Report

To the Board of Public Works of the City of Lewes, DE

Analysis of Available Options for

Providing Cost-Effective Utility Services

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I.

The Board of Public Works of the City of Lewes, Delaware ("BPW") hired J.W. Wilson & Associates, Inc. and Whitfield Russell Associates ("Consultants") to provide management consulting services in performing an evidence-based analysis of all available options for cost-effectively providing utility services to BPW customers. BPW is the municipally owned electric, water, wastewater, and storm water utility of the City of Lewes, Delaware. This report provides the Consultants' analysis of the available options open to the BPW and the City of Lewes.

This report will first describe the BPW. It will then provide an estimate of the fair market value of the electric utility. Finally, it will examine the possible alternatives for future utility service, with a discussion of the anticipated costs and benefits of each alternative.

Although the Consultants have committed to examine water, sewer and storm water operations, management of the BPW indicated that the primary focus of the Report should be on the electric utility which has been the object of a buyout offer from the surrounding Delaware Electric Cooperative ("DEC" or the "Coop"). The electric department is the largest of BPW's utilities, and it shares interdependencies (e.g., employees, overheads and cross-subsidies in some instances) with the other BPW utility operations. Because of these shared interdependencies and subsidies, a sale of BPW's electric utility would result in changes in the operations and financial performance of the City's remaining utilities and changes in costs to the City and its residents for utility services. A sale of the electric utility would also have a significant impact on City revenues, as the electric department's current payments to the City significantly exceed tax revenues that the City could expect to recover from a new electric utility owner.

II. Summary

This Report concludes that the City of Lewes has two acceptable options with respect to future electric service. First is a continuation of BPW's operation of the municipal electric department with its hundred-year-long record of local control, prudent management and stable rates and with certain potential improvements as discussed below. Second is the sale of the electric department to DEC. That sale would result in substantial proceeds to the City and the reasonable probability of continued economic electric utility service from a reliable and efficient customer-owned electric supplier. This would be offset by the loss of local control and the loss of other quantifiable and non-quantifiable advantages of municipal ownership. Most notably, the sale of the electric utility would result in the loss of substantial payments to the City (now approximately $580,000 annually) and subsidies that are now provided by the electric department to the water, sewer and storm water utilities. The loss of these subsidies would very likely necessitate significantly higher rates for other utility services. We estimate that water, sewer and storm water utility charges would have to increase by approximately $250,000 per year if the electric utility is sold.

Although DEC would pay property taxes, we believe those taxes would be considerably less than the electric utility's current and prospective payments in-lieu-of-taxes ("PILOT") that are now made by the BPW to the City. If the electric utility is sold, we estimate that the City's net tax proceeds (projected PILOT payments less the property taxes that would be paid by the Coop)

would decline by about $600,000 per year and that this amount would increase over time. Further, the sale of the electric utility would likely result in reduced BPW space requirements and less rental income (now $125,000) for the City.

Finally, while DEC's rates are currently lower than BPW's rates for equivalent electric service, much of the present rate differential results from the BPW's large PILOT payments and support for water and sewer services. Moreover, although DEC's current wholesale power costs are significantly less than BPW's, BPW's other electric utility operating costs are actually less than the Coop's. Our analysis further indicates that it may be possible to substantially reduce BPW's current wholesale power cost disadvantage. If that is accomplished, BPW's total prospective annual costs of electric operation (including both power supply costs and system operating costs) may be expected to be less than DEC's by approximately $144,000.

Considering all of these factors (taxes, water and sewer rates, rental payments and comparative costs) we estimate that the sale of the electric utility could cost Lewes and its utility customers more than $1 million annually. In that case, in order to break even over the long term on a present value basis, an electric utility sale would require a purchase price in excess of $20 million. A purchase price of that amount, in our opinion, exceeds the fair market value of the electric utility as a going concern to a willing buyer. Using multiple valuation methods, we estimate the current fair market value of BPW's electric utility to be approximately $17 million. In short, because of the factors noted above (i.e., support of other utility services and income to the City), the long term value of the electric utility to the City of Lewes very likely exceeds its current going concern market value to an independent utility service provider.

In addition to these conclusions, the Report's other findings are:

(1) Based on the Delaware Municipal Electric Corporation's ("DEMEC") cost projections, BPW could very likely reduce its future power supply costs by acquiring its wholesale power requirements from DEMEC instead of its current power supplier.

(2) If the City's ownership of the electric utility is retained, retaining ownership and operation of the water and waste water departments would very likely preserve significantly lower rates for these utility services than those attainable if these utilities are sold.

(3) Moving current waste water treatment facility operations "in house", rather than contracting these out, would very likely reduce waste water operating costs.

(4) Having the City directly absorb the BPW's utility departments as City-provided services, rather than maintaining the BPW as an independent chartered political subdivision of the City, would not serve to reduce costs, improve management or maintain utility service quality.

III.

The BPW is a municipal utility located in the City of Lewes, Delaware. Lewes is located on the southern shore of the Delaware Bay, where it meets the Atlantic Ocean at Cape Henlopen. The City has many seasonal residents and substantial tourism. It hosts the ferry that connects Delaware to Cape May, New Jersey. Many City residents are of retirement age, and the community has above-average incomes. The major businesses in town include a hospital, schools, an extended care facility, and a pharmaceutical company.

The BPW is a chartered political subdivision of the City of Lewes ("City"). It is governed by a five-member elected Board which sets BPW's utility rates. Board vacancies can be filled by appointment between elections. The need for this Report arises out of the desire to examine possible future scenarios for utility operations for the City of Lewes.

The BPW currently has 12 employees (down from 18 a short time ago) who, in concert, provide water, electric, sewer and storm water services. This employee count is expected to increase to 14 in the near future. The BPW is one of nine municipal electric utility systems in the State of Delaware. All nine of these municipal utilities are members of the Delaware Municipal Electric Corporation ("DEMEC"). DEMEC provides wholesale power supplies to seven of its nine members, but not to Lewes. The Delaware Electric Cooperative ("DEC" or "the Coop") has about 80,000 customers throughout most rural areas in Kent and Sussex Counties. DEC's service area abuts that of BPW. Delmarva Power & Light ("DPL"), the investor owned utility that provides transmission to Lewes, serves the majority of the load in Delaware, primarily in urban areas, and its service area also abuts that of BPW.

The following table provides the revenue and expense statements of the BPW over the most recent five year period.

Table 1

Board of Public Works					
Lewes, Delaware					
Statement of Revenues, Expenses, and Changes in Net Assets					
	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Operating Revenues					
Sales & Assessments	9,139,311	9,188,893	11,746,118	14,051,480	14,630,102
Other	50,710	51,715	88,548	172,318	127,384
Total Operating Revenues	9,190,021	9,240,608	11,834,666	14,223,798	14,757,486
Operating Expenses					
Purchased Power	5,361,065	5,411,122	7,763,360	8,023,140	8,484,563
Payroll/Employee Expenses	0	0	0	995,888	1,121,845
Utilities	0	0	0	380,312	417,100
Repairs & Maintenance	0	0	0	389,500	335,138
Professional/Contractual Services	0	0	0	441,470	440,827
Other Supplies & Expenses	0	0	0	267,134	333,780
Administrative	1,593,568	1,299,611	1,625,074	1,045,010	1,063,716
Bad Debt	0	0	0	6,522	32,349
Depreciation & Amortization	798,137	972,313	1,054,551	1,023,480	1,442,906
Total Operating Expenses	7,752,770	7,683,046	10,442,985	12,572,456	13,672,224
Operating Income (Loss)	1,437,251	1,557,562	1,391,681	1,651,342	1,085,262
Non-Operating Revenues (Expenses)					
Interest Income	300,552	800,266	934,365	711,702	182,050
Interest Expense	(402,273)	(710,078)	(873,543)	(425,088)	(448,650)
Impact Fees	0	0	0	462,379	127,465
Gain (Loss) on Sale of Assets	0	0	0	(323,231)	(10,428)
In-kind/Capital Contributions	277,849	85,959	236,099	1,148,930	
Grants	0	0	967,900	85,772	4,909
Net Non-Operating Revenues (Expenses)	176,128	176,147	1,264,821	1,660,464	(144,654)
Change in Net Assets	1,613,379	1,733,709	2,656,502	3,311,806	940,608
Net Assets (Beginning of Year)	27,633,413	29,246,792	30,980,501	33,637,003	36,948,809
Net Assets, End of Year)	29,246,792	30,980,501	33,637,003	36,948,809	37,889,417

As is evident from this table, the BPW has increased its revenues in spite of the difficult economic times of the last few years. Seeing the reduction in Operating Income in 2009, BPW management hired a consultant to prepare a cost of service study, which was the basis of changes in its rate structure. In addition to changing its rate structure, the Board also increased rates for several utility services. Based upon the December 31, 2010 Year-to-Date Statement of Revenues and Expenditures, the rate changes have had their desired effect, and the BPW's revenues and income are increasing as anticipated.

Currently, the electric department provides the bulk of BPW's revenues (78.6%) and operating expenses (76.2%), while the water department maintains a smaller profile in the overall scheme of the BPW. The sewer department is responsible for the bulk of the outstanding debt (70.7% of

the total at $18.15 million). The storm water department just recently has been established as a separate entity from the water and sewer departments,

Below is a table that illustrates the percentages each department holds in operating revenues, operating expenses, net assets and liabilities.

Table 2

Board of Public Works					
Lewes, Delaware					
Department Percentages in Various Categories					
	Electric	Water	Sewer	Stormwater	Total
Net Assets $	16,569,593	6,417,552	14,094,579	807,691	37,889,415
%	43.7%	16.9%	37.2%	2.1%	100.0%
Liabilities $	4,034,139	3,314,425	18,150,499	164,351	25,663,414
%	15.7%	12.9%	70.7%	0.6%	100.0%
Operating Revenues $	11,605,353	1,107,698	2,044,432	0	14,757,483
%	78.6%	7.5%	13.9%	0.0%	100.0%
Operating Expenses $	10,415,919	1,261,896	1,953,029	41,378	13,672,222
%	76.2%	9.2%	14.3%	0.3%	100.0%

Despite the dislocations caused by the recent severe economic recession and the large capital outlay for sewer treatment, the BPW is conservatively managed and has considerable cash reserves. BPW Financial Statements prepared by PKS & Company, P.A. for the six months ending March 31, 2010, indicate (at 3) that:

> The assets of BPW exceed its liabilities at the close of the most recent six month period by $37,849,769 (net assets). Of this amount, $17,038,592 are unrestricted net assets.
>
> . . . .
>
> As of the close of the current six month period, BPW reported combined ending cash balances of $20,113,046, an increase of $271,556 in comparison with the prior year. Approximately 49% of this total amount, $9,827,912, is available for spending as designated, undesignated and unreserved fund balances.

