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August 23, 2010

Terry J. Romine, Executive Secretary  
Public Service Commission  
Of Maryland  
6 St. Paul Street, 16<sup>th</sup> Floor  
Baltimore, Maryland 21202

**Re: Case No. 9226**

Dear Ms. Romine:

Enclosed please find an original and seventeen (17) copies of the Rebuttal Testimony of each of Mr. Stephen G. Hill and Mr. Jonathan Wallach on behalf of the Office of People's Counsel in the above-referenced case. A copy has been provided to all parties of record.

If you have any questions, please do not hesitate to contact me.

Very truly yours,

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Anne L. Johnson  
Assistant People's Counsel

ALJ/eom  
Enclosure  
cc: All Parties of Record

BEFORE THE  
PUBLIC SERVICE COMMISSION  
OF MARYLAND

IN THE MATTER OF )  
 )  
THE REVIEW OF DELMARVA POWER & LIGHT )  
COMPANY STANDARD OFFER SERVICE ) Case No. 9226  
ADMINISTRATIVE CHARGE )  
 )  
AND )  
 )  
THE REVIEW OF POTOMAC ELECTRIC POWER )  
COMPANY STANDARD OFFER SERVICE ) Case No. 9232  
ADMINISTRATIVE CHARGE )

REBUTTAL TESTIMONY OF STEPHEN G. HILL

ON BEHALF OF

MARYLAND OFFICE OF PEOPLE'S COUNSEL

AUGUST 23, 2010

1 Q: PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.

2 A: My name is Stephen G. Hill. I am self-employed as a financial consultant, and principal  
3 of Hill Associates, a consulting firm specializing in financial and economic issues in  
4 regulated industries. My business address is P.O. Box 587, Hurricane, West Virginia,  
5 25526 (e-mail: [hillassociates@gmail.com](mailto:hillassociates@gmail.com)).

6

7 Q: ARE YOU THE SAME STEPHEN HILL THAT TESTIFIED PREVIOUSLY IN THIS  
8 PROCEEDING ON BEHALF OF THE MARYLAND PEOPLE’S COUSEL  
9 REGARDING RETURN AND CASH WORKING CAPITAL ISSUES?

10 A: Yes, I am.

11

12 Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?

13 A: I will respond briefly to the testimony filed by the Apartment and Office Building  
14 Association (AOBA) witness Bruce Oliver with regard to the return that should be  
15 allowed in the Standard Offer Service (SOS) tariffs at issue in this proceeding. In  
16 addition, while it is my understanding that the Staff of the Maryland Public Service  
17 Commission is in the process of amending its testimony regarding the need for a separate  
18 return allowance for Pepco and Delmarva to be congruent with its position taken in the  
19 parallel Baltimore Gas and Electric SOS proceeding, i.e., that no such allowance is  
20 necessary, I will discuss briefly Staff witness Schultz’s original pre-filed testimony on  
21 that issue.

22

1 Q: WHAT ARE YOUR COMMENTS REGARDING MR. OLIVER'S TESTIMONY ON  
2 BEHALF OF AOBA?

3 A: First, at pages 10 through 13 of his Direct Testimony in this proceeding, Mr. Oliver  
4 makes the case for the use of a short-term debt rate in the calculation of Cash Working  
5 Capital (CWC). He and I are in theoretical agreement on this point. The need for CWC  
6 is fundamentally short-term in nature and should be funded with short-term capital,  
7 which has a much lower cost rate than the Companies' overall cost of capital determined  
8 in their rate proceedings.

9 While we are in agreement that the cost attributed to CWC is more likely to be  
10 similar to short-term debt than it is to the overall cost of capital, Mr. Oliver recommends  
11 using only a current Company-specific short-term debt rate, while I recommend a hybrid  
12 approach. Because this Commission has, in the past, utilized the most recently  
13 established overall cost of capital as the cost of CWC monies, I recommend maintaining  
14 that approach for the portion of CWC related to monthly billing. For the incremental  
15 costs related to PJM's change to weekly billing (the primary impetus for the Companies'  
16 requested increases in CWC costs), I recommend the use of a short-term debt cost  
17 index—the prime rate of interest. While that cost rate is more moderate (somewhat  
18 higher) than the cost of the Companies' short-term debt, I believe it strikes an appropriate  
19 balance between investor and consumer interests, is less volatile than the Companies'  
20 short term debt cost rates, and is a widely available and verifiable cost rate to use for  
21 regulatory purposes.

