

**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**

**SECOND REPLY TESTIMONY OF**  
**JONATHAN WALLACH**  
**ON BEHALF OF**  
**THE OFFICE OF PEOPLE’S COUNSEL**

Resource Insight, Inc.

**JUNE 10, 2015**

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Exhibit JFW-1 Professional Qualifications of Jonathan F. Wallach  
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1 **I. Introduction and Summary**

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

3 A: My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc.,  
4 5 Water Street, Arlington, Massachusetts.

5 **Q: Please summarize your professional experience.**

6 A: I have worked as a consultant to the electric-power industry since 1981. From  
7 1981 to 1986, I was a research associate at Energy Systems Research Group. In  
8 1987 and 1988, I was an independent consultant. From 1989 to 1990, I was a  
9 senior analyst at Komanoff Energy Associates. I have been in my current  
10 position at Resource Insight since September of 1990.

11 Over the past thirty years, I have advised and testified on behalf of clients  
12 on a wide range of economic, planning, and policy issues relating to the  
13 regulation of electric utilities, including: electric-utility restructuring; wholesale-  
14 power market design and operations; transmission pricing and policy; market-  
15 price forecasting; market valuation of generating assets and purchase contracts;  
16 power-procurement strategies; risk assessment and mitigation; integrated  
17 resource planning; mergers and acquisitions; cost allocation and rate design; and  
18 energy-efficiency program design and planning.

19 My resume is attached as Exhibit JFW-1.

20 **Q: Please summarize your experience with regard to the establishment and**  
21 **derivation of the Administrative Charge.**

22 A: I have advised and testified on behalf of the Office of People's Counsel  
23 ("OPC") in most of the major proceedings relating to Maryland's restructuring  
24 process since 1997. During that time, I assisted OPC during settlement

1 negotiations and testified in support of the settlement agreement that established  
2 the Administrative Charge in Case No. 8908 (“2003 Settlement”).<sup>1</sup> I also  
3 testified in Case Nos. 8994 and 8995 regarding derivation of the uncollectible-  
4 cost component of the Administrative Charge for Potomac Electric Power  
5 Company (“PEPCO”) and Delmarva Power and Light Company (“Delmarva”).  
6 In addition, I testified in Case No. 9099 regarding the Commission’s  
7 investigation of residential Standard Offer Service (“SOS”) rates, including the  
8 Administrative Charge. In 2010 and again in 2014, I testified in Case Nos. 9226  
9 and 9232 regarding proposals by Delmarva and PEPCO for modifying the  
10 Administrative Charge. Finally, in 2010, I testified in this proceeding regarding  
11 the proposal by Baltimore Gas and Electric Company (“BGE”; “the Company”)  
12 to modify the Administrative Charge.

13 **Q: Have you testified previously in other utility regulatory proceedings?**

14 A: Yes. I have sponsored expert testimony in more than sixty state, provincial, or  
15 federal proceedings in the U.S. and Canada. Exhibit JFW-1 includes a detailed  
16 list of my previous testimony.

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

18 A: I am testifying on behalf of the Office of People’s Counsel.

19 **Q: What is the purpose of your testimony?**

20 A: On November 10, 2014, the Commission issued Order No. 86703 reversing a  
21 proposed order by the Hearing Examiner in the instant proceeding and  
22 remanding the matter of the Administrative Charge for BGE to the Public Utility  
23 Law Judge. On January 21, 2015, the Company filed direct testimony by

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<sup>1</sup> The 2003 Settlement was filed on November 15, 2002, and adopted pursuant to Order No. 78400, issued April 29, 2003, in Case No. 8908.

1 William B. Pino regarding the Company's proposals for the structure and  
2 pricing of the Administrative Charge and by David M. Vahos supporting the  
3 Company's request for an increase in the recovery of SOS-related cash working  
4 capital ("CWC") revenue requirements.

5 On March 3, 2015, the Commission issued Order No. 86881 remanding to  
6 the Public Utility Law Judge the matter of a proposed settlement agreement in  
7 Case Nos. 9226 and 9232 regarding the Administrative Charges for Delmarva  
8 and PEPCO. In response, BGE filed in this proceeding supplemental direct  
9 testimony by Mr. Vahos and direct testimony by Kurt G. Strunk.

10 This testimony responds to the Company's proposals regarding the  
11 Administrative Charge and cash working capital for residential SOS