IV. for BPW and Relations with City of Lewes

The BPW was chartered in 1901. Three years ago, BPW's charter was changed significantly for the first time in over 50 years. Effecting this change involved an elaborate process of redoing the charter through legislation, as the charter is established for Lewes and the BPW by the Delaware legislature. BPW has a unique status as a chartered subdivision of the City pursuant to State

legislation. Although BPW's Board is elected and sets rates, the BPW requires City approval in order to seek charter changes.

There were several reasons for these recent charter changes. First, it was desired to include greater transparency in the BPW-City relationship. Second, a storm water study that was done for the BPW had determined that the BPW did not have authority to collect fees for storm water utility services. Thus, BPW's need for the authority to provide storm water service as a utility became a driver to change the charter. Also, BPW did not have independent authority to own real property or incur debt, and the desire for those independent authorities also drove the desire for charter changes.

Under the charter changes, BPW has commenced making PILOT payments to the City of Lewes, as well as paying rent for department headquarters. BPW did not previously pay any PILOT or rent. Instead, the BPW and the City exchanged BPW rent for City utility expenses, without valuing either amount.[1] As part of the new arrangement, the electric department began charging the municipality for utility services, which were previously provided free of any explicit charge to the City. Under the new "transparent" regime, the City is a substantial net recipient of funds from the BPW (i.e., the City of Lewes' receipt of PILOT and rent from BPW substantially exceeds the BPW's charges to the City for utility services).[2] Putting a price on the power has also created an incentive for the City to conserve, and it has reduced usage by 20%.

The new franchise fee (or PILOT) was originally 3.75% of sales revenue, but was recently raised to 5%. While the City received the franchise fee as part of the charter changes, the BPW was also allowed to own real property, and issue limited amounts of debt, and it now has the authority to bill for storm water services. The BPW is also now allowed to incur debt for a term of ten years or less without City Council approval, and it can issue revenue bonds with a City council vote of approval.

The charter changes also included changes in how a prospective sale of a utility would be treated. In the redrafting of the charter, a form of "poison pill" was added, requiring two votes of the City Council one year apart to call a referendum election concerning the sale of a utility. The charter was further amended in July, 2010 to provide that a sale of a utility requires a vote of the Mayor and City Council to call for a referendum concerning the sale of a utility. Under the July, 2010 revision, the referendum election may be held no sooner than ninety (90) days and within one hundred twenty (120) days, and must be passed by a majority of the voters, qualified as for a Board election, voting at the election, to approve the sale.

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[1] Under an August 7, 2009, five-year lease, the BPW agreed to pay the City $125,000 per year (1/2 at six month intervals escalated by CPI) for 6,800 square feet in the two-story addition to City Hall adjacent to Franklin Street. .

[2] Notes to Financial Statements for March 31, 2010 and September 30, 2009 ("NON-CASH TRANSACTIONS"), indicate (at 23):

> The Board provides the City of Lewes with electric, water and sewer at no charge. The Board occupies buildings and offices owned by the City of Lewes and pays no monies to the City. However, in order to reflect true income and expense, the Board shows $128,939 and $277,139 as municipal revenue in the water, sewer and electric (sic) and offset by a posting to administrative operating expense for the six months ended March 31, 2010 and the year ended September 30, 2009, respectively.

V. Department

The BPW electric department is a relatively small municipal electric utility system serving a relatively affluent area. The entire electric system has been upgraded over time, so that the average age of its facilities is less than 10 years old, which is quite new by the standards of electric distribution systems. BPW's service area is relatively dense compared to the surrounding area, which results in lower costs per customer served. In addition, BPW recently carried out an upward voltage conversion and added spare interconnection capacity which made its system more efficient and more cost-effective. These characteristics mean that rates now paid by BPW's customers recover the costs of surplus interconnection and distribution capacity for serving future growth in load. Customers can expect cost reductions as load grows into that surplus capacity.

As a distribution electric utility, the BPW purchases 100% of its energy from a third-party provider, Constellation Energy, under a contract that was renewed for another year on May 31, 2011.[3] The power is delivered over the transmission system of Connectiv (formerly Delmarva Power & Light, now owned by Pepco Holdings, Inc.). Connectiv's transmission system is served by several power plants on the Delmarva Peninsula, and is interconnected to the remainder of the PJM grid at its northern end (through which Connectiv and other utilities on the Delmarva Peninsula can obtain limited amounts of backup and lower-cost power supplies). Connectiv's transmission system operates at 230 kV, 138 kV and 69 kV. The BPW takes service from a 69 kV line supplying the Schley Avenue Substation. That 69 kV line is served from Connectiv's Harbeson-to-Rehoboth 69 kV line.[4] The BPW then distributes this energy to approximately 3,500 electric customers in the City of Lewes.

At various periods, Constellation Energy conducts auctions on behalf of the BPW, purchasing power and transmission service from the competitive markets run by the PJM Interconnection ("PJM"). PJM is a regional transmission organization ("RTO") that coordinates the wholesale electricity markets in all or parts of 13 States and the District of Columbia. However, it is the BPW that is responsible for providing reliable service to its customers, including maintaining its distribution system.

The BPW has previously opted out of participation in generation projects that were developed by the Delaware Municipal Electric Corporation ("DEMEC"), a joint powers agency of which BPW is a member. However, the BPW has the option of considering future supply from DEMEC, including both DEMEC's next planned project, which will be a gas-fired turbine, and DEMEC purchases of power supply on behalf of its member municipal systems. Later in this Report, we examine the option of having DEMEC purchase power on behalf of the BPW as one of Lewes' possible future options.

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[3] Previously, the BPW owned a small generator (approximately 1 MW in size), which it stopped using about five years ago. It ran in very few hours per year.

[4] See Appendix A to BPW's April 2005 Long-Range Plan Update by Booth & Associates, Inc. That report indicates that as of April, 2005, "[t]he recently completed Schley Avenue Substation houses two 15/28 MVA transformers and serves load at 12.5 kV. Currently, the entire BPW electrical system is fed from four circuits from the Schley Avenue Substation." It appears that the 28 MVA emergency rating of each transformer would enable BPW to meet all or most of its entire 25 MW peak demand even if one of the two transformers is out of service.

In 2009 the electric department reported a winter peak demand of 16.24 MW and a summer peak demand of 18.46 MW. In 2008 these seasonal peak demands were slightly lower, with the summer peak at 17.93 MW and winter peak at 15.52 MW.[5] Average hourly loads are about half of peak loads.

Total energy purchased by BPW in 2009 amounted to 80,723 MWH, and its sales amounted to 73,332 MWH. The difference between energy purchased and sold was accounted for by

1,009 MWH of energy furnished without charge to the City

2,659 MWH of energy consumed by BPW without charge and

3,723 MW of energy line losses

The Electric Department reported sales to three classes of customers, as follows:

SALES TO ULTIMATE CUSTOMERS

	RESIDENTIAL	COMMERCIAL	INDUSTRIAL	TOTAL
Revenue	$4,673,000	$1,462,000	$4,628,000	$10,763,000
MWH	28,854	8,916	35,562	73,332
Customers	3070	387	30	3487
Cents/kWh	16.195	16.397	13.014	14.677

Electric Rates

As of April, 2011, BPW's electric rates were significantly higher than those of DEC but somewhat lower than the rates of DPL and all of the other eight municipal power systems in Delaware. However, recent history has shown these differences can vary considerably over time. Wholesale power market prices have been very volatile and have fallen by 50% from recent highs. There is some prospect for this volatility to decline if, as we expect, currently low natural gas costs extend into the future.

The table below shows comparisons of (1) average monthly electricity bills over a period of more than five years, and (2) April of 2011 electricity bills, for a typical residential customer using 1000 kWh per month at the rates charged by DEC, the various Delaware municipal utilities

[5] See BPW's 2009 and 2008 Annual Reports.

and Delmarva.[6] DEC's rate differential advantage shown here for residential customers has also been the case for business customers.

Table 3

Utility	$/1000 kWh Average 2006 To 2011	Rank	$/1000 kWh April 2011	Rank
DEC	115.79	1	111.72	1
Dover	138.45	2	147.38	5
New Castle	140.88	3	144.63	4
Lewes	143.52	4	138.02	2
Newark	144.55	5	163.71	11
DPL	146.33	6	153.01	7
Milford	149.34	7	143.53	3
Seaford	150.64	8	156.05	8
Middletown	152.15	9	157.92	9
Smyrna	158.61	10	152.48	6
Clayton	159.34	11	162.70	10

VI. Department

As shown in Table 2, the water department plays a smaller role in the total BPW system than does the electric department (water revenues represent 7.5% of BPW's revenues versus 78.6% for electric). The water department is separate from the waste water (sewer) and storm water departments, yet relies upon many of the same employees, including administrative and support staff. The BPW continues to make water system capital improvements to meet federal regulations on clean water, and to ensure that infrastructure to deliver water is maintained.

The BPW receives its water from five wells that draw water from the Columbia Aquifer. The water department had 3,214 customers in 2010, pumped over 400 million gallons of water from its five wells, and sold nearly 350 million gallons of water in that same year.

In the past, the water department has not brought in enough revenue to cover its costs. Also, capital improvements for the water department have been paid for out of escrowed funds (including funds received from electric revenues). In the last few years, the water department has tended to run a net operating loss. The BPW increased water rates in 2010. These new rates

[6] Sources are the "Residential Rate Comparison @ 1,000 kWh" sheets distributed by DEMEC from February 2006 to April 2011, with a few missing months.

are inclining block rates that are designed to encourage customers to save by using less water. The BPW differentiates rates based upon the meter size. The BPW also charges higher rates to non-resident customers.

BPW has, in the past, considered privatizing the water and waste water departments by selling their assets and utility business to private water companies such as Tidewater and Artesian. This has not been done because of likely adverse rate impacts on customers. The present Report does not provide a detailed re-examination of the benefits and disadvantages of selling the water department to others. That may become a valid reconsideration in the future if the electric utility were to be sold. In that event, the provision of water service would become more expensive for BPW and rates would have to increase because of the loss of shared overheads and support staff employees with the electric department. On the other hand, if the electric utility is not sold, BPW operation of the Lewes water utility will remain the most economical choice.

VII. (Wastewater) Department

As noted above, the water and sewer departments tend to operate together. The same employees work for both departments. Beginning in 2006, the BPW began a major expansion of its waste water treatment facility ("WWTF") and made other water capital investments in order to meet federal environmental regulations. The sewer department's capital assets now constitute 60% of the total capital assets of the BPW, while its total liabilities are over 70% of the BPW's total liabilities. However, the sewer department brings in only 14% of BPW's total revenues.