22 Second, while Mr. Oliver focuses on the equalization of a separate return

1 component between rate classes in his testimony, he notes at page 14 of that testimony  
2 that allowing the Companies a return as a separate per kWh charge included in the SOS  
3 Administrative Charge that is “unrelated to [the] provision of capital for financing CWC”  
4 and is, in fact, duplicative of the return provided on rate base in the distribution  
5 proceedings. As a solution to that problem, Mr. Oliver offers the following:

6                   Alternatively, the Commission could find that the equity  
7                   portion of Pepco’s return on funds used to finance CWC  
8                   represents the return component required by Maryland law,  
9                   and therefore, the added allowance for return that Pepco  
10                  presently receives as part of its Administrative [sic] Charge is  
11                  unnecessary and should be eliminated. [Oliver Direct, p.  
12                  15, ll. 1-5]

13 Here, Mr. Oliver’s alternative recommendation mirrors that of the People’s Counsel, i.e.,  
14 a separate, explicit return element included in the CWC administrative charge is  
15 unnecessary, duplicative and results in an excessive return for the Companies at the  
16 ratepayers expense. The separate “return” component of the Administrative Charge  
17 should be eliminated and the return included in that allowed for CWC is the return  
18 component required by Maryland law.

19  
20 Q: WHAT COMMENTS DO YOU HAVE REGARDING THE TESTIMONY OF STAFF  
21 WITNESS SCHULTZ?

22 A: At pages 12 and 13 of his Direct Testimony Mr. Schultz quantifies the impact of the  
23 increased return afforded by the return component of the Administrative Charge for  
24 Pepco and Delmarva. Mr. Schultz’s calculations indicate that the additional return  
25 afforded Pepco by the inclusion of this charge was equivalent to an increase in the  
26 allowed return of 71 basis points. Mr. Schultz also testifies that the return component of  
27 the Administrative Charge effectively increased Delmarva’s authorized return on equity  
28 by 64 basis points. These effective increases in the allowed return (over the cost of

1 equity capital determined to be appropriate by this Commission) are uneconomical,  
2 unnecessary for the purpose of attracting capital, and unfair to ratepayers. Staff witness  
3 Schultz’s analysis shows that an explicit return allowance included in the SOS  
4 Administrative Charge will cause the effective allowed return to exceed the Companies’  
5 cost of capital. Again, the explicit return allowance included in the Administrative  
6 Charge should be eliminated.  
7

8 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

9 A. Yes it does.

**STATE OF MARYLAND**  
**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of the Review of )**  
**Delmarva Power and Light Company )**  
**Standard Offer Service Administrative Charge )**

**Case No. 9226**

**REBUTTAL TESTIMONY OF**  
**JONATHAN WALLACH**  
**ON BEHALF OF**  
**THE OFFICE OF PEOPLE'S COUNSEL**

Resource Insight, Inc.

**AUGUST 23, 2010**

1 **Q: Please state your name, occupation, and business address.**

2 A: I am Jonathan F. Wallach. I am Vice President of Resource Insight, Inc., 5  
3 Water Street, Arlington, Massachusetts.

4 **Q: Are you the same Jonathan F. Wallach that filed reply testimony in this**  
5 **proceeding?**

6 A: Yes.

7 **Q: On whose behalf are you testifying?**

8 A: I am testifying on behalf of the Office of People's Counsel.

9 **Q: What is the purpose of your rebuttal testimony?**

10 A: On August 9, 2010, the staff of the Public Service Commission ("Staff") filed  
11 the Direct Testimony and Exhibits of Matthew Schultz regarding Staff's  
12 proposal for the residential Administrative Charge and regarding the proposal by  
13 Delmarva Power and Light Company ("Delmarva"; "the Company") with  
14 respect to the return on cash working capital ("CWC"). In addition, on August  
15 17, 2010, Staff filed the Reply Testimony and Exhibits of Matthew Schultz in  
16 Case No. 9221 regarding Baltimore Gas and Electric's ("BGE") residential  
17 Administrative Charge. Mr. Schultz's reply testimony in Case No. 9221  
18 apparently revises Staff's proposal in this proceeding with respect to the return  
19 component of the residential Administrative Charge.

