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November 17, 2008

Terry J. Romine, Esquire
Executive Secretary
Public Service Commission of Maryland
William Donald Schaefer Tower
6 St. Paul Street, 16th Floor
Baltimore, Maryland 21202

RE: Formal Case No. 8796

Dear Ms. Romine:

Enclosed for filing are the original and twenty-two (22) copies of Potomac Electric Power Company's (Pepco; the Company) proposed update to Rider "DS" to be effective as described below.

The proposed tariff update implements the results of the proposed closure of all outstanding issues with respect to the divestiture of the Company's generating assets which occurred at the beginning of this decade as part of the industry restructuring. The proposed tariff provides customers with a third, and unanticipated, divestiture sharing credit due to the Company's successful management of the Mirant bankruptcy, as explained below.

Pepco's restructuring was effected through several settlement agreements that were filed with the Commission in Case No. 8796: (a) a Phase I Agreement of Stipulation and Settlement, an Amendment to the Phase I Agreement, and a Phase II Agreement, all of which were approved by the Commission in its Order No. 75850, entered on December 22, 1999, *Re Potomac Electric Power Company*, 90 PSC Md. 329 (1999), and (b) a Second Amendment approved by the Commission in its Order No. 76078, entered on April 12, 2000, *Re Potomac Electric Power Company*, 91 PSC Md. 170 (2000) (collectively referred to as the "Restructuring Agreements").

As provided in Article I of the Phase I Agreement, and as contemplated by the Electric Customer Choice and Competition Act of 1999 (Subtitle 5 of Title 7 of the Public Utility Companies Article of the Maryland Code), Pepco divested substantially all of its electric generation facilities through asset sales to unrelated third parties that were completed in December, 2000 and January, 2001. Most of Pepco's generating facilities were sold to Mirant pursuant to the Asset Purchase and Sale Agreement for Generating Plants and Related Assets. The timing of Pepco's divestiture of its electric generation facilities was propitious and resulted in gross sale proceeds of over \$2.9 billion for assets that had a net book value of approximately

\$1.85 billion. The Restructuring Agreements approved by the Commission have provided substantial tangible direct benefits to the Company's Maryland customers, including (i) guaranteed distribution service rate reductions that provided over \$92 million in benefits to those customers; (ii) divestiture sharing credits amounting to over \$213 million (consisting of the elimination of \$17.4 million of accrued DSM costs that had not been recovered from customers as of the divestiture date and \$195.8 million of customer billing credits); and (iii) generation procurement credits of over \$64 million; for a total benefit to customers of \$369 million.

At the time the Phase I Settlement was reached, Pepco was a party to several Commission-approved power purchase agreements that constituted an economic liability under current and projected market conditions. The principal remaining power purchase agreement was an agreement between the Company and Panda-Brandywine, L.P. (Panda PPA), which was approved by the Commission in its Order No. 70017 in Cases Nos. 8413 and 8346, entered on July 21, 1992, *Re Potomac Electric Power Company*, 83 PSC Md. 191, (1992). Under the Panda PPA, Pepco was obligated to purchase from Panda 230 megawatts of capacity and energy annually through 2021. Pursuant to the Back-to-Back Arrangement¹ with Mirant that was part of the divestiture of the Company's generating assets, Pepco continued to be directly liable to make payments to Panda and to take delivery of the power specified in the Panda PPA, but Mirant in turn was obligated to purchase from Pepco the capacity and energy that the Company was required to purchase under the Panda PPA at a price equal to the price Pepco paid to Panda.

After filing for reorganization under Chapter 11 of the United States Bankruptcy Code, Mirant sought to reject the Back-to-Back Arrangement. Over a period of almost four years, Pepco vigorously opposed Mirant's effort to renounce its contractual obligations under the Back-to-Back Arrangement. On May 31, 2006, the Company entered into the Settlement Agreement and Release (Mirant Settlement Agreement), which allowed this dispute (and all other outstanding issues between the parties arising from or relating to the bankruptcy of Mirant) to be resolved in a manner that serves to significantly benefit Pepco's customers. In particular, as a result of the rejection and termination of the Back-to-Back Arrangement pursuant to the Mirant Settlement Agreement, the Company received a monetary payment of \$413.9 million² from Mirant as compensation on August 8, 2007. After receipt of the payment, the funds were used to cover the ongoing above market costs of the Panda PPA. The Company subsequently executed an agreement on June 20, 2008 to transfer the Panda PPA to an unaffiliated third party, Sempra Energy Trading LLC (SET) in exchange for a payment to SET. This agreement closed on September 8, 2008, at which time the Company and its customers were relieved of all obligations under the Panda PPA. The amount remaining from the Mirant Settlement after the payment to SET and the payment of the above market costs of the Panda PPA during the intervening period between Mirant's rejection of its obligations and the transfer of the Panda PPA to SET, as offset