The expansion of BPW's sewage treatment facility resulted in a plant with about twice the capacity presently needed by the City. This provides ample capacity for future growth requirements without substantial added capital costs. Rates for sewage were changed recently by adding a demand charge, which tends to impact seasonal residents proportionately more than others.

Presently, an independent contractor, Severn Trent Environmental Services ("Severn Trent"), operates the WWTF plant for a fee of about $30,000/month, plus reimbursement of all expenses. The BPW is considering the feasibility and cost-effectiveness of taking back operation of the sewage plant at the end of Severn Trent's contract and has developed in-house management capability that will enable it to take that course of action. Various amendments to the original 2002 contract have been made over the years, changing the fee and the term of the contract. At this time, the contract is rolling over on an approximately annual basis. The BPW's new General Manager has been certified to perform the duties necessary at the plant, and it is believed that BPW's own operation of the plant would reduce expenses, including employee costs.

VIII. Water Department

As noted previously, the BPW just recently received Charter authority to charge for storm water services. BPW began separating storm water costs into a separate category as of its FY 2009 financial statements. In 2010, the BPW began charging a small $5 charge per residential

customer for storm water, with a higher $10 charge for commercial customers and $20 for industrial customers. These amounts were then removed from the waste water rates to eliminate duplicate charges.

IX. of Finances by Service Department

Below is a table that breaks down the Statement of Revenues, Expenses, and Changes in Net Assets for the most recent fiscal year period, ending September 30, 2009, by service department.

Table 4

Board of Public Works					
Lewes, Delaware					
Statement of Revenues, Expenses, and Changes in Net Assets					
FY Ending 9/30/09 by Department					
	Electric	Water	Sewer	Stormwater	Total
Operating Revenues					
Sales & Assessments	11,558,002	1,032,707	2,039,390	0	14,630,099
Other	47,351	74,991	5,042	0	127,384
Total Operating Revenues	11,605,353	1,107,698	2,044,432	0	14,757,483
Operating Expenses					
Purchased Power	8,484,563	0	0	0	8,484,563
Payroll/Employee Expenses	561,128	513,526	38,953	8,238	1,121,845
Utilities	22,518	144,824	249,758	0	417,100
Repairs & Maintenance	96,563	116,047	122,034	493	335,137
Professional/Contractual Services	3,809	7,909	423,564	5,545	440,827
Other Supplies & Expenses	264,697	46,832	16,403	5,847	333,779
Administrative	521,220	255,293	287,203	0	1,063,716
Bad Debt	32,349	0	0	0	32,349
Depreciation & Amortization	429,072	177,465	815,114	21,255	1,442,906
Total Operating Expenses	10,415,919	1,261,896	1,953,029	41,378	13,672,222
Operating Income (Loss)	1,189,434	(154,198)	91,403	(41,378)	1,085,261
Non-Operating Revenues (Expenses)					
Interest Income	89,096	44,076	47,904	974	182,050
Interest Expense	(170,000)	(99,008)	(179,642)	0	(448,650)
Impact Fees	20,092	55,520	51,853	0	127,465
Gain (Loss) on Sale of Assets	(7,731)	(4,295)	1,598	0	(10,428)
Grants	0	4,909	0	0	4,909
Net Non-Operating Revenues (Expenses)	(68,543)	1,202	(78,287)	974	(144,654)
Change in Net Assets	1,120,891	(152,996)	13,116	(40,404)	940,607
Net Assets (Beginning of Year)	15,448,702	6,570,548	14,081,463	848,095	36,948,808
Net Assets, End of Year)	16,569,593	6,417,552	14,094,579	807,691	37,889,415

X. to Be Examined

The Consultant has been asked to evaluate six specific alternative courses of action with respect to the future provision of utility services in Lewes:

1. Maintain as is (*status quo* for all departments)
2. Sell the electric department
3. Outsource the purchase of electricity to DEMEC
4. Sell the water/waste water department
5. Move in-house the WWTF operations from what are now being conducted by Severn Trent
6. Have the City absorb BPW departments

The major alternatives to examine are (1) and (2) -- the *status quo* versus selling the electric department to DEC, which has already expressed interest in purchasing the BPW electric system. Alternative 3 is best considered (as we do below) as a potential cost reducing element of alternative 1. Also, as noted above, the practicality of alternative 4 depends largely on the choice between alternatives 1 and 2. Likewise, as discussed above, the practicality of alternative 5 is likely to reduce costs in any case, and especially if the *status quo* is maintained and the water and sewer departments are therefore retained in conjunction with the electric department as City-provided services.

We have given consideration to the possibility of the City directly absorbing BPW operations and see no great merit to that possibility if ownership and operation of the electric department is maintained. Electric utility operations and service are a highly specialized industry requiring expertise and responses that differ substantially from most municipal government functions. In our opinion, the structure that has been carefully put in place and now exists, separating BPW from other municipal service functions, including finance, is an efficient and sensible one that is well designed to provide reliable and efficient service on a cost-effective basis. While there may be specific instances of natural overlap where the City can benefit from assistance or task-sharing with the BPW and vice versa, that can generally best be done without directly absorbing utility service functions into those of the municipal government.

1. *Quo* Alternative

Under the *status quo* alternative the BPW would keep operating as it has been doing for over the past hundred years – operating as an entity within, but organizationally separate from, the City, for the provision of electric, water, sewer and storm water services to customers in and around the City of Lewes. As noted above, the BPW has been operating profitably for many years, has accumulated a substantial amount of cash and cash equivalents, has contributed substantial

payments to the City, and has been fiscally responsible. The benefits to retaining municipal electric utility ownership include the ability to control and formulate utility policy in concert with the City's goals and objectives. This includes responsiveness to local customers and the ability to allow for the support of other utility services as necessary. The BPW has survived for over 100 years through some difficult times, including depressions, recessions, energy crises, and deregulation of much of the electric industry. City residents can be elected to the Board, can vote on members, and have the ability to express their opinions to staff and to local and accessible management at nearly any time. Moreover, the City maintains ultimate control over the utility and its policies and courses of action.

In addition to the lost benefits of municipal utility ownership that can be quantified in monetary terms, such as financial support for other city-provided services like sewer and water service and PILOT payments to the city, there are often other lost benefits. Well-managed municipal electric utilities often provide other support in their communities. In Lewes' case, an example of the community benefit provided by municipal utility ownership is holiday street decoration and lighting provided annually by DPW.

Municipal utility ownership also provides the benefit of being able to decide and direct the City's own public service priorities and investment decisions rather than being obligated to pay for decisions that are made by utility management groups that are not part of, or controlled by, the local community. These non-quantifiable benefits of municipal ownership should be weighed in evaluating the proceeds the City would obtain from selling the utility.

As noted, the BPW now pays rent ($125,000 annually) to the City, as well as 5% of revenue as a payment in-lieu-of-tax or franchise fee. If the electric utility is sold, rent revenue would, very likely, decline and the financial benefit of in-lieu-of-tax payments, now exceeding $500,000 per year, would be lost. In its place, the new utility owner would pay property taxes at the mill rate that we understand is now typically applicable to this class of property in Delaware (i.e., in the range of $0.0045). We estimate that tax rate would produce annual property tax revenues on the order of $60,000 to $75,000. Any assessments beyond regular property taxes, such as municipal franchise fees, are likely to be billed back to City residents by the new utility owner as part of their electric bills.

The BPW also provides other smaller benefits to the City, such as holiday lighting – both providing electricity free of charge and the installation and removal of the lights each year. If the electric utility is sold, these services would no longer be provided to the City free of charge.

2. Electric Department Alternative

The first step in considering the potential sale of the electric department is to determine its fair market value. This value may be significantly different from the economic value to the City and its residents of retaining ownership of the utility. The value to the City of retaining ownership (or the financial cost to the City and its residents of giving up ownership) may include considerations that would not influence the utility's market value to a potential buyer. Factors such as subsidies that the electric department now provides to other utility services or the payment of proceeds to the City fall into this category. The estimated market value of the electric utility is our estimate of the fair value that could be expected to be paid to the City for

the electric utility as a going business enterprise, under prevailing public utility market conditions in Delaware.

As explained in detail below, we used five different valuation methods to estimate the market value of the Lewes electric utility. These are:

- Net Plant
- Energy Sales
- Number of Customers
- Potential Income
- Revenues

Using these methods, we estimate that the market value of the Lewes electric utility, if the business, together with its public utility service franchise and electric plant and equipment, were to be sold as a going concern to a willing buyer, would be in the range of $14.2 to $18.4 million. Our best estimate within this range is approximately $17 million.

Net Plant Valuation

Net plant investment is an important indication of the business value of an electric utility. Utility business profits, especially under rate regulatory practices employed in Delaware and elsewhere in the United States, are closely related to net plant investment. Regulators allow utilities to earn a rate of return on their rate base. Utility rate base is measured primarily on the basis of plant investment minus accrued plant depreciation, or "net plant". As discussed below, because the primary potential buyer of the Lewes electric utility system, Delaware Electric Cooperative, is not a regulated utility, the net plant measure of value may be less important in this case than it would be if a regulated utility, such as Delmarva Power, were to be a potential buyer.

On the numerous occasions during the past decade when electric utilities have been purchased or merged, the market value of the acquired utility has generally been established in a price range of 1.2 times to 1.9 times the utility's net plant value. Details concerning these acquisitions and the specific relation of market acquisition value to the net plant value of the acquired utility are summarized in Table 5. As shown there, the average ratio of market price to net plant value in these transactions has been approximately 1.42.

Table 5

Major Electric Utility Market Acquisitions

(2000 - 2009)

ACQUIRED COMPANY	ACQUIRED BY	DATE	PRICE	BOOK VALUE	MARKET / BOOK	NET PLANT	PREMIUM / NET PLANT
Aquila Inc.	Great Plains / Black Hills	7/14/08	$2,640 mil	$1,303 mil	2.03	$1,971 mil	67.82%
Cinergy Corp.	Duke Energy	4/06	$9,070 mil	$4,496 mil	2.02	$10,043 mil	45.54%
CMP Group	Energy East	9/01/00	$957 mil	$585 mil	1.64	$887 mil	41.94%
Conectiv	PEPCO	8/02	$2,200 mil	$1,351 mil	1.63	$3,744 mil	22.69%
Constellation Energy	FPL Group	10/06**	$11,068 mil	$4,934 mil	2.24	$10,667 mil	57.50%
Constellation Energy	MidAmerican Energy	12/17/08**	$4,700 mil	$3,181 mil	1.48	$10,437 mil	14.55%
Cheyenne Light, Fuel & Power	Black Hills Corp.	1/21/05	$68 mil	$36 mil	1.93	$85 mil	38.79%
Duquesne Light Holdings	Macquarie Consortium	5/31/07	$1,760 mil	$701 mil	2.51	$1,873 mil	56.54%
Eastern Utilities Associates	New England Electric System	4/00	$643 mil	$358 mil	1.80	$605 mil	47.08%
Empire District Electric	Utilicorp United Inc.	1/02/01**	$507 mil	$230 mil	2.20	$579 mil	47.79%
Energy East	Iberdrola SA	9/16/08	$4,500 mil	$3,286 mil	1.37	$6,247 mil	19.43%
Florida Progress Corp.	Carolina Power & Light	11/30/00	$5,325 mil	$2,188 mil	2.43	$4,276 mil	73.38%
Florida Public Utilities	Chesapeake Utilities	4/20/09*	$74 mil	$50 mil	1.47	$142 mil	16.62%
GPU, Inc.	First Energy	11/01	$4,700 mil	$3,449 mil	1.36	$7,775 mil	16.09%
Green Mountain Power Corp.	Northern New England Energy Corp.	4/12/07	$187 mil	$127 mil	1.48	$247 mil	24.44%

Table 1 cont.