20 This rebuttal testimony responds to Mr. Schultz's proposals in this  
21 proceeding regarding the Administrative Charge for residential standard offer  
22 service ("SOS"), as modified by his testimony in Case No. 9221. People's  
23 Counsel is also sponsoring rebuttal testimony by Stephen Hill regarding Mr.  
24 Schultz's testimony in this proceeding on the return component of the  
25 residential Administrative Charge, as modified by his testimony in Case No.  
26 9221.



1 **Q: Please summarize your conclusions and recommendations regarding Staff's**  
2 **proposal for the residential Administrative Charge.**

3 A: Contrary to the Commission's rulings in Order No. 83345, Staff's proposal to  
4 radically restructure the residential Administrative Charge would artificially and  
5 arbitrarily increase the rate for the Administrative Charge beyond that necessary  
6 to recover actual costs. This outcome is not an accidental by-product of Staff's  
7 proposal. Instead, Staff's intention is to charge more than actual costs, based on  
8 an unsupported allegation that SOS-related costs are currently being recovered  
9 in distribution rates and an unfounded belief that any such recovery would  
10 grievously harm the retail competitive market. And with this narrow focus on  
11 the plight of retail suppliers, Staff appears indifferent to the potential harm to  
12 consumers from the inefficient price signals that would result from its proposal  
13 to artificially raise SOS prices.

14 I therefore recommend that the Commission reject Staff's proposal,  
15 including those modifications presented in Case No. 9221, in its entirety.

16 **Q: Please summarize Staff's proposal for the residential Administrative**  
17 **Charge.**

18 A: Staff is recommending a radical restructuring of the residential Administrative  
19 Charge.

20 According to Mr. Schultz, Staff proposes to combine the incremental-cost,  
21 uncollectible-cost, and Administrative Adjustment components of the current  
22 Administrative Charge into a single, new "Incremental Cost Component." The  
23 rate for this Incremental Cost Component would be fixed at 2.5 mills/kWh,  
24 which is equal to the sum of the rates established in the settlement agreement in

1 Case No. 8908 (“Settlement Agreement”) for the three components to be  
2 combined under Staff’s proposal.<sup>1</sup>

3 Staff further proposes two new components for the residential  
4 Administrative Charge. First, Staff adopts the Company’s proposal for a new  
5 “CWC Component” to recover CWC costs in excess of the amount that  
6 Delmarva assumes to be recovered through the 1.5 mills/kWh return  
7 component.<sup>2</sup> Second, Staff proposes a new “Allocated Cost Component” to  
8 recover from SOS customers the portion of the costs in FERC Accounts 903,  
9 907, 908, 909, and 910 that Staff believes should be classified as SOS-related  
10 costs.

11 Finally, Staff proposes to continue collection of the return component at  
12 the fixed rate of 1.5 mills/kWh established in the Settlement Agreement.  
13 However, according to Mr. Schultz’s reply testimony in Case No. 9221, Staff  
14 further proposes to compensate for over-charging residential SOS customers  
15 through the return component by including return revenues in excess of the  
16 amount assumed to be associated with CWC costs as electric operating revenue  
17 in the next distribution rate case.

18

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<sup>1</sup> As I discussed in my reply testimony, the Settlement Agreement established a fixed rate of 0.5 mills/kWh for incremental costs. The Settlement Agreement further established that the sum of the rates for uncollectible costs and the Administrative Adjustment would be fixed at 2 mills/kWh, with the individual rate for the Administrative Adjustment rising or falling commensurately with changes to the uncollectible-cost rate determined in distribution rate cases.

<sup>2</sup> As I discussed in my reply testimony, the Settlement Agreement fixed the rate for the return component at 1.5 mills/kWh and established that the return component was the sole means for recovery of SOS-related CWC costs. In addition, I discussed in my reply testimony why the Company’s proposal for incremental CWC costs was unreasonable. I will not repeat my arguments in this rebuttal testimony.