¹ Under the back-to-back arrangement ("Back-to-Back Arrangement") that Pepco entered into in connection with the Asset Purchase and Sale Agreement for Generating Plants and Related Assets that Pepco executed in 2000, Pepco was to sell to Mirant and Mirant was to purchase, at Pepco's cost, all capacity, energy, ancillary services and other benefits Pepco was entitled to receive under certain existing power purchase agreements that Pepco had entered into with third parties.

² The payment of \$413.9 million equals the agreed upon payment of \$450 million at the time of the Mirant Settlement less \$36.1 million as compensation to Mirant for its above market payments under the Back-to-Back Arrangement from the date of the Mirant Settlement (May 31, 2006) through the receipt of the payment on August 8, 2007.

by any market earnings on the remaining funds, is \$101.9 million. As a result, not only have customers been relieved of the responsibility for any shortfall in covering the above market Panda PPA costs, but, under the Phase I Agreement, any funds remaining from the Mirant payment are to be shared with customers.³ Absent the Mirant Settlement Agreement and the transfer of the Panda PPA to SET, any above market costs would be borne by Pepco customers if the Back-to-Back Arrangement had been rejected, as specified in Section 3.01 of the Phase I Settlement.

The Company proposes to share the remaining amounts from the Mirant Settlement with Maryland customers in accordance with the divestiture sharing formula approved by the Commission in Formal Case No. 8796.⁴ The calculation of the proposed amount to be shared from the funds remaining from the Mirant Settlement Agreement is provided in the attached Exhibits A-C. Exhibit A shows the calculation of the net amount to be provided to customers. The calculation begins with the remaining amount available from the Mirant Settlement of \$101.9 million, and allocates that amount to Maryland customers. A payment to Panda related to a litigation dispute by Panda challenging the Back-to-Back Arrangement after divestiture is deducted from this amount. The amount was in addition to an amount paid to Panda to resolve a billing dispute that was settled in 2003. The effect on energy payments to Panda pre-divestiture (which were included in pre-divestiture fuel rates) from the resolution of the billing dispute were included in the Generation Procurement Credit calculations for the fourth GPC period.

Furthermore, the initial calculation of divestiture sharing included amounts that were accrued to cover transition costs. Some of the accrued funds were not spent and the Maryland allocated share of these unspent funds is included in the amounts that are now available for sharing with customers. In addition, the initial calculation of divestiture sharing included amounts to reflect funds that were accrued at the time of divestiture to reflect committed DSM costs. Not all of the funds have been spent and the Maryland allocated share is included in the amounts that are now available to credit customers. The resulting net amount available for sharing with Maryland customers is \$54,500,685. This amount is then shared with customers based on the sharing formula agreed to in the Restructuring Settlements, resulting in \$27,250,343 to be provided to Maryland customers through the divestiture sharing formula. Added to this amount is \$1,586,213 to account for an under-disbursement to customers in the first two

³ Under the Phase I Agreement approved by the Commission in Formal Case No. 8796, any amounts remaining in the Panda Account would be shared with customers in accordance with the divestiture sharing formula described in footnote 4, *infra*.

⁴Section 2.03 of the Phase I Settlement approved by the Commission in Order No. 11576 provides the following sharing formula:

Additional System Amount	Percentage Allocated To System Customers
\$100 million or less	70%
\$100 million to \$200 million	60%
All over \$200 million	50%

divestiture payments, as calculated in Exhibit C. The total amount to be provided to customers is \$28,836,556. The per kilowatt-hour rate for calculating the divestiture credit is \$0.00190, as shown in Exhibit B. For a residential customer using 1,000 kilowatt-hours per month, the resulting one-time credit will be \$22.80.