ACQUIRED COMPANY	ACQUIRED BY	DATE	PRICE	BOOK VALUE	MARKET / BOOK	NET PLANT	PREMIUM / NET PLANT
Illinova Corp.	Dynegy, Inc.	2/01/00	$3,269 mil	$1,175 mil	2.78	$4,803 mil	43.59%
IPALCO Enterprises, Inc.	AES Corp.	3/27/01	$2,021 mil	$724 mil	2.79	$1,815 mil	71.44%
MidAmerican Energy Holdings Co.	Berkshire Hathaway	3/14/00	$2,067 mil	$995 mil	2.08	$5,463 mil	19.63%
New Century Energies	Northern States Power	8/21/00	$4,717 mil	$2,790 mil	1.69	$6,865 mil	28.07%
New England Electric System	National Grid	3/23/00	$3,200 mil	$1,593 mil	2.01	$2,751 mil	58.43%
Northeast Utilities	Con Edison	3/02**	$3,300 mil	$2,083 mil	1.58	$4,124 mil	29.50%
Northwestern Energy	Babcock & Brown	7/07**	$1,313 mil	$737 mil	1.78	$1,409 mil	40.88%
PacifiCorp	MidAmerican Energy	3/06	$5,100 mil	$3,333 mil	1.53	$8,604 mil	20.54%
Portland General	N. W. Natural	5/16/02**	$1,875 mil	$1,090 mil	1.72	$1,953 mil	40.19%
Portland General	Sierra Pacific	4/01**	$2,100 mil	$1,041 mil	2.02	$1,865 mil	56.78%
Public Service Enterprise Group	Exelon Corp.	09/06**	$12,200 mil	$5,739 mil	2.13	$13,752 mil	46.98%
Puget Energy	Macquarie Consortium	2/6/09	$7,450 mil	$2,161 mil	3.45	$5,522 mil	95.77%
RGS Energy	Energy East	6/28/02	$1,365 mil	$787 mil	1.73	$1,230 mil	46.95%
St. Joseph Light & Power Co.	Utilicorp United Inc.	12/31/00	$190 mil	$96 mil	1.99	$176 mil	53.76%
Texas - New Mexico	Public Serv. of New Mexico	6/06/05	$189 mil	($30) mil	NMF	$579 mil	37.80%
Texas - New Mexico	S. W. Acquisitions	4/07/00	$592 mil	$332 mil	1.78	$908 mil	28.64%
	Average Premium Over Net Plant						42.23%

* Date of announcement; acquisition pending completion.
** Date of termination; acquisition was not completed.

BPW's net electric utility plant value, inclusive of inventories, at 12/31/10 was $9,241,499. The sales and acquisitions of electric systems that have occurred during the past decade indicate that electric utility market value tends to be in the range of 1.2 times to 1.9 times net plant value. Applying the mid-point of this range (1.55) to BPW's electric utility net plant value of $9.241 million would produce a market value estimate of $14.3 million.

Number of Customers Valuation

A second valuation method is based on the number of customers served by the electric utility. To obtain a baseline value per customer we again examined electric utility sales during the past decade, and we also examined stock and debt market values per customer for publicly traded electric utility companies. Since a company's stock and debt prices reflect the market value of capital invested in the company, they are a good proxy for market valuation of the enterprise, keeping in mind that in most utility company sales there is usually a premium paid over the stock price value prior to the transaction.

In applying the value per customer method, it is essential to limit the comparison companies to those that are wholly or predominantly in the electric utility business. In the case of "combination" companies that provide both electric and gas utility service or diversified companies with substantial unregulated enterprises, a significant part of the stock or market acquisition price may be related to factors other than the number of electric customers served. Eight of the market acquisitions listed in Table 5 involved the purchase of companies that were wholly or very largely electric utilities. In addition, we have identified another ten wholly or predominantly electric utility companies with publicly traded stock and debt that are appropriate to consider using this valuation approach. These companies and their market value per customer are listed in Table 6. As shown there, the market value per customer varies widely, from less than $3,000/customer up to more than $8,000/customer. Companies at the upper end of this range are vertically integrated utilities with substantial generation and transmission plant investment that result in a higher market value per customer than is typically the case for an electric utility like BPW's Electric Department that purchases its generation supply in wholesale markets. The higher value companies also tend to have more large industrial customers, thus increasing their business market value per customer. While Lewes has a relatively large industrial load (about 47% of total kwh sales) it does not have generation and transmission plant investment. It is therefore appropriate to use a value at or below the middle of the indicated range in developing a per-customer valuation estimate for BPW's electric utility business.

Table 6

Electric Utility Market Value Per Customer

Company	Year	Market Price*	Customers	Market Price / Customer
CMP	1999	1,169.60	536,651	2,179.44
Duquesne Light Holdings	2006	2,933.00	585,678	5,007.87
Empire Distric Electric	2001	882.60	150,673	5,857.72
Green Mountain Power Corp.	2006	302.90	92,459	3,276.05
Ipalco Enterprises, Inc.	2000	2,850.90	436,058	6,537.89
New England Electric System	1999	4,297.30	1,353,870	3,174.09
St Joseph Light & Power Co.	1999	264.00	62,515	4,222.99
Texas - New Mexico	1999	1,051.70	231,442	4,544.12
Central Vermont Public Service	current	420.80	159,039	2,645.87
DPL Inc.	current	4,611.24	514,586	8,961.07
El Paso Electric	current	1,761.26	367,059	4,798.31
Empire District Electric	current	1,438.35	168,023	8,560.44
Idacorp, Inc.	current	3,126.74	488,175	6,404.95
Nevada Energy (Sierra Pacific Res.)	current	8,373.18	1,193,191	7,017.46
Northeast Utilities	current	9,778.84	1,901,193	5,143.53
Portland General	current	3,221.12	815,916	3,947.86
Progress Energy	current	22,079.20	3,092,093	7,140.54
UIL Holdings Corp.	current	1,547.09	324,865	4,762.26

*/ For those companies with a “current” valuation, the indicated “Market Price” is the market value of the company’s equity and debt capital.

BPW serves about 3,500 electric customers. Using a value of $5,000 per customer, we derive as market valuation estimate of $17.5 million.

Energy Sales Valuation

An electric utility's energy sales volume is sometimes regarded as a more direct valuation measure than its number of customers. While the number of customers served by a company is an indicator of its likely sales volume, examining sales directly eliminates issues such as variation in customer size and differences in customer mix between utilities.

The same group of comparable electric utility companies as used above in deriving the valuation estimate based on customer count can be used to estimate a kwh sales valuation metric. Again, the differences noted above between BPW's electric utility and the electric utility companies in the comparison group should be taken into account.

As in the case of per-customer valuations, there is a wide range of valuations based on kwh sales. As shown in Table 7, this range tends to be from about $0.12/kwh up to $0.28/kwh. BPW's electricity sales are in the range of 75 to 80 million kwh annually (which may be expected to increase with improved economic conditions). Using $0.20/kwh (the middle of the range) as the appropriate valuation metric, without any sales adjustment for economic conditions, the kwh valuation method indicates a market value for BPW's electric utility business of approximately $15.5 million.

Table 7

Electric Utility Market Value Per Kwh Sold

Company	Year	Market Price*	Kwh Sold	Market Price / Kwh Sold
CMP	1999	1,169.60	9,994,032	0.117
Duquesne Light Holdings	2006	2,933.00	13,784,129	0.213
Empire District Electric	2001	882.60	4,591,700	0.192
Green Mountain Power Corp.	2006	302.90	2,403,819	0.126
Ipalco Enterprises, Inc.	2000	2,850.90	16,420,870	0.174
New England Electric System	1999	4,297.30	24,084,530	0.178
St Joseph Light & Power Co.	1999	264.00	1,828,909	0.144
Texas - New Mexico	1999	1,051.70	9,369,163	0.112
Central Vermont Public Service	current	420.80	3,018,298	0.139
DPL Inc.	current	4,611.24	16,589,859	0.278
El Paso Electric	current	1,761.26	10,687,696	0.165
Empire District Electric	current	1,438.35	5,409,839	0.266
Idacorp, Inc.	current	3,126.74	16,784,308	0.186
Nevada Energy	current	8,373.18	31,107,663	0.269
Northeast Utilities	current	9,778.84	38,385,097	0.255
Portland General	current	3,221.12	24,973,204	0.129
Progress Energy	current	22,079.20	98,812,281	0.223
UIL Holdings Corp.	current	1,547.09	5,492,621	0.282

*/ For those companies with a “current” valuation, the indicated “Market Price” is the market value of equity and debt capital.

Potential Income Valuation

Valuing the BPW's electric department business on the basis of actual earnings in recent years would not be appropriate because the utility has not been operated as a profit-maximizing enterprise. However, a potential earnings-based valuation for the BPW Electric Department can be developed.

This valuation can be developed by assuming that BPW's electric utility operations would be acquired by a regulated electric utility and that its net plant costs would be incorporated into the utility's rate base. Because the rate base on which regulated utilities are permitted to earn a rate of return is comprised largely of net plant value, this approach should be expected to produce an end result similar to that associated with the net plant valuation method described above.

The addition of BPW's Electric Department to a regulated utility's rate base would directly increase that acquiring company's electric rate base by about $10.75 million. This rate base estimate is comprised of net plant, working capital inclusive of prepaid expenses, all at 12/31/10 levels, plus 5 percent growth. Assuming a typical utility capital structure of 50% debt and 50% equity, with an 11% equity return and a price earnings multiple of 15 times equity earnings[7] and with full debt cost recovery, this rate base addition would have a projected earnings value of $14.24 million:

$$\$10{,}750{,}000 \times 0.11 \times 15 + \$10{,}750{,}000 \times \tfrac{1}{2} = \$14{,}243{,}750.$$

This earnings value estimate very likely understates total earnings value of BPW's electric business, as the acquiring utility, in addition to earning the return calculated above on the rate base addition acquired from Lewes, would also be able to increase its generation earnings. In the case of the Delaware Electric Cooperative, which does not directly own generation, additional generation earnings would likely occur for its supplier, Old Dominion Electric Cooperative, of which DEC is an owner. As an ODEC owner, DEC would benefit from such additional generation profits. As noted above, since DEC is not a rate regulated utility, it would not be constrained by this potential income method in its own valuation of the Lewes electric system.