1 **Q: What does Staff propose for the total rate for the residential Administrative**  
2 **Charge?**

3 A: I cannot determine what the total rate would be under Staff's proposal, because  
4 Staff does not recommend specific rates for the CWC Component or the  
5 Allocated Cost Component. All that can be determined at this time is that, under  
6 Staff's proposal, the rate for the residential Administrative Charge would be set  
7 at the sum of: (1) 4 mills/kWh (i.e., the sum of rates for the Incremental Cost  
8 and Return Components); (2) the rate for the CWC Component; and (3) the rate  
9 for the Allocated Cost Component. In other words, the rate for the  
10 Administrative Charge under Staff's proposal would exceed the current rate of 4  
11 mills/kWh by the sum of the rates for the Allocated Cost and CWC  
12 Components.<sup>3</sup>

13 **Q: What does Staff propose with regard to the Administrative Adjustment?**

14 A: Under Staff's proposal, the Administrative Adjustment would no longer be a  
15 separate component of the residential Administrative Charge. Instead, as  
16 described above, the Administrative Adjustment would be folded into the  
17 proposed Incremental Cost Component, along with the current incremental-cost  
18 and uncollectible-cost components to yield a fixed rate for this new component  
19 of 2.5 mills/kWh.

20 Although it would eliminate the Administrative Adjustment as a separate  
21 component, Staff's proposal for the Incremental Cost Component would still

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<sup>3</sup> Unlike in Case No. 9232 for Potomac Electric Power Company, I do not have data from Delmarva to independently estimate the rate for the residential Administrative Charge under Staff's proposal. However, if my estimate in my rebuttal testimony in Case No. 9232 is any indication, then the residential Administrative Charge for Delmarva under Staff's proposal could be on the order of two times the current rate of 4 mills/kWh.

1 provide for an administrative adjustment-like mechanism by setting the rate for  
2 the Incremental Cost Component at a level that exceeds actual incremental and  
3 uncollectible costs. The Staff proposal would then refund to all residential  
4 ratepayers the difference between the revenues collected through the  
5 Incremental Cost Component and the actual incremental and uncollectible costs  
6 incurred.<sup>4</sup>

7 **Q: Is Staff’s proposal to continue effectively charging consumers an**  
8 **“administrative adjustment” reasonable?**

9 A: No. Staff’s proposal to charge more than actual incremental and uncollectible  
10 costs through the Incremental Cost Component runs contrary to rulings in Order  
11 No. 83345, where the Commission found that the utilities now have actual cost  
12 data for the components of the Administrative Charge and concluded that “any  
13 changes needed to any of the components may be determined using this actual  
14 data, rather than changing one component using actual data while maintaining  
15 the other components at a fixed rate....”<sup>5</sup>

16 Moreover, as I discussed in my reply testimony, the administrative  
17 adjustment mechanism – conceived as a temporary means to reduce barriers to  
18 entry in an immature market – no longer serves a useful purpose in the fully  
19 competitive retail market in Maryland.

20 Finally, an administrative adjustment mechanism is inconsistent with the  
21 new Allocated Cost Component proposed by Staff. According to Mr. Schultz,  
22 Staff supported the Administrative Adjustment in Case No. 8908 as a reasonable  
23 proxy for an explicit functional unbundling of certain costs that the Company

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<sup>4</sup> As discussed below, Staff also proposes an administrative adjustment-like refund of revenues collected through the Allocated Cost Component.

<sup>5</sup> *Order No. 83345*, Case Nos. 9226 and 9232, May 20, 2010, p. 3.

1 treated as wholly distribution-related, but which Staff believed were partially  
2 SOS-related. However, in this proceeding, Staff proposes just such an explicit  
3 unbundling, with the unbundled costs determined to be SOS-related to be  
4 collected through the new Allocated Cost Component. As such, no form of  
5 administrative-adjustment proxy is necessary under Staff's proposal, because  
6 that proposal explicitly provides for recovery in SOS retail prices of those  
7 distribution costs that Staff believes to be SOS-related.

8 **Q: Why does Staff propose a new Allocated Cost Component?**

9 A: Staff contends that certain expenses that are currently recovered through  
10 distribution rates – specifically costs recorded in FERC Accounts 903, 907, 908,  
11 909, and 910 – are more appropriately classified as SOS-related and  
12 consequently should be recovered through the Administrative Charge. Staff  
13 therefore proposes to recover these allegedly misclassified costs through a new  
14 Allocated Cost Component of the Administrative Charge.

