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September 17, 2010

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

**Re: Case No. 9221**

Dear Ms. Romine,

Enclosed please find an original and seventeen (17) copies of the Rebuttal Testimony of Jonathan Wallach on behalf of the Maryland Office of People's Counsel. A copy has been provided to all parties of record.

If you have any questions or concerns, please feel free to contact me.

Sincerely,

Anne L. Johnson  
Assistant People's Counsel

ALJ/bl  
Enclosure  
cc: All Parties of Record

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

**In the Matter of a Request by** )  
**Baltimore Gas and Electric Company for** )  
**Recovery of Standard Offer Service Related** )  
**Cash Working Capital Revenue Requirement** )

**Case No. 9221**

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

Resource Insight, Inc.

**SEPTEMBER 17, 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 17, 2010, the staff of the Public Service Commission ("Staff") filed  
11 the Reply Testimony and Exhibits of Matthew Schultz regarding Staff's  
12 proposal for the residential Administrative Charge and regarding the proposal by  
13 Baltimore Gas and Electric Company ("BGE"; "the Company") with respect to  
14 the return on cash working capital ("CWC").

15 This rebuttal testimony responds to Mr. Schultz's proposals regarding the  
16 Administrative Charge for residential standard offer service ("SOS").

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

19 A: Contrary to the Commission's rulings in Order No. 83347, Staff's proposal to  
20 radically restructure the residential Administrative Charge would artificially and  
21 arbitrarily increase the rate for the Administrative Charge beyond that necessary  
22 to recover actual costs. This outcome is not an accidental by-product of Staff's  
23 proposal. Instead, Staff's intention is to charge more than actual costs, based on  
24 an unsupported allegation that SOS-related costs are currently being recovered  
25 in distribution rates and an unfounded belief that any such recovery would

1 grievously harm the retail competitive market. And with this narrow focus on  
2 the plight of retail suppliers, Staff appears indifferent to the potential harm to  
3 consumers from the inefficient price signals that would result from its proposal  
4 to artificially raise SOS prices.

5 I therefore recommend that the Commission reject Staff's proposal in its  
6 entirety.

7 **Q: Please summarize Staff's proposal for the residential Administrative**  
8 **Charge.**

9 A: Staff is recommending a radical restructuring of the residential Administrative  
10 Charge.

11 According to Mr. Schultz, Staff proposes to combine the incremental-cost,  
12 uncollectible-cost, and Administrative Adjustment components of the current  
13 Administrative Charge into a single, new "Incremental Cost Component." The  
14 rate for this Incremental Cost Component would be fixed at 2.5 mills/kWh,  
15 which is equal to the sum of the rates established in the settlement agreement in  
16 Case No. 8908 ("Settlement Agreement") for the three components to be  
17 combined under Staff's proposal.<sup>1</sup>

18 Staff further proposes two new components for the residential  
19 Administrative Charge. First, Staff proposes a new "CWC Component" to  
20 recover CWC costs in excess of the amount that Staff assumes to be recovered

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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.

1 through the 1.5 mills/kWh return component.<sup>2</sup> Second, Staff proposes a new  
2 “Allocated Cost Component” to recover from SOS customers the portion of the  
3 costs in FERC Accounts 903, 907, 908, 909, and 910 that Staff believes should  
4 be classified as SOS-related costs.

5 Finally, Staff proposes to continue collection of the return component at  
6 the fixed rate of 1.5 mills/kWh established in the Settlement Agreement.  
7 However, Staff further proposes to compensate for over-charging residential  
8 SOS customers through the return component by including return revenues in  
9 excess of the amount assumed to be associated with CWC costs as electric  
10 operating revenue in the next distribution rate case.