Revenues Valuation

When electric utility service in Delaware is transferred from Delmarva Power to a municipal utility, as may occur if a municipality were to annex a new area into the city and the municipal utility serving the city were to take over electric service in that area, which was previously furnished by Delmarva, there is an established revenue-based formula for calculating the amount that must be paid for the takeover. (We understand that the same basic formula applies to DEC customer transfers.) The formula is essentially 2.0 times annual residential revenues plus 3.0 times annual revenues for small non-residential customers and 1.0 times annual revenues plus $2,100 per customer for large non-residential customers. If this revenue formula were applied to the BPW's 2009 electric revenues it would yield a value of $18.42 million:

[7] The average stock Price/Earnings ratio ("P/E") for publicly traded electric utilities was 15.4 in both 2008 and 2009.

Residential	$4,673,000	x 2.0	=	$9,346,000
Commercial	$1,462,000	x 3.0	=	$4,386.000
Industrial	$4,628,000	x 1.0	=	$4,628,000
	$2,100	x 30	=	$63,000
Total				$18,423,000

Business Market Value Estimate

As described above, there are multiple ways of estimating the probable market value of an electric utility enterprise. The estimates derived here for the potential sale of BPW's electric department are as follows:

Net Plant Valuation	$14.3 million
Number of Customers Valuation	$17.5 million
Energy Sales Valuation	$15.5 million
Potential Income Valuation	$14.2 million
Revenues Valuation	$18.4 million

Based on these valuation estimates as discussed above, it is our opinion that the fair market value of the BPW's electric utility business is approximately $17 million. This estimated value takes into consideration that both the net plant value estimate and the potential income method of estimating probable earnings are conservative in that they both give little weight to the acquiring utility's ability to realize generation profits as a result of the acquisition. It also recognizes that both the per-customer and per-kwh sales valuations discount the upper end of the comparable transaction range because BPW's electricity sales rely on wholesale power purchases rather than on generation plant ownership.

Delaware Electric Cooperative Proposal

DEC is a rural electric distribution cooperative that serves approximately 80,000 customers (over 90% residential) in Sussex and Kent Counties. DEC is a member-owner of the Old Dominion Electric Cooperative that owns coal, nuclear, and gas-fired generation and provides wholesale electricity to DEC and similar distribution cooperatives throughout Maryland and Virginia. DEC's 2009 Annual Report (at page 2) describes itself as follows:

> We are a member-owned, member-focused, not-for-profit Cooperative which provides high valued energy and service to our members at cost. Our rates are designed to recover our costs to provide electric energy and service to our members and nothing else.

> However, we must make a small margin to assure our suppliers and creditors that we can pay our bills and assure our members that we will be able to keep the lights on. Another good part about being a Cooperative is, if we do make a margin, we allocate it back to our members in the form of capital credits.

According to Mr. William ("Bill") Andrew, President and CEO of DEC, as a result of the recent economic downturn, the Coop was not meeting its load growth expectations and viewed its best growth option to be the acquisition of new customer/members through the purchase of municipal power systems in Delaware. DEC's proposal to acquire the Lewes electric utility is part of that effort. Similar overtures have been made to several other municipal systems in Delaware, but none have, as yet, agreed to sell.

Another reason for DEC's interest in acquiring municipal systems is the loss of customers that occurs when rural areas are annexed into municipalities. Such annexation poses unique issues when the acquiring municipality of a coop-served area operates its own electric utility. In that situation, the municipality is not required to condemn and purchase Coop assets but may allow (or require) the Coop to continue service to existing customers. However, the municipal system has the right to serve new electric customers in the annexed area. In this situation, the cooperative is likely to lose desirable high density load over time and be left with unused distribution and substation capacity. DEC's interest in avoiding this problem, and its interest in acquiring more commercial and industrial load, are among its reasons for wanting to acquire the Lewes electric department.

The service area of the Coop abuts that of the BPW Electric Department. Accordingly, one significant advantage to the Coop if it takes over BPW's electric system is that it would confront few near-term needs for capital improvements to the electric system and could use the significant spare transformer and interconnection capacity in BPW's substation to serve cooperative customers located near the BPW system. In essence, the Coop could extend distribution lines from the BPW system to serve nearby distribution feeders of the Coop at low incremental cost. Moreover, the Coop could extend lines into the City from substations other than the substation that is now supplying BPW. This feature is a further value enhancement for DEC.

While DEC's management has had discussions with BPW's Board, there has been no official written offer, although several draft documents have been provided (i.e., a power point presentation, a draft Letter of Intent, etc.). In response to DEC's overture, BPW provided certain data to the Cooperative. DEC reviewed these data but did not conduct a full-blown due diligence effort. We understand that at that time DEC discussed a possible sale price in the range of $12-14 million dollars, noting that it had not conducted a complete due diligence. A $14 million price is at the lower end of what we would consider to be the fair market value of the Lewes electric system (see valuation analysis above). We expect that this suggested amount represents DEC's initial non-binding proposal before considering a full due diligence analysis. As such, it should not be viewed as a best and final offer. As discussed above, a higher valuation can be justified. Indeed, there are additional value factors specific to DEC's prospective acquisition of the Lewes electric department, some of which are not discussed in this Report, that we believe would likely cause DEC to agree to a higher price, close to our valuation, in actual negotiations leading up to any sale. As part of DEC's proposal, we understand that the Coop would like to retain all of the BPW's current electric department employees as Coop employees, as long as

they join the established union and pass the Coop's usual employee background checks. While this employee transfer to DEC is likely to be a positive feature of DEC's offer from the perspective of employees, it could pose some problems for BPW's remaining utility services that are now in part supported by electric department employees who may depart.

In giving consideration to a potential takeover of the municipal utility by DEC, we also considered alternative takeover scenarios. Of these, the most feasible would appear to be a sale of the Lewes electric system to Delmarva Power (Connectiv). Delmarva is a far more likely candidate than other investor-owned utilities because of its nearby location. Based on our comparative review of Delmarva (which is subsidiary of Pepco Holdings) and DEC, we have concluded that DEC is clearly a far superior alternative. DEC has lower rates and costs than Delmarva, as well as much more stable, reliable and known future electric generation supply sources. In addition, DEC is customer-owned and managed by Delaware residents (Lewes residents would also become owner-members of the Coop if DEC acquires the Lewes electric system), and it is not subject to remote corporate strategies and manipulations. Pepco has recently sold off much of it historic generating capacity and entered into questionable purchase contracts to replace self-generation. We do not rank Pepco's (or Delmarva's) management nearly as high as we would DEC's, and we would speculate that in the near future Pepco (and Delmarva) will become takeover candidates, much as Constellation Energy (BG&E) and Progress Energy (Carolina Power and Light) are today. We have reviewed DEC's resources and operations and find DEC to be a highly qualified and capable alternative for Lewes, in the event that the City determines to sell its electric utility.

Financial Status of DEC

DEC, like the BPW, also has a solid financial basis. As noted previously, DEC's electric rates are lower than those of all other Delaware utilities, largely because its purchased power costs are lower. Below is a table comparing several aspects of the BPW and DEC for the most recent year available (FY ending in 2009).

As shown below, in 2009 DEC took in less revenue per kWh, at 12.4 ¢/kWh, compared to the BPW's revenues of 14.4 ¢/kWh. This was largely attributable to DEC's lower purchased power supply costs of 8.8 ¢/kWh compared to the BPW's 10.5 ¢/kWh. Other reasons for DEC's lower rates are Lewes' higher operating margins (profits), the allocation of some sewer and water costs to the electric utility and payments by Lewes (and free electricity in 2009) to the City. On a cost basis, excluding purchased power costs, DEC's operating costs were actually slightly higher than the BPW's by 0.35 ¢/kWh.

Table 8

Lewes BPW Electric Department and Delaware Electric Cooperative				
2009 Operating Statistics				
Revenues And Operating Expenses				
	Lewes		Delaware Coop	
Description	Dollars	Dollars/kWh	Dollars	Dollars/kWh
Total kWh	80,723,000		1,151,037,083	
Operating Revenue	$ 11,605,355	$ 0.1438	$ 142,429,511	$ 0.1237
Cost Of Electric Service				
Purchased Power	$ 8,484,563	$ 0.1051	$ 101,749,592	$ 0.0884
Total Operating Expense	$ 9,986,847	$ 0.1237	$ 120,139,049	$ 0.1044
Total Operating Expense				
Excluding Purchased Power	$ 1,502,284	$ 0.0186	$ 18,389,457	$ 0.0160
Total Cost of Elec. Service	$ 10,484,462	$ 0.1299	$ 134,271,266	$ 0.1167
Total Cost of Electric Service				
Excluding Purchased Power	$ 1,999,899	$ 0.0248	$ 32,521,674	$ 0.0283
Operating Margins	$ 1,120,893	$ 0.0139	$ 8,158,245	$ 0.0071

While DEC has substantial assets, comprised of $153 million in net utility plant assets, as well as over $97 million in Equities & Margins, unlike Lewes it reports relatively little in the way of cash and cash equivalents on its balance sheet.

Power Supply of DEC

DEC purchases all of its power and transmission service from Old Dominion Electric Cooperative ("ODEC"), of which it is an owner, and has a contract covering all-requirements power through 2054. That contract continues past 2054 unless three years' notice of cancellation is provided. ODEC is a power supply cooperative, formed in 1948 to provide power to a consortium of electric distribution cooperatives in Virginia, Maryland and Delaware, who are its owners.

ODEC, as a consumer-owned power supplier, generates, purchases and delivers electricity to its wholesale customer-owners, including DEC. DEC is the third largest of eleven cooperative

member-owners of ODEC, and it provided nearly 13% of ODEC's total revenues in 2010.[8] ODEC recovers all of its costs, expenses and financial obligations by means of a formula rate, which is filed at the Federal Energy Regulatory Commission ("FERC"). DEC, in turn, recovers all of these costs through wholesale power revenues obtained from its customer-members, without any State regulation. (See ODEC 10-K, p. 5).