15 Under Staff's proposal, the rate for the Allocated Cost Component would  
16 be set to recover a portion of the costs recorded in FERC Accounts 903, 907,  
17 908, 909, and 910, with the portion derived based on the ratio of SOS revenues  
18 to total system revenues. However, since these costs are allegedly already being  
19 recovered in distribution rates, Staff proposes to refund the revenues from the  
20 Allocated Cost Component back to all residential ratepayers.

21 **Q: What is the basis for Staff's assertion that SOS-related costs are currently**  
22 **being recovered through distribution rates?**

23 A: Mr. Schultz fails to offer any evidence in support of his claims that: (i) a  
24 portion of the costs recorded in the FERC accounts in question are due to the  
25 provision of standard offer service; (ii) the portion of the costs Staff believes to  
26 be SOS-related are in fact recovered through distribution rates; or (iii) the

1 portion of the costs Staff believes to be SOS-related are not already recovered  
2 through the incremental-cost component of the Administrative Charge.

3 In other words, Staff's recommendations regarding the Allocated Cost  
4 Component appear to be based purely on speculation regarding the extent to  
5 which SOS-related costs are currently recovered through distribution rates.

6 **Q: Are there any indications that Staff's proposal would lead to double-**  
7 **recovery of costs already collected through the incremental-cost**  
8 **component?**

9 A: Yes. The Company's response to Staff Data Request 1-2 indicates that the  
10 Company may already be collecting as incremental costs the SOS-related  
11 portions of the costs recorded in the FERC accounts included in Staff's  
12 proposal.<sup>6</sup> If so, then Staff's proposal to recover these same costs through the  
13 Allocated Cost Component would result in double-recovery of those  
14 incremental costs.

15 **Q: How should the Commission determine whether and to what extent SOS-**  
16 **related incremental costs are being recovered through distribution rates?**

17 A: The most appropriate way to determine whether SOS costs are currently  
18 recovered through distribution rates is through a full evidentiary review in a  
19 distribution rate case of the Company's proposed functional unbundling of total  
20 system costs into distribution-related and SOS-related cost categories. This  
21 process would provide a record for the Commission to rely on to ensure that the  
22 only costs classified as SOS-related and recovered through the Administrative  
23 Charge are those incremental costs incurred as a result of providing standard  
24 offer service.

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<sup>6</sup> A copy of the Company's response to Staff DR 1-2 is attached hereto as Attachment JFW-R1.

1 **Q: What does Staff propose with respect to the return component of the**  
2 **residential Administrative Charge?**

3 A: Staff appears to have modified its proposal for the return component since filing  
4 direct testimony in this proceeding.

5 In his direct testimony in this proceeding, Mr. Schultz recommends that the  
6 Company continue to charge a fixed rate of 1.5 mills/kWh for the return  
7 component, based on his belief that this rate “offers the Companies a reasonable  
8 return for providing SOS.”<sup>7</sup>

9 In contrast, in his reply testimony in Case No. 9221, Mr. Schultz argues  
10 that allowing recovery of a “return” in excess of the return on cash working  
11 capital “is simply not necessary to provide reasonable return to [BGE].”<sup>8</sup>  
12 However, even though Mr. Schultz apparently now agrees with OPC witness  
13 Hill regarding the unreasonableness of charging consumers a “return” in excess  
14 of CWC costs, Staff declines to recommend as I do in my reply testimony in this  
15 proceeding to limit the return component to recovery of the return on cash  
16 working capital. Instead, Staff proposes in Case No. 9221 to continue charging  
17 consumers a fixed rate of 1.5 mills/kWh. To compensate for over-charging  
18 residential SOS customers through the return component, Staff further proposes  
19 in Case No. 9221 to include return revenues in excess of the amount assumed to  
20 be associated with CWC costs as electric operating revenue in the next  
21 distribution rate case, “thereby reducing the rate increase required.”<sup>9</sup>

22

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<sup>7</sup> *Direct Testimony and Exhibits of Matthew Schultz*, Case Nos. 9226 and 9232, August 9, 2010, p. 13.

