that a separated gas company would experience approximately twice the expense of the present gas operation. In view of the fact that the reliability of these estimates

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54/ *e.g.* Delmarva's vice-president in charge of marketing testified that Krapf's estimates relating to marketing personnel did not give consideration to possibilities of combining positions nor to having certain of the marketing functions taken over by an independent contractor. (Tr. 804-05).

is founded upon Krapf's judgment, which in turn appears to have been predicated upon an arbitrary assumption that 50% of actual expenses experienced in these accounts by the present combined operation was reasonable, it is concluded that acceptance of Krapf's figures on these accounts would not be warranted.

Further glaring deficiencies in the loss of economies study are Krapf's acceptance, without review, of Delmarva's methods of allocation of common expenses between gas and electric operations and his assumption that a separated gas company would terminate all relationships with Delmarva. In the latter connection, Krapf increased the cost of independent gas operations by nearly $100,000 for computer rental, giving no consideration to the possibility of the new company timesharing in Delmarva's computer, and escalated the new company's billing and meter-reading costs without thought of the possibility of economies by cooperative use of personnel and facilities with Delmarva. Those possibilities should have been taken into account by Krapf. Equally applicable here are the views the Commission expressed in the case of Eastern Utilities Associates,[55/] "We believe that the separation of the gas and electric properties into independent companies will not cause a total absence of good managerial judgment, and that thereafter the mutual benefits to be derived from the economic soundness of the present arrangement are such as to prompt its continuance under contract." With respect to Krapf's failure to make a critical analysis of Delmarva's allocation practices, it suffices to note, as the Division did,[56/] that methods of

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55/ 31 S.E.C. 329, 349 (1950).

56/ Division's Brief at 33.

allocating common costs depend ultimately upon judgments and cannot be accepted simply because of faith in the fairness or good judgment of management, especially when that management may have motivation to favor one operation over another in recording allocable costs.[57/]

With regard to the projected additional financing costs of $1,525,000 for an independent gas operation, the Division argues that cost of capital is not a proper or valid element in considering "loss of economies," stating in effect that whether or not divestiture occurs, any future change in money markets will benefit separate gas and electric utilities in the same manner as they would benefit the present combined company. Assuming that the latter statement is true, there would still remain the relative positions of those companies in the money market where combined companies, according to the testimony in the record, have enjoyed a lower capital cost and better reception for their securities than have straight gas companies. Further, it appears that the Commission views additional financial costs as a factor to be taken into consideration where a basis is found in the record for evaluating the increased cost.[58/]

Here, however, the claimed $1,525,000 additional financing cost is not predicated upon the difference in financing costs that would be experienced by Delmarva as a combined company as compared to those of a separated gas company, each raising the same capital in the same market. Instead, Delmarva

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57/ Delmarva allocates its administrative and general expenses to its gas and electric businesses using a method adopted some twenty years ago by the Wisconsin Public Service Commission for use of the public utilities in that State. The record is silent on whether the Wisconsin formula is suitable to Delmarva's operations or tends to favor either its gas or electric business over the other.

58/ Cf. General Public Utilities Corporation, 32 S.E.C. 807, 831 (1951).

claims that the economic loss should be calculated on the basis of the difference between the present relatively low embedded cost of Delmarva's fixed capital and the cost of capital to financé a new gas company in today's money market. In its argument Delmarva misconceives the proper approach to determining "loss of substantial economies" within the meaning of Section 11(b)(1). "'Substantial economies' must mean, as was said in North American Co. v. Securities Exchange Commission, 2 Cir. 133 F.2d 148, 152, 'important economies.' The required importance must relate to the healthful continuing business and service of the freed utility."[59/] In the present case, the claimed $1,525,000 annual increase in financing costs reflects the amount of difference existing at a given date, December 31, 1971, and gives no consideration to the effect that continuation in business by Delmarva and the new gas company would have upon their respective financing costs. That the difference will narrow over the years until it closely approaches no more than the difference between the rates that Delmarva and the new company must pay for additional capital in the same market is clear. The present embedded cost of capital enjoyed by Delmarva will change not only as its old bonds mature and refinancing is undertaken, but also as the company seeks additional capital to finance the ambitious plant expansion it contemplates completing during the next ten years.

Under the circumstances, Delmarva's claimed loss of economies to the extent of $1,525,000 for financial costs cannot be recognized Moreover, because no basis exists in the record for evaluating the increased cost of

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59/ Engineers Public Service Co. v. SEC, 138 F.2d 936, 944 (D.C. Cir. 1943); Philadelphia Company, 28 S.E.C. 35, 48 n. 22 (1948).

financing that might be experienced by a continuing independent gas operation, no consideration can be given to the that factor in calculating the loss of economies resulting from a divestiture of Delmarva's gas properties. It should also be noted that a determination of the possible additional costs of financing would be further complicated by the fact that in making its presentation on that subject, Delmarva limited the comparision to the cost of capital to Delmarva and to an independent gas company. As noted by the Division, the differential may vary depending upon the form of divestiture.

There being an inadequate showing of the extent to which loss of economies may result if the present gas properties are not retained by Delmarva, it is concluded that those gas properties are not retainable under the provisions of Section 11(b)(1). Because, however, it appears that Delmarva is entitled to an exemption under Section 3(a)(2) subject to the reservation of jurisdiction with respect to the retainability of the gas properties, it is further concluded that an order of divestiture pursuant to the provisions of Section 11(b)(1) should not be entered.[60/]

Accordingly, IT IS ORDERED that the application of Delmarva Power & Light Company for an exemption pursuant to Section 3(a)(2) of the Act from all provisions of the Act except Section 9(a)(2) thereof be, and it hereby is, granted subject to a reservation of jurisdiction with respect to retainability of the company's gas properties; and

IT IS FURTHER ORDERED that the proceeding instituted under Section 11(b)(1) of the Act with respect to Delmarva Power & Light Company and its subsidiary

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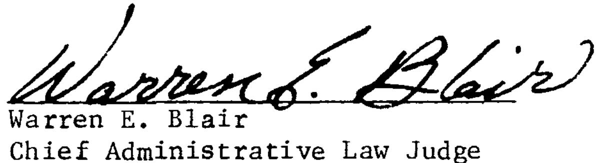
60/ Cf. Pacific Lighting Corporation, Holding Company Act Release No. 17855, 8-9 (1973).

companies, Delmarva Power & Light Company of Maryland and Delmarva Power & Light Company of Virginia, be, and the same hereby is, dismissed.[61/]

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Warren E. Blair
Chief Administrative Law Judge

Washington, D.C.
June 26, 1974

61/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.