In 2010, ODEC generated over 45% of the energy it sold to its members from its ownership in one nuclear plant, one coal plant, and three gas-fired combustion turbine facilities. ODEC owns 2,000 MW of generation resources (11% nuclear, 22% coal-fired and 67% gas-fired). These resources and one long term power purchase contract provide 62% of DEC's energy needs, with the remainder being met with contracts for renewable resources, mid-term purchase contracts and shorter term market purchases. As a result of ODEC's resource ownership, it has a physical hedge against volatility in movements in market prices. This is especially true with respect to ODEC's coal and nuclear assets, whose capital costs have largely been written off, and which rely on fuels whose costs tend to be lower and more stable than gas-driven market supply costs. ODEC's owned generation also meets a large share of the "capacity" needs of ODEC and its members (over 75%), as PJM requires utilities to have adequate installed generating capacity resources on hand in order to meet loads. ODEC also hedges its risks in the market by means of various contracts.

ODEC's 2010 operating cost of power supply totaled approximately 6.2 ¢/kWh (Operating Expenses of $790.8 million divided by 12,751,906 MWH, as provided in ODEC's 10-K at pages 6 and 34). The average cost to the member cooperatives for the same period was 6.92 ¢/kWh (*Ibid*, page 32). DEC has been told that ODEC's expected power supply costs in 2015 are estimated to be approximately 8 ¢/kWh.[9] ODEC's current total average cost per kWh of wholesale power supply is under 8 ¢/kWh, which includes the cost of transmission service.

Physical Interconnection

As described above in the discussion of the *Status Quo* alternative, the BPW system is supplied by Connectiv's Harbeston-Rehoboth 69 kV line, from which the tap line extends into the BPW's Schley Avenue Substation. While the BPW has worked with Connectiv on segmenting this line so that Lewes can continue receiving service if a portion of the 69 kV line experiences an outage, the entire BPW system is susceptible to a complete outage of the 69 kV line feeding Schley Avenue Substation. A new Wellfield Substation was proposed in 2005 by Booth & Associates in order to provide a second 69 kV supply feed but was not built because of its substantial cost and because it would have been fed from the same segment of Connectiv's 69 kV circuit that supplies Schley Avenue Substation, still leaving BPW susceptible to an outage of that Connectiv 69 kV supply.

[8] ODEC 2010 10-K at page 2.

[9] As reported to Consultants in a 5/3/11 telephone conference with Bill Andrew, Gary Cripps and Bruce Campbell of DEC. We understand that the estimate was made from a recent market power report from the Alliance for Competitive Energy Services Power Marketing LLC ("ACES"), an energy trading firm that assists ODEC.

The Coop's service area abuts the City of Lewes, and DEC's management has indicated that its existing 12 kV feeders can be extended along several routes into the City of Lewes. Such 12 kV extensions could enable the Coop to provide backup for the Schley Avenue Substation and also enable it to draw upon the extra transformer capacity in the Substation to serve as a primary or backup supply for existing and new Coop customers located outside Lewes.

Other Factors

If the Lewes system is acquired by DEC, customers in Lewes would be charged the same rates as DEC's other Delaware customers, with a possible short term exception depending on how the addition of the Lewes load alters DEC's wholesale power costs. When a member coop of ODEC acquires new loads in this way, ODEC makes a determination of whether that new load will increase or decrease its average annual power supply costs. If an increase or a decrease is indicated, that amount is reflected in wholesale power supply charges to the member coop for three years (75 % of the difference in the first year, 50% in the second year and 25% in the third year). In two similar situations in the recent past, one resulted in a cost increase and one resulted in a cost decrease. In Lewes' case, the need for ODEC to increase its incremental power supply at market costs could result in a (we think small) cost increase. On the other hand, the addition of Lewes' relatively high load factor load could result in a cost decrease for both ODEC and DEC. On balance, it is our best judgment at this time that any cost impact of adding the Lewes load would be small. Moreover, if there is such an impact, DEC has the option of embedding the cost surcharge in its overall average rates rather than tracking it through to customers in Lewes. This would be a matter of negotiation between DEC and Lewis. However, since we anticipate that any ODEC surcharge would be small, we do not see this as a major issue.

Another important issue regarding the sale of the electric department is that such a sale would cause an increase in support costs to be recovered by the other BPW utility departments. This increase would occur because the electric department has been subsidizing the water, sewer and storm water utilities. With a sale of BPW's electric department, the water, sewer and storm water departments would no longer receive those cross subsidies and would be required to bear a substantial portion of overhead costs that are now allocated to, and borne by, the electric department (and reflected in electric rates).

Similarly, approximately five years ago BPW was forced to incur substantial debt for capital improvements to its water and sewer departments. In order to ease the burden of external financing, the BPW decided to take funds set aside from earnings by the electric department. If the electric department were sold, that option would not be available in the future if the BPW is again faced with a similar need for capital funds to meet the needs of water, sewer or storm water customers.

Likewise, in FY 2008 and 2009, the BPW's financial statements show interfund borrowings going from the electric department to the water and sewer departments. In 2009, this amount was $774,451, while in 2008 the amount was $692,936. We understand that these loans from one department to another have not always been repaid. While the BPW's forecasted budget for the next five years does not show any interfund borrowings occurring, the income projections for

the water, sewer and storm water departments show substantially lower margins for these departments, and therefore a greater risk of being in the red. In any event, rates for these other utility services would have to increase if the electric department is sold, as they would then have to bear the BPW's entire overhead cost, which is now being carried largely by the electric utility.

A final issue is that, in the event of a sale, BPW could also be at risk of losing to the Coop employees who are cross-trained to provide skills needed by both the electric department and one or more of BPW's other utilities. Such an outcome could leave the non-electric utility departments with unfilled needs for skilled employees.

3. the Purchase of Electricity to DEMEC Alternative

In recent years, the BPW electric utility has purchased 100% of its power supply requirements from Constellation Energy, most recently under a 27-month contract that expired on May 31, 2011. Under that contract, BPW paid a fixed energy charge per Mwh, plus various PJM-related capacity and transmission charges. During BPW's fiscal year ended September 30, 2009, BPW experienced an annual average total cost of purchased power (both energy and capacity) of $100.88 per MWh, or $0.1088 per Kwh. More recently, the total cost of purchased power under the Constellation Energy contract declined substantially to $81.10 per Mwh, based on a $58.84 per MWh energy charge, for the seven months ended December 31, 2011.[10] This decline was due largely to a corresponding decrease in natural gas generating costs.

Earlier this year, the BPW and Constellation Energy entered into a new full requirements power supply contract effective June 1, 2011, that will terminate May 31, 2012. Under the new contract, BPW will pay a fixed energy charge of $63.84 per Mwh, which, when combined with the capacity and transmission charges, will result in a total cost of purchased power during June 2011 through May 2012 of approximately $87.44 per Mwh, or $0.0874 per Kwh.

In performing the analysis of alternatives available to the City for meeting the electricity needs of its residents and businesses, we have made two comparisons. First, we compared the BPW electric utility's actual cost of service in 2009, using Constellation Energy as a power supplier, with DEC's actual cost of service in that same year. Second, we compared the BPW electric utility's cost of service using DEMEC as a power supplier, with DEC's cost of service, on both an historical and projected basis.

We first compared the BPW's actual cost of service during its fiscal year ended September 30, 2009, with DEC's actual cost of service during calendar year 2009. [11] That comparison showed that the BPW's average annual cost of purchased power during the year ended September 30, 2009 ($0.1002 per Kwh), was significantly greater than that which was experienced during calendar year 2009 by DEC ($0.0821 per Kwh). DEC's cost of purchased power advantage in

[10] Constellation Energy invoices to BPW for June 2010 – December 2010.

[11] Calendar year 2009 purchased power costs and other operating expenses information is not available for the BPW, and comparable information for the year ended September 30, 2009, is not available for DEC. However, because both year-end time periods include 12 consecutive months including nine common months, the cost comparisons that have been made for 2009 are reasonable.

2009 over the BPW electric utility was partially offset by the BPW having somewhat lower "Other Operating Expenses." Nevertheless, the BPW electric utility's average *total* cost of electric service, including all distribution costs, during the year ended September 30, 2009, was greater than DEC's average *total* cost of service in calendar year 2009. This is shown in the cost of service comparisons of the BPW electric utility with DEC that are presented in Table 9. As shown there, during 2009, with the BPW electric utility buying all of its power supply requirements from Constellation Energy, DEC's total cost of service of $0.1165 per Kwh was $0.0126 per Kwh below BPW's. This produced an annual cost advantage in 2009 for DEC over the BPW of $1.0 million.

It should be emphasized that the historical cost advantage of DEC over the BPW electric utility of $1.0 million in 2009, as shown in Table 9, was entirely due to DEC's lower purchased power costs. Indeed, as is also shown at line 27 of Table 9, the BPW electric utility had lower "Other Operating Expenses" per Kwh in 2009 ($0.0233) than DEC ($0.0282). This suggests that if the BPW were to reduce its power supply costs, in comparison with DEC, the total cost of service advantage that DEC had in 2009 would in turn be reduced, or perhaps even entirely eliminated.

With this in mind we next evaluated an alternative power supply arrangement that is available to the BPW electric utility - a switch to a different supplier when the current contract with Constellation Energy terminates on May 31, 2012. An obvious and readily available alternative for this purpose is DEMEC, of which Lewes is already a member. In addition to gaining the potential advantage of DEMEC rates, this switch would largely eliminate BPW's power supply acquisition function which is now a major management responsibility and work requirement.

DEMEC is a public corporation constituted as a Joint Action Agency in 1979, made possible by an act of the Delaware General Assembly on June 6, 1978. DEMEC operates as an actual or potential wholesale electric utility supplier to its nine members, who are the cities and towns of Clayton, Dover, Lewes, Middletown, Milford, New Castle, Newark, Seaford, and Smyrna. These DEMEC members represent all of the major cities and towns in Delaware, except Wilmington, and they provide retail electricity service to over 100,000 residential and business customers in their respective communities.

DEMEC is a generation owner and the PJM Load Serving Entity for seven of its municipal utility members (all except Lewes and Dover) and provides 100% of their wholesale power supply requirements, amounting to over 231 MW of peak day requirements, and over 1,100,000 Kwh of total annual electricity demand. In total, all nine of DEMEC's members have a combined peak load of over 450 MW, and a total annual power supply requirement of nearly 2 million Mwh.

DEMEC owns Unit #1 of the Warren F. "Sam" Beasley Power Station, a 45 MW natural gas fired combustion turbine generator located in Smyrna, Delaware. The seven DEMEC members being supplied by DEMEC (Lewes and Dover not included) are entitled to their contractual share of all power supply and ancillary products generated from the Smyrna facility. In addition, each of the seven participating DEMEC members purchases 100% of their remaining power supply requirements from DEMEC, under long-term full requirements contracts that became effective January 1, 2004, and which will remain in effect unless terminated upon one year's written notice by either party.