11 **Q: What does Staff propose for the total rate for the residential Administrative**  
12 **Charge?**

13 A: Mr. Schultz does not recommend specific rates for the CWC Component or the  
14 Allocated Cost Component in his reply testimony. However, based on data  
15 provided by the Company in response to OPC DR 7-1, I estimate that the rate  
16 for the Allocated Cost Component under Staff’s proposal would be 2.02  
17 mills/kWh.<sup>3</sup> In addition, based on data provided by the Company in response to  
18 OPC DR 3-3 and OPC DR 6-1, I estimate that the rate for the CWC Component  
19 under Staff’s proposal would be 0.95 mills/kWh.<sup>4</sup> Adding these estimates to

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<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 recovery of any amount of CWC costs outside of the return component was unreasonable. I will not repeat my arguments in this rebuttal testimony, since they apply as well to Staff’s proposal to recover incremental CWC costs outside of the return component.

<sup>3</sup> The Company’s response to OPC DR 7-1 is attached hereto as Attachment JFW-R1.

<sup>4</sup> The Company’s response to OPC DR 3-3 is attached hereto as Attachment JFW-R2. The Company’s response to OPC DR 6-1 is attached hereto as Attachment JFW-R3.

1 Staff's proposed rates for the Incremental Cost and Return Components yields a  
2 total rate for the residential Administrative Charge under Staff's proposal of  
3 6.97 mills/kWh, or more than 1.7 times the current rate of 4 mills/kWh.

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

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

11 Although it would eliminate the Administrative Adjustment as a separate  
12 component, Staff's proposal for the Incremental Cost Component would still  
13 provide for an administrative adjustment-like mechanism by setting the rate for  
14 the Incremental Cost Component at a level that exceeds actual incremental and  
15 uncollectible costs. The Staff proposal would then refund to all residential  
16 ratepayers the difference between the revenues collected through the  
17 Incremental Cost Component and the actual incremental and uncollectible costs  
18 incurred.<sup>5</sup>

19 **Q: Is Staff's proposal to continue effectively charging consumers an**  
20 **"administrative adjustment" reasonable?**

21 A: No. Staff's proposal to charge more than actual incremental and uncollectible  
22 costs through the Incremental Cost Component runs contrary to rulings in Order  
23 No. 83347, where the Commission found that BGE now has actual cost data for  
24 the components of the Administrative Charge and concluded that "any changes

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<sup>5</sup> As discussed below, Staff also proposes an administrative adjustment-like refund of revenues collected through the Allocated Cost Component.

1 needed to any of the components may be determined using this actual data,  
2 rather than changing one component using actual data while maintaining the  
3 other components at a fixed rate....”<sup>6</sup>

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

8 Finally, an administrative adjustment mechanism is inconsistent with the  
9 new Allocated Cost Component proposed by Staff. According to Mr. Schultz,  
10 Staff supported the Administrative Adjustment in Case No. 8908 as a reasonable  
11 proxy for an explicit functional unbundling of certain costs that the Company  
12 treated as wholly distribution-related, but which Staff believed were partially  
13 SOS-related. However, in this proceeding, Staff proposes just such an explicit  
14 unbundling, with the unbundled costs determined to be SOS-related to be  
15 collected through the new Allocated Cost Component. As such, no form of  
16 administrative-adjustment proxy is necessary under Staff’s proposal, because  
17 that proposal explicitly provides for recovery in SOS retail prices of those  
18 distribution costs that Staff believes to be SOS-related.

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

20 A: Staff contends that certain expenses that are currently recovered through  
21 distribution rates – specifically costs recorded in FERC Accounts 903, 907, 908,  
22 909, and 910 – are more appropriately classified as SOS-related and  
23 consequently should be recovered through the Administrative Charge. Staff

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<sup>6</sup> *Order No. 83347*, Case Nos. 9221, May 20, 2010, p. 3.

1           therefore proposes to recover these allegedly misclassified costs through a new  
2           Allocated Cost Component of the Administrative Charge.