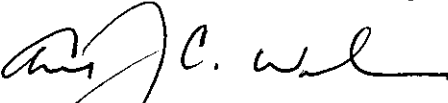
The Company also urges the Commission to rule on the two outstanding issues relating to the divestiture of its generating assets, which will then close out all the issues from the divestiture of the Company's generating assets nearly eight years ago. The major unresolved issue concerning the calculation of the net proceeds to be shared with customers is the disposition of the generation related excess deferred income taxes (EDIT), and accumulated deferred income tax credits (ADITC). The Hearing Examiner on November 21, 2003, issued a Proposed Order addressing all the issues concerning the divestiture proceeds. In particular, he held that the EDIT and ADITC normalization reserves should be included in the divestiture sharing calculation. Disregarding the flowthrough requirements of the March 4, 2003 proposed regulations, the Hearing Examiner ruled (Proposed Order at p. 19) "that EDITs and ADITCs be treated as having reverted to ratepayers upon the sale of Pepco's underlying assets." The Company noted an appeal of that Proposed Order to the Commission on December 22, 2003. In its Memorandum on Appeal filed on January 2, 2004, Pepco again urged that any decision on the EDIT and ADITC issues be delayed until the IRS issued final regulations on the subject.

In a letter submitted on January 12, 2006, the Company advised the Commission that in a Notice of Proposed Rulemaking issued on December 21, 2005 (70 Fed. Reg. 75762-65), as corrected on December 27, 2005 (70 Fed. Reg. 7643 3-34), the IRS had withdrawn the 2003 proposed regulations and had issued new proposed regulations related to the disposition of the EDIT and ADITC reserves associated with an electric utility's deregulated generating assets. Responding to letters submitted by the Staff and OPC, on February 15, 2006, Pepco submitted a letter to the Commission explaining that the 2005 proposed regulations supported the Company's position that a return to customers of the EDIT and ADITC normalization reserves would violate the normalization requirements of the Internal Revenue Code. On March 20, 2008, the IRS issued final regulations (73 Fed. Reg. 14934-37) making it clear that, because Pepco divested its generating assets before December 21, 2005 (the date of publication of the 2005 proposed regulations), the return to customers of the related EDIT and ADITC reserves would violate the normalization rules. The Company also appealed the Hearing Examiner's ruling concerning the deductibility from the proceeds of certain corporate reorganization costs that resulted from the divestiture of the Company's generating assets.

The Commission has not yet rendered any decision on the appeal from the Hearing Examiner's Proposed Order. With the issuance of the final regulations, this matter is now ripe for a Commission decision confirming Pepco's proposed treatment of deferred taxes. In addition, the other remaining issue concerning the deductibility of costs from the asset sale proceeds is also ripe for decision at this time. The Company urges the Commission to rule on these two outstanding issues, and to rule on the proposed crediting of the customer's share of the remaining funds in the Mirant Settlement Proceeds accounts. The Company respectfully requests that the Commission approve this filing, with a customer record date as of December 17, 2008 and an effective date of December 17, 2008, with a disbursement of credits to customers in the billing

month of January 2009. The Company will make a compliance filing after the Commission's Order which will reflect the final balances in the Mirant Settlement Accounts.

Sincerely,
On Behalf of
Potomac Electric Power Company



Anthony Wilson

Enclosure

**Panda Settlement Proceeds
PEPCO GENERATION DIVESTITURE
Maryland Customer Sharing**

<u>Line No.</u>		<u>System Amount</u>	<u>Maryland Amount</u>	<u>Basis</u>
1	Proceeds From Panda Settlement	<u>\$ 101,888,510</u> ¹	\$ 53,980,533	A
2	Previously Unreimbursed Panda Dispute Costs	\$ 500,000	\$ 264,900	A
3	Net Settlement Proceeds (Line 1 - Line 2)		\$ 53,715,633	
	Plus			
4	Unspent Accrued Transition (Retail Access) Costs	\$ 704,682	\$ 481,298	B
5	Unspent DSM Cost Accrual		\$ 303,755	C
6	Net (Line 3 plus Lines 4 and 5)		\$ 54,500,685	
	Sharing Amount By Tiers			
7	<u>3rd Tier</u>		<u>\$ 54,500,685</u>	D
	Customer Refund			
8	Customers' Share of 3rd Tier -- 50%		\$ 27,250,343	
9	True-up of Previous Customer Sharing Distributions		<u>\$ 1,586,213</u>	E
10	Total Amount to be Provided to Customers		\$ 28,836,556	

A – Allocated based on Average and Excess 4CP ratio of 52.98%.