Table 9

Annual Cost Of Electricity Service For Lewes BPW And Delaware Electric Coop
Based On Actual 2009 Operating Statistics

Line No.		Market Requirement And Total Supply Requirement					
		Lewes BPW Fiscal Year 2009		1/	DEC Calendar Year 2009		
		Kwh	$/Kwh		Kwh	$/Kwh	
1	Kwh Market Requirement	80,226,088			1,152,618,732		
2	Kwh Losses	3,878,983			86,567,692		
3	Kwh Purchases	84,105,072	$ 0.10088		1,239,186,424	$ 0.08211	
4							
5		Actual Cost Of Service					
6		Lewes BPW Fiscal Year 2009		1/	DEC Calendar Year 2009		
7			$/Kwh Of			$/Kwh Of	
8		Kwh Or	Market		Kwh Or	Market	
9	Costs Of Service	Dollars	Requirement		Dollars	Requirement	
10	Purchased Power Costs	$ 8,484,563	$ 0.1058		$ 101,749,592	$ 0.0883	
11	Other Operating Expenses						
12	Payroll/Employ. Related Exp.	$ 561,128	$ 0.0070				
13	Utilities	$ 22,518	$ 0.0003				
14	Repairs & Maintenance	$ 96,563	$ 0.0012				
15	Professional and Contract Svcs.	$ 3,809	$ 0.0000				
16	Other Supplies & Expenses	$ 264,697	$ 0.0033				
17	Administrative	$ 291,544	$ 0.0036				
18	Interest Expense	$ 170,000	$ 0.0021				
19	Bad Debt	$ 32,349	$ 0.0004				
20	Depreciation & Amortization	$ 429,072	$ 0.0053		$ 9,239,978	$ 0.0080	
21	Distribution Expense				$ 8,538,513	$ 0.0074	
22	Consumer Accounts Expense				$ 4,169,733	$ 0.0036	
23	Administrative & General				$ 5,681,211	$ 0.0049	
24	Taxes				$ 2,253	$ 0.0000	
25	Interest on Long-Term Debt				$ 4,520,387	$ 0.0039	
26	Other Deductions				$ 369,599	$ 0.0003	
27	Total Other Operating Expenses	$ 1,871,680	$ 0.0233		$ 32,521,674	$ 0.0282	
28	Total Costs of Electric Service	$ 10,356,243	$ 0.1291		$ 134,271,266	$ 0.1165	
29	**2009 DEC Cost Advantage vs Lewes BPW**						
30	**Per Kwh**		**$ 0.0126**				
31	**Total Dollars**		**$ 1,010,517**				
32							
33	1/ Lewes BPW fiscal year is 12-months ended September 30, 2009.						
34							
35	Sources: (a) Lewes BPW data: February 2010 *Cost of Service/Unbundling Study FY2010*, and EIA-861 Report.						
36	(b) DEC data: 2009 Annual Report and 2010 Power Requirements Study.						

The Consultants have discussed with DEMEC the possibility of the BPW electric utility becoming full requirements customer of DEMEC after the current contract with Constellation Energy expires on May 31, 2012.[12] As a test of the economic feasibility of switching to DEMEC for power supplies in the future, Table 10 was prepared to see first how the BPW's electric utility cost of service would have compared with DEC's if DEMEC had been BPW's power supplier in 2009. As is shown there, replacing Constellation Energy's power supply cost of $0.1009 per Kwh in 2009 with DEMEC's lower average annual power supply cost of $0.0916 per Kwh significantly reduces DEC's total cost of service advantage over the BPW in 2009, from $1,010,517, down to $228,297, or $0.0028 per Kwh.[13]

We then made a comparison of the future cost of service for the BPW electric utility and DEC for 2015. This was done by obtaining from DEMEC and DEC their currently available best estimates of their average annual full requirements power supply costs for 2015.[14] We used the BPW's April 2011 five-year revenue and cost of service projection to estimate BPW's 2015 "other operating expenses", i.e., operating expenses excluding power supply costs. For DEC, we increased its 2009 other operating expenses by the percentage increases from 2009 to 2015 that the BPW used in its projection of 2015 other operating expenses. Using those projections, Table 11 was prepared to present a comparison of projected BPW *total* cost of service using DEMEC as a supplier in 2015, with projected DEC *total* cost of service in 2015.

One of the comparisons presented in Table 11 shows that if the recent DEMEC and DEC power supply cost projections are accurate, with DEMEC as BPW's power supplier, the BPW electric utility would have a total cost of service advantage over DEC in 2015, amounting to $144,010, or $0.0018 per Kwh. This $144,010 cost advantage may be an understatement as it does not account for recently implemented BPW personnel changes that have reduced staffing to 14 employees. In this connection, it should be noted that the cost comparisons contained in Table 11 include estimated annual payments to the City of Lewes by the BPW electric utility of $125,000 for rent, and a $675,800 PILOT payment. While these payments show up in the analysis as part of "Other Operating Expenses" of the BPW electric utility in 2015, they also represent substantial economic benefits to the city of Lewes, most of which would be eliminated if DEC were to acquire the BPW electric utility.

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[12] May 25, 2011, teleconference with Patrick McCullar, President and CEO of DEMEC. Mr. McCullar assured the Consultants that DEMEC would be pleased to be the BPW electric utility's full requirements power supplier.

[13] The costs of purchased power for DEMEC and DEC shown in Table 2 are both for calendar year 2009. Thus, only the "Other Operating Expenses" data shown there are for slightly different time periods, i.e, the year ended September 30, 2009, in the case of the BPW, and calendar year 2009, for DEC.

[14] For DEMEC, based on the May 25, 2011 teleconference with Mr. McCullar, in which he reduced DEMEC's May 5, 2011, projected 2015 rate of REDACTED so as to reflect DEMEC's recent downward adjustment to the PJM capacity cost rate (from $0.02175 per Kwh to $0.015 per Kwh). For DEC, based on the $0.08 per Kwh estimated rate for 2015, as was told to the Consultants in a May 3, 2011, teleconference with Bill Andrew, Gary Cripps and Bruce Campbell of DEC, adjusted downward to $0.0763 per Kwh, to reflect the same downward adjustment to the PJM capacity cost rate (from $0.02175 per Kwh to $0.015 per Kwh).

Table 10

Annual Cost Of Electricity Service For Lewes BPW And Delaware Electric Coop
Based On Adjusted 2009 Operating Statistics For Lewes BPW and Actuals For DEC

Line No.		Market Requirement And Total Supply Requirement			
		Lewes BPW Fiscal Year 2009		1/ DEC Calendar Year 2009	
		Kwh	$/Kwh	Kwh	$/Kwh
1	Kwh Market Requirement	80,226,088		1,152,618,732	
2	Kwh Losses	3,878,983		86,567,692	
3	Kwh Purchases	84,105,072	$ 0.09158	1,239,186,424	$ 0.08211
4					
5		With Adjusted Cost Of Service For Lewes BPW			
6		Lewes BPW Fiscal Year 2009		1/ DEC Calendar Year 2009	
7			$/Kwh Of		$/Kwh Of
8		Kwh Or	Market	Kwh Or	Market
9	Costs Of Service	Dollars	Requirement	Dollars	Requirement
10	Purchased Power Costs	$ 7,702,342	$ 0.0960	$ 101,749,592	$ 0.0883
11	Other Operating Expenses				
12	Payroll/Employ. Related Exp.	$ 561,128	$ 0.0070		
13	Utilities	$ 22,518	$ 0.0003		
14	Repairs & Maintenance	$ 96,563	$ 0.0012		
15	Professional and Contract Svcs.	$ 3,809	$ 0.0000		
16	Other Supplies & Expenses	$ 264,697	$ 0.0033		
17	Administrative	$ 291,544	$ 0.0036		
18	Interest Expense	$ 170,000	$ 0.0021		
19	Bad Debt	$ 32,349	$ 0.0004		
20	Depreciation & Amortization	$ 429,072	$ 0.0053	$ 9,239,978	$ 0.0080
21	Distribution Expense			$ 8,538,513	$ 0.0074
22	Consumer Accounts Expense			$ 4,169,733	$ 0.0036
23	Administrative & General			$ 5,681,211	$ 0.0049
24	Taxes			$ 2,253	$ 0.0000
25	Interest on Long-Term Debt			$ 4,520,387	$ 0.0039
26	Other Deductions			$ 369,599	$ 0.0003
27	Total Other Operating Expenses	$ 1,871,680	$ 0.0233	$ 32,521,674	$ 0.0282
28	Total Cost of Electric Service	$ 9,574,022	$ 0.1193	$ 134,271,266	$ 0.1165
29	**Adjusted 2009 DEC Cost Advantage vs Lewes BPW**				
30	**Per Kwh**		**$ 0.0028**		
31	**Total Dollars**		**$ 228,297**		
32					
33	1/ Lewes BPW fiscal year is 12-months ended September 30, 2009.				
34					
35					
36	Sources: (a) Lewes BPW data: February 2010 *Cost of Service/Unbundling Study FY2010*, and EIA-861 Report.				
37	(b) DEC data: 2009 Annual Report and 2010 Power Requirements Study.				
38	(c) Demec power supply cost data: DEMEC's May 5, 2011 Power Supply Cost Study.				

Table 11

Projected 2015 Annual Cost Of Electricity Service For Lewes BPW And Delaware Electric Coop
Based On Recent DEMEC And DEC Purchased Power Cost Projections And
Equal Percentage Increases in Certain Other Operating Expenses