3           Under Staff’s proposal, the rate for the Allocated Cost Component would  
4           be set to recover a portion of the costs recorded in FERC Accounts 903, 907,  
5           908, 909, and 910, with the portion derived based on the ratio of SOS revenues  
6           to total system revenues. However, since these costs are allegedly already being  
7           recovered in distribution rates, Staff proposes to refund the revenues from the  
8           Allocated Cost Component back to all residential ratepayers.

9           **Q: Does Staff reasonably support its proposal for apportioning costs recorded**  
10           **in FERC Accounts 903, 907, 908, 909, and 910?**

11           A: No. Mr. Schultz fails to offer any evidence in support of either his claim that a  
12           portion of the costs recorded in the FERC accounts in question are incremental  
13           costs attributable to the provision of standard offer service, or his apparent belief  
14           that such alleged incremental costs are not already recovered through the  
15           incremental-cost component of the residential Administrative Charge.  
16           Furthermore, to the extent that incremental SOS-related costs are in fact  
17           recorded in these FERC accounts and not already recovered through the  
18           incremental-cost component, Mr. Schultz fails to offer any evidence that the  
19           proposed method for apportioning costs will properly unbundle those  
20           incremental costs from distribution costs.

21           In other words, Staff’s proposal regarding the Allocated Cost Component  
22           appears to be based purely on speculation regarding the extent to which  
23           incremental SOS-related costs are currently recovered through distribution rates  
24           and not through the Administrative Charge.

25



1 **Q: Is there any indication that Staff's proposal would overstate the amount of**  
2 **incremental costs attributable to the provision of standard offer service?**

3 A: Yes. According to data provided in Attachment JFW-R1, SOS revenues  
4 constituted 82% of combined residential SOS and distribution revenues during  
5 the twelve-month period ending July 31, 2010. Consequently, under Staff's  
6 proposal, 82% of the costs recorded in FERC Accounts 903, 907, 908, 909, and  
7 910 that are allocated to the residential class would be deemed to be incremental  
8 costs attributable to the provision of residential SOS. Staff's approach therefore  
9 implies that the cost to provide the customer services associated with these  
10 FERC accounts to a residential SOS customer would be reduced on average by  
11 82% simply as a result of that customer switching to competitive retail supply. It  
12 is unrealistic to expect that a switch to competitive retail supply would so  
13 dramatically reduce the Company's costs to provide these customer services,  
14 most of which would need to be provided regardless of whether a customer  
15 takes regulated or competitive supply.

16 **Q: What harm might come from overstating the amount of incremental costs**  
17 **appropriately recovered through the residential Administrative Charge?**

18 A: Overstating actual incremental costs would be contrary to the public interest in  
19 three respects. First, charging more than incremental cost as part of the retail  
20 SOS price would distort price signals, and could lead to consumers making  
21 economically inefficient choices between standard offer and competitive retail  
22 service.

23 Second, if the portion of total costs properly attributable to standard offer  
24 service were overstated, then the remaining portion properly attributable to  
25 distribution service would be necessarily understated. If so, then customers  
26 served by competitive retail suppliers would not be charged the full cost for the

1 distribution services they receive, and SOS customers would be charged the  
2 difference through the Administrative Charge. In other words, if incremental  
3 costs were overstated, then SOS customers would subsidize the cost of  
4 distribution services received by customers served by competitive retail  
5 suppliers.

6 Finally, if an SOS customer were over-charged for incremental costs and  
7 that customer were to switch to competitive retail supply, then the reduction in  
8 incremental-cost revenues resulting from that switch would exceed the actual  
9 reduction in incremental costs incurred by BGE. As a result, if SOS customers  
10 were charged more than incremental cost, BGE would incur an economic loss  
11 every time an SOS customer switched to competitive retail supply. In this  
12 circumstance, BGE would have a perverse incentive to hinder migration from  
13 SOS to competitive retail supply.