B – Allocated Based on ratio of number of customers (MD to total system) of 68.30%

C – There was \$1,778,000 accrued for committed but unspent Maryland DSM funds at the time of divestiture

D – First Two Tiers Fully Shared in Initial Distribution- All Additional Proceeds Fall in Third Tier

E – See Exhibit C

1 Amount Remaining in the Restricted Cash Accounts after Sale of Panda Obligation, including accrual of expected future PJM expenses of \$50,000 related to the Panda PPA Account.

This Amount to be Trued-up at Time of Company's Compliance Filing

**Maryland
Panda Proceeds
Divestiture Sharing
Allocation of Sharing between
Residential and Non-Residential Customers**

Total Refund	\$	28,836,556
Total KWH Sales 1/		15,184,370,959
Total Refund Rate (\$/KWH)		0.00190

1/ KWH sales for 12 months ended October 2008,
the latest available 12 month KWH sales numbers.

**Maryland
Panda Proceeds
Divestiture Sharing
True-up of Prior Divestiture Sharing Distributions**

1	Total Amount to be Shared From Proceeds Source: Rejoinder Testimony Of Mr. Kamerick, Exhibit AJK-10, Page 2, Line 11	\$ 188,665,000.00	A
2	Interest on Initial Distribution Source: Rejoinder Testimony Of Mr. Kamerick, Exhibit AJK-10, Page 2, Line 12	\$ 6,285,000.00	B
3	Interest on Second Distribution Source : Company Filing of October 11, 2002, Exhibit B, Line 14	\$ 1,013,000.00	C
4	Total To be Provided to Customers [(1) + (2) + (3)]	\$ 195,963,000.00	
5	Amount Provided in Bill Credits in First Distribution	\$ 187,180,816.48	
6	Amount Provided in Bill Credits in Second Distribution	\$ 7,195,970.81	
7	Total Amount Provided to Customers [(5) + (6)]	\$ 194,376,787.29	
8	True-up Amount to be distributed to Customers [(4) - (7)]	\$ 1,586,212.71	

A - This is the final figure presented in the Company's filings in this Case and it reflects the Company's position on Taxes and Restructuring Costs, which are subject to appeal to the Commission.

B - The initial distribution of divestiture proceeds was proposed by the Company in its filing of April 22, 2001. The Commission approved the first distribution that included \$6,285,000 of interest on May 23, 2001.

C - The second distribution of divestiture proceeds was proposed by the Company in its filing of October 11, 2002. The Commission approved the second distribution that included \$1,103,000 of interest on December 4, 2002.

PROPOSED

MD

RATE SCHEDULES

FOR

ELECTRIC SERVICE

IN

MARYLAND

POTOMAC ELECTRIC POWER COMPANY



RATES AND REGULATORY PRACTICES GROUP

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DIVESTITURE SHARING CREDIT

RIDER "DS"

RIDER "DS" – DIVESTITURE SHARING CREDIT

This rider is applicable to Schedules "R", "R-TM", "GS", "MGT LV II", "MGT LV III", "MGT 3A II", "MGT 3A III", "GT LV", "GT 3A", "GT 3B", "T", "OL", "SL", "TM-RT", "EV" and "TN". Pursuant to the May 23, 2001 letter order issued by the Maryland Public Service Commission, the Company will provide to its Maryland customers a share of the net proceeds received from the sale of the generation assets through a bill credit.

The amount of credit to be provided will be calculated by the Company on an individual customer basis for each customer served by the Company in its Maryland service territory, as shown on the books and records of the Company as of the close of business on May 22, 2001.

The amount of the credit is calculated as follows:

1. The total amount of the credit due to such Maryland customers is divided by the total kilowatt-hours delivered by the Company to its Maryland customers during the twelve (12) months ended March 31, 2001. The credit is \$0.01331 per kilowatt-hour.
2. Each customer's credit is determined by multiplying \$0.01331 by the number of kilowatt-hours delivered by the Company to such customer's premise during the twelve (12) months ended March 31, 2001.