<sup>8</sup> *Reply Testimony and Exhibits of Matthew Schultz*, Case No. 9221, August 17, 2010, p. 8.

<sup>9</sup> *Id.*

1 **Q: Why does Staff propose this particular approach in Case No. 9221?**

2 A: Staff argues in Case No. 9221 that this approach:

3 ... will have the effect of phasing out the non-CWC related return earned  
4 by [BGE] for offering SOS over time, rather than causing an immediate  
5 shock to [BGE]. This will give [BGE] time to adjust to the decreased return  
6 the Administrative Charge will provide.<sup>10</sup>

7 **Q: Is Staff's proposal for the return component in Case No. 9221 reasonable?**

8 A: No. It is not reasonable to continue over-charging consumers into the indefinite  
9 future in order to slowly wean Delmarva off of what Staff now concedes are  
10 unjust and unreasonable return revenues. The Company should not continue to  
11 be unjustly compensated simply because it has gotten used to windfall gains  
12 over the past six years.

13 Moreover, Staff's proposal to include return revenues as electric operating  
14 revenues in the next distribution rate case may not adequately compensate  
15 consumers for being charged in excess of the return on cash working capital.  
16 Staff apparently believes that including such revenues will necessarily result in  
17 less of a rate increase for residential ratepayers than would be expected without  
18 such revenues. Including such revenues will, all else equal, increase the  
19 calculated amount of earned return from the residential class. However, this  
20 increase in earned return may not result in a commensurate decrease in the  
21 allocation of total system under-earnings to the residential class. Instead, the  
22 effect on the allocation of system under-earnings would depend on such  
23 considerations as the relative contributions to overall system earned returns by  
24 individual customer classes, the extent to which each class is under- or over-  
25 earning, the potential for rate shock, and equity among classes. In other words,

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<sup>10</sup> *Id.*



1 including return revenues as residential operating revenues might not have any  
2 impact on the increase allowed for residential rates.

3 **Q: What do you recommend for the return component of the residential**  
4 **Administrative Charge?**

5 A: As I discussed in my reply testimony, I recommend that the return rate be set so  
6 that the return component recovers only that amount required to provide the  
7 Company with a reasonable return on SOS-related cash working capital. The  
8 Company should not be allowed to recover any other costs or other deemed  
9 return through the return component of the Administrative Charge for residential  
10 SOS.

11 **Q: Does this conclude your rebuttal testimony?**

12 A: Yes.

## Attachment JFW-R1

PSC 9226 – In the Matter of the Review of  
The Delmarva Power and Light Company  
Standard Offer Service Administrative Charge

DELMARVA POWER & LIGHT COMPANY  
MARYLAND CASE NO. 9226  
RESPONSE TO STAFF DATA REQUEST NO. 1

QUESTION NO. 2

Q. FOR THE SAME TIME PERIOD AS ABOVE PLEASE PROVIDE THE COSTS ASSOCIATED WITH EACH OF THE FOLLOWING CATEGORIES FOR EACH OF RESIDENTIAL, TYPE I, TYPE II, AND HOURLY PRICED SERVICE:

- A. CALL CENTER SERVICES
- B. CREDIT AND COLLECTION SERVICES
- C. BILLING
- D. CUSTOMER ACCOUNT MANAGEMENT

RESPONSE:

A. Delmarva has not classified its incremental costs into the categories listed in the question above. The Company does however provide annual costs for two cost components namely "Customer Education" and "Manage Revenues" The costs in these components are for services provided as described below.

Customer Education – Represents Incremental costs related to communicating information on SOS retail rates, customer care training, call center support, and the costs for printing and mailing SOS information to all customers.

Manage Revenue – Represents costs for SOS-related technical services associated with updating and maintaining customer information and billing systems.

The total incremental costs are allocated by SOS kWh sales. Using this method, the costs for the most recent year available (twelve months ended May 31, 2009) are as follows:

	<u>Customer Education</u>		<u>Manage Revenue</u>
Residential	\$ 4,687	\$	152,344
Type I	593		19,273
Type II	871		28,313
HPS	71		2,305
Total	<u>\$ 6,222</u>	<u>\$</u>	<u>202,235</u>

SPONSOR: A. Glenn Simpson