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

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

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

3 A: Mr. Schultz argues that allowing recovery of a “return” in excess of the return  
4 on cash working capital “is simply not necessary to provide reasonable return to  
5 the Company.”<sup>7</sup> Thus, Mr. Schultz agrees with OPC witness Stephen Hill that it  
6 is unreasonable to charge consumers a “return” in excess of CWC costs. Even  
7 so, Staff declines to recommend as I do in my reply testimony to limit the return  
8 component to recovery of the return on cash working capital. Instead, Staff  
9 proposes to continue charging consumers a fixed rate of 1.5 mills/kWh. To  
10 compensate for over-charging residential SOS customers through the return  
11 component, Staff further proposes to include return revenues in excess of the  
12 amount assumed to be associated with CWC costs as electric operating revenue  
13 in the next distribution rate case, “thereby reducing the rate increase required.”<sup>8</sup>

14 **Q: Why does Staff propose this particular approach for the return**  
15 **component?**

16 A: Staff argues that this approach:

17 ... will have the effect of phasing out the non-CWC related return earned  
18 by the Company for offering SOS over time, rather than causing an  
19 immediate shock to the Company. This will give the Company time to  
20 adjust to the decreased return the Administrative Charge will provide.<sup>9</sup>

21 **Q: Is Staff’s proposal for the return component reasonable?**

22 A: No. There is no need to “give the Company time to adjust to the decreased  
23 return,” because the Company already foregoes all of the revenues collected

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<sup>7</sup> Reply Testimony and Exhibits of Matthew Schultz, Case No. 9221, August 17, 2010, p. 8.

<sup>8</sup> *Id.*

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

1 through the return component pursuant to the provisions of Senate Bill 1 and the  
2 2008 settlement agreement between the Company, the State of Maryland, and  
3 the Commission (“2008 Settlement Agreement”).<sup>10</sup> In other words, BGE would  
4 not be “shocked” by an immediate change to the return rate, because any such  
5 change would have no impact on its earnings.

6 On the other hand, Staff’s proposal to include return revenues as electric  
7 operating revenues in the next distribution rate case would have a “shocking”  
8 impact on the Company’s earnings. Since BGE is already refunding these return  
9 revenues to ratepayers, Staff’s proposal would effectively double the refund  
10 amount.

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

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

19 In addition, revenues collected through the return component should  
20 continue to be refunded in full to residential ratepayers through December 31,  
21 2016, pursuant to the provisions of Senate Bill 1, as modified by the 2008  
22 Settlement Agreement.

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

24 A: Yes.

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<sup>10</sup> Chapter 5, Acts 2006 Special Session and Chapter 133, Acts 2008. The 2008 Settlement Agreement was attached to my reply testimony as Attachment JFW-1.

## **Attachment JFW-R1**

PSC 9221- In the Matter of a Request by  
Baltimore Gas and Electric Company  
For Recovery of Standard Offer Service  
Related Cash Working Capital Revenue Requirement

**Maryland Office of People's Counsel**  
**Data Request No. 7**  
**To: Baltimore Gas and Electric Company ("BGE")**  
**Maryland PSC Case No. 9221**  
**August 23, 2010**

**Item No.: OPCDR 7-1**

Referencing page 15, lines 8 through 11 of the Reply Testimony of Matthew Schultz,

- a) For the test-year period in Case No. 9230, please provide for the BGE system:
  - i) Residential SOS revenues.
  - ii) Residential electric distribution revenues.
  - iii) Costs allocated to the residential class in the electric distribution cost of service study filed in Case No. 9230 for each of the FERC Accounts 903, 907, 908, 909, and 910.

**RESPONSE:**

- i) Residential SOS revenues during the period August 2009 through July 2010 totaled \$1,480,393,922.
- ii) Residential electric distribution revenues during the period August 2009 through July 2010 totaled \$325,218,502. Please note that this total does not include any allocation of other electric revenues which are not distributed to residential / non-residential within the test year.
- iii) Of the total cost included in these accounts (\$33,153,811), the residential classes received \$30,249,570 in the cost of service study.