Commercial customers will receive a credit on the first bill rendered after June 1, 2001.

Residential customers will receive a credit on the first bill rendered after July 1, 2001.

Customers will receive an additional one-time credit of \$0.00051 per kilowatt-hour to reflect the customer's share of additional proceeds from the sale of generation assets. Customers will receive this credit on bills rendered on and after December 18, 2002. This credit will be provided to customers of record as of September 30, 2002 served by the Company in Maryland. The additional credit per kilowatt-hour is calculated by dividing the additional amount of the customers' share by the total kilowatt-hours delivered by the Company to its Maryland customers during the twelve (12) months ended August 31, 2002. The additional one-time credit on each bill is calculated by multiplying the total kilowatt-hours delivered to the premises for the 12 billing months ended August 31, 2002, by the \$0.00051 credit per kilowatt-hour.

Customers will receive a third one-time credit of \$0.00190 per kilowatt-hour to reflect the customer's share of additional proceeds resulting from the settlement with the Mirant Bankruptcy Estate and the transfer of the responsibility for the Panda Power Purchase Agreement to a third party. Customers will receive this credit on bills rendered in the billing month of January, 2009. This credit will be provided to customers of record as of December 17, 2008 served by the Company in Maryland. The credit per kilowatt-hour pursuant to this paragraph is calculated by dividing the additional amount of the customers' share by the total kilowatt-hours delivered by the Company to its Maryland customers during the twelve (12) billing months ended October 31, 2008. The one-time credit on each bill pursuant to this paragraph is calculated by multiplying the total kilowatt-hours delivered to the premises for the 12 billing months ended October 31, 2008, by the \$0.00190 credit per kilowatt-hour.

REDLINED

RATE SCHEDULES

FOR

ELECTRIC SERVICE

IN

MARYLAND

POTOMAC ELECTRIC POWER COMPANY



RATES AND REGULATORY PRACTICES GROUP

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The amount of credit to be provided will be calculated by the Company on an individual customer basis for each customer served by the Company in its Maryland service territory, as shown on the books and records of the Company as of the close of business on May 22, 2001.

The amount of the credit is calculated as follows:

1. The total amount of the credit due to such Maryland customers is divided by the total kilowatt-hours delivered by the Company to its Maryland customers during the twelve (12) months ended March 31, 2001. The credit is \$0.01331 per kilowatt-hour.
2. Each customer's credit is determined by multiplying \$0.01331 by the number of kilowatt-hours delivered by the Company to such customer's premise during the twelve (12) months ended March 31, 2001.

Commercial customers will receive a credit on the first bill rendered after June 1, 2001.
Residential customers will receive a credit on the first bill rendered after July 1, 2001.

Customers will receive an additional one-time credit of \$0.00051 per kilowatt-hour to reflect the customer's share of additional proceeds from the sale of generation assets. Customers will receive this credit on bills rendered on and after December 18, 2002. This credit will be provided to customers of record as of September 30, 2002 served by the Company in Maryland. The additional credit per kilowatt-hour is calculated by dividing the additional amount of the customers' share by the total kilowatt-hours delivered by the Company to its Maryland customers during the twelve (12) months ended August 31, 2002. The additional one-time credit on each bill is calculated by multiplying the total kilowatt-hours delivered to the premises for the 12 billing months ended August 31, 2002, by the \$0.00051 credit per kilowatt-hour.

Customers will receive a third one-time credit of \$0.00190 per kilowatt-hour to reflect the customer's share of additional proceeds resulting from the settlement with the Mirant Bankruptcy Estate and the transfer of the responsibility for the Panda Power Purchase Agreement to a third party. Customers will receive this credit on bills rendered in the billing month of January, 2009. This credit will be provided to customers of record as of December 17, 2008 served by the Company in Maryland. The credit per kilowatt-hour pursuant to this paragraph is calculated by dividing the additional amount of the customers' share by the total kilowatt-hours delivered by the Company to its Maryland customers during the twelve (12) billing months ended October 31, 2008. The one-time credit on each bill pursuant to this paragraph is calculated by multiplying the total kilowatt-hours delivered to the premises for the 12 billing months ended October 31, 2008, by the \$0.00190 credit per kilowatt-hour.