Line No.		Projected 2015 Market Requirement And Total Supply Requirement Set Equal To 2009					
		Lewes BPW			DEC		
		Kwh		$/Kwh	Kwh		$/Kwh
1	Kwh Market Requirement	80,226,088			1,152,618,732		
2	Kwh Losses	3,878,983			86,567,692		
3	Kwh Purchases	84,105,072		Redacted	1,239,186,424		Redacted
4							
5		Projected 2015 Cost Of Service - Including BPW Payments in Lieu Of Taxes					
6		Lewes BPW			DEC		
7		Actual	Projected	$/Kwh Of	Actual	Projected	$/Kwh Of
8		FY 2009	2015	Market	CY 2009	2015	Market
9	Costs Of Service	Dollars	Dollars 1/	Requirement	Dollars	Dollars 2/	Requirement
10	Purchased Power Costs	$ 8,484,563	Redacted		$ 101,749,592	Redacted	
11	Other Operating Expenses						
12	Depreciation & Amortization	$ 429,072	$ 505,912	$ 0.0063	$ 9,239,978	$ 10,894,712	$ 0.0095
13	Interest Expense	$ 170,000	$ 321,100	$ 0.0040	$ 4,520,387	$ 8,538,213	$ 0.0074
14	Distribution, A&G and Other	$ 1,272,608	$ 2,047,300	$ 0.0255	$ 18,761,309	$ 30,182,136	$ 0.0262
15	Payment in Lieu of Taxes	$ -	$ 675,800	$ 0.0084	$ -	$ -	$ -
16	Total Other Oper. Expenses	$ 1,871,680	$ 3,550,112	$ 0.0443	$ 32,521,674	$ 49,615,061	$ 0.0430
17	Total Cost of Electric Service	$ 10,356,243	$ 9,984,150	$ 0.1245	$ 134,271,266	$ 145,512,601	$ 0.1262
18	**Estimated 2015 Lewes BPW Cost Advantage vs DEC**						
19	**Per Kwh**			**$ 0.0018**			
20	**Total Dollars**			**$ 144,010**			
21		Projected 2015 Cost Of Service - Excluding BPW Payments in Lieu Of Taxes					
22		Lewes BPW			DEC		
23		Actual	Projected	$/Kwh Of	Actual	Projected	$/Kwh Of
24		FY 2009	2015	2015 Market	CY 2009	2015	2015 Market
25	Costs Of Service	Dollars	Dollars 1/	Requirement	Dollars	Dollars 2/	Requirement
26	Purchased Power Costs	$ 8,484,563	Redacted		$ 101,749,592	Redacted	
27	Other Operating Expenses						
28	Depreciation & Amortization	$ 429,072	$ 505,912	$ 0.0063	$ 9,239,978	$ 10,894,712	$ 0.0095
29	Interest Expense	$ 170,000	$ 321,100	$ 0.0040	$ 4,520,387	$ 8,538,213	$ 0.0074
30	Distribution, A&G and Other	$ 1,272,608	$ 2,047,300	$ 0.0255	$ 18,761,309	$ 30,182,136	$ 0.0262
31	Total Other Oper. Expenses	$ 1,871,680	$ 2,874,312	$ 0.0358	$ 32,521,674	$ 49,615,061	$ 0.0430
32	Total Cost of Electric Service	$ 10,356,243	$ 9,308,350	$ 0.1160	$ 134,271,266	$ 145,512,601	$ 0.1262
33	**Estimated 2015 Lewes BPW Cost Advantage vs DEC**						
34	**Per Kwh**			**$ 0.0102**			
35	**Total Dollars**			**$ 819,810**			

Sources: (a) Lewes BPW data: For Fiscal Year 2009, February 2010 *Cost of Service/Unbundling Study FY2010*, and EIA-861 Report. For 2015, BPW's April 2011, updated 5-year budget projectio for 2011-2015.
(b) DEC 2009 data: 2009 Annual Report and 2010 Power Requirements Study. 2015 Other Operating Expense was escalated from 2009 at the same percentage increase that applies to Lewes BPW, i.e.,
(c) Demec 2015 power supply cost projections, dated June 1, 2011.

Table 11 also contains a comparison of the BPW electric utility's projected costs of service in 2015 using DEMEC as a supplier, but excluding PILOT payments of $675,800, with the projected DEC cost of service in 2015. This was done so as to present a 2015 costs comparison of BPW with DEC that takes into account the significant benefit that the City of Lewes realizes from PILOT payments that would largely be lost if the BPW electric utility is sold to DEC. As shown in Table 11, the exclusion of PILOT payments from BPW's cost of service increases the estimated 2015 cost advantage of the BPW electric utility over DEC to $819,810, or $0.0102 per Kwh.

Assuming that the smaller cost advantage of $144,010, as indicated in Table 11, is added to a net loss of $600,000 in tax payments (PILOT less DEC's property tax assessment) and $50,000 in rent, plus $250,000 of higher rates for sewer and water services, the sale of the electric utility would have a net present value ("NPV") cost to the City of approximately $18 million discounted at 5% over 40 years. This amount increases to about $22 million if we give consideration to the minimal likely growth of PILOT payments to the City as costs and sales increase over time (i.e., a combined annual sales and cost increase of 2.5%). On a perpetual basis, the NPV cost to the city would be about $21 million without PILOT growth and more than $25 million considering PILOT growth. Thus, a payment to the City of more than $20 million for the utility would be required to achieve break even in a long run assessment.

4. **the Water/Sewer Departments Alternative**

The BPW water and sewer departments could very likely be sold to one of two water utility companies, both of which are publicly traded and are regulated by the Delaware Public Service Commission. These companies are primarily focused on water, but both have some waste water customers. These companies have not been contacted, nor do we know whether they have any active interest in acquiring the BPW water and/or sewer departments. However, we do understand that Tidewater Utilities ("TU") took over the Town of Milford's water department not long ago.

Tidewater Utilities, is part of the Middlesex Water Company, which operates in New Jersey, Delaware and Pennsylvania. Middlesex had net income of $14.3 million on operating revenues of $102.7 million in 2010. As of 12/31/10, the total assets of Middlesex were $489 million, while its long-term debt was $133.8 million. Tidewater Utilities and Southern Shores, the Delaware subsidiaries of Middlesex, provide water services to 34,000 retail customers in New Castle, Kent and Sussex Counties, close to Lewes.

Artesian Water Company is a subsidiary of Artesian Resources Corporation, which does business in Delaware, Maryland and Pennsylvania. Artesian had operating revenues of $56.7 million in 2010, and net income of $7.6 million. Artesian's total assets at year-end 2010 were $345.4 million, while its long-term debt was $106.6 million. Artesian had a total of 78,400 metered customers in 2010, primarily in Delaware.

Below is a comparison of the water tariff rates for the BPW, Tidewater ("TDU") and Artesian ("AWC").

Table 12

Water Tariff Comparison							
		BPW	BPW	TU	TU	AW	AW
		Quarterly	Water	Quarterly	Water	Quarterly	Water
		Facilities	Usage	Facilities	Usage	Facilities	Usage
		Charge	Charge	Charge	Charge	Charge	Charge
Size of Meter		$/3-Months	$/1000 gal*	$/3-Months	$/1000 gal	$/3-Months	$/1000 gal*
5/8"		45.00	0.90	47.62	6.7769	34.67	5.893
1"		57.30	0.90	79.37	6.7769	55.44	5.893
1-1/2"		73.62	1.28	142.87	6.7769	110.85	6.133
2"		118.62	1.28	222.24	6.7769	145.50	6.133
3"		450.00	1.52	428.61	6.7769	221.73	6.565
4"		552.24	1.52	666.73	6.7769	318.75	6.565
6"		859.11	1.64	1301.70	6.7769	554.34	6.781
* Graduated Usage Charge							
		0 - 4,500	0.900			0 - 5,000	5.893
		4,501-9,000	1.650			5,001-20,000	6.372
		Over 9,001	2.000			Over 20,000	7.429
			BPW		TU		AW
5/8" Meter at 4,500 gal:			$ 49.05		$ 78.12		$ 61.19
2" Meter at 8,000 gal:			$ 128.45		$ 276.46		$ 194.08
6" Meter at 25,000 gal:			$ 902.59		$ 1,471.12		$ 679.39

As Table 12 shows, BPW has the lowest rates for the modeled customers in all but one instance. The BPW also has higher rates for those customers outside of city limits. Each utility also has miscellaneous fees for turning off and turning on the water (primarily for seasonal residents), as well as other fees that may be in addition to the tariff rates shown above.

Tidewater and its affiliates in Delaware serve close to 10,000 residential customers with waste water service. Tidewater charges a set rate for its waste water services, which varies depending upon the community served. Annual rates range from $850 to $1,125 per year per residential

dwelling. Artesian also charges an annual waste water service rate of $900 for each residential dwelling unit. Commercial and industrial service is determined separately, and rates are not available. The BPW, on the other hand, establishes sewer rates on the same cost of service basis as is used in setting its water rates.

Below are BPW's sewer rates, effective June 1, 2010:

Table 13

BPW Sewer Rates Effective 6/1/2010			
		Monthly Facilities Charge In-City	Monthly Facilities Charge Outside City
Size of Meter		$/Month	$/Month
5/8"		50.00	75.50
1"		63.65	96.11
1-1/2"		81.80	123.52
2"		131.80	199.02
3"		500.00	755.00
4"		613.60	926.54
6"		954.55	1441.37
Consumption Charge ($/1000 gallons based on 80% water used)			
		In-City	Outside
Residential		5.500	8.31
Commercial		6.050	9.14
Industrial		6.050	9.14

A small residential customer, using 4,500 gallons each month, would end up paying less than $840 per year under these rates, slightly lower than Tidewater's lowest rate, and lower than Artesian's residential rate.

Comparison of Monthly Residential Sewer Bill			
Customer	**Lewes**	**Tidewater**	**Artesian**
Residential (4,500 gal)	$ 69.80	$ 70.83	$ 75.00

At this time, it does not appear cost-effective to sell the BPW's water and sewer departments if ownership of the electric utility is retained. However, if a sale of the electric utility results in a large increase in rates for water or sewer service as indicated above, this would have an impact on the comparisons shown here and make a prospective sale more advantageous.

5. **the Waste Water Facility Operations In-House Alternative**

One of the alternatives that the BPW is considering is terminating its service contract with Severn Trent as operator of BPW's waste water treatment facility ("WWTF") plant, and having plant operations performed in-house. The current service contract with Severn Trent costs approximately $30,333 per month ($364,000 annually), with the BPW also paying all expenses of the WWTF in addition to this fee. Other expenses include costs for chemicals, maintenance and other operating costs. Thus, if the BPW can replace the employees now provided by Severn Trent to service the WWTF at less than the current $364,000 annual cost, it would be economically effective to terminate the contract and move these operations in-house.

The General Manager estimates that three additional BPW employees would be needed to take over operation of the WWTF. These new employees would be augmented by current BPW water/sewer staff already on hand, who would help provide 24-hour service at the plant. BPW records indicate that water treatment plant employees are being paid $30,000 to $45,000 per year, not including benefits. Using the midpoint of this range, and assuming that benefits would add 100% to base salary costs, the estimated annual cost of the additional employees required to assume full BPW operation of the WWTF would be approximately $225,000 per year. This, in turn, would represent annual savings for the BPW of approximately $140,000 compared to the present contract. Furthermore, the BPW's new General Manager has recently been certified to operate the WWTF facility. Thus, this alternative makes good economic sense no matter what other alternatives are pursued.

6. **Absorbs All or Remaining Departments Alternative**

As noted above, we have given consideration to the possibility of the City directly absorbing BPW operations and see no great merit to that possibility if ownership and operation of the

electric department is maintained. Electric utility operations and service is a highly specialized industry requiring expertise and responses that differ substantially from most municipal government functions. In our opinion, the structure that has been carefully put in place and that now exists and is working properly should be retained. This structure, which separates BPW from other municipal service functions, including finance, is an efficient and sensible one that is well designed to provide reliable and efficient service on a cost-effective basis. While there may be specific instances of natural overlap where the City can benefit from assistance or task-sharing with the BPW and vice versa, that can generally best be done as such opportunities occur without directly absorbing utility service functions into those of the municipal government.