## **Attachment JFW-R2**

PSC 9221- In the Matter of a Request by  
Baltimore Gas and Electric Company  
For Recovery of Standard Offer Service  
Related Cash Working Capital Revenue Requirement

**Case No. 9221**  
**Baltimore Gas and Electric Co.**  
**Response to OPC Data Request 3**

**Item No.: OPCDR3-3**

Referencing page 6, lines 8 – 10 of Mr. Pino’s Testimony:

- a. Please provide separately BGE’s proposed charges for the incremental cost, return, CWC, uncollectible-cost, and Administrative Adjustment components of the proposed 4.5 mills/kWh Administrative Charge for residential SOS.
- b. Please state whether BGE is proposing a charge for the CWC component that is different than the 1.27 mills/kWh rate derived on page 9 of the Testimony of Robert G. Castagnera, dated June 25, 2010.
  - i. Please begin your answer with either “yes,” “no” or “cannot state yes or no.”
  - ii. If your answer is wholly or partly in the affirmative, please provide a detailed explanation of the basis for your answer.
  - iii. Please provide copies of all workpapers, internal memoranda, reports, or other documentation relied on to derive this proposed charge for the CWC component.
  - iv. If your answer is “cannot state yes or no,” please provide a detailed explanation for your answer.

**RESPONSE:**

- a. Provided below are BGE’s proposed charges for the incremental cost, return, CWC, and uncollectible cost components of the proposed 4.5 mills/kWh Administrative Charge for residential SOS.

	\$	\$/MWh
Return <sup>1</sup>	\$ 18,451,931	\$ 1.50
Incremental Costs	\$ 1,641,385	\$ 0.13
Uncollectible Costs	\$ 19,592,015	\$ 1.59
Cash Working Capital Costs	\$ 15,685,992	\$ 1.28
	<u>\$ 55,371,322</u>	<u>\$ 4.50</u>
1. Credit to customers of Return component became effective June 1, 2010.		

- b. BGE is proposing an initial CWC recovery of \$1.28/MWh. The difference between this rate and the \$1.27/MWh in Mr. Castagnera’s testimony is simply due to rounding variance.



## **Attachment JFW-R3**

PSC 9221- In the Matter of a Request by  
Baltimore Gas and Electric Company  
For Recovery of Standard Offer Service  
Related Cash Working Capital Revenue Requirement

**Maryland Office of People’s Counsel**  
**Data Request No. 6**  
**To: Baltimore Gas & Electric Company (“BGE”)**  
**Maryland PSC Case No. 9221**  
**August 12, 2010**

**Item No.: OPCDR6-1**

Referencing Attachment 2 of BGE’s response to OPC Data Request 3-4.

- a) Please provide separately BGE’s estimates of incremental costs, CWC, and uncollectible costs relied on to estimate the amounts shown for “Costs” for each of the 12-month periods ending May 31, 2007, May 31, 2008, and May 31, 2009.

**RESPONSE:**

<b>Version 2007</b>	
<b>Residential Administrative Costs</b>	
<b>12 Month Period Ending May 31, 2007</b>	
Incremental	\$ 766,049
Uncollectibles	\$ 1,507,164
CWC	<u>\$ 4,021,355</u>
Total	\$ 6,294,568

<b>Version 2008</b>	
<b>Residential Administrative Costs</b>	
<b>12 Month Period Ending May 31, 2008</b>	
Incremental	\$ 86,336
Uncollectibles	\$ 8,746,298
CWC	<u>\$ 4,175,174</u>
Total	\$ 13,007,808

<b>Version 2009</b>	
<b>Residential Administrative Costs</b>	
<b>12 Month Period Ending May 31, 2009</b>	
Incremental	\$ 585,171
Uncollectibles	\$ 17,599,102
CWC	<u>\$ 4,476,335</u>
Total	\$ 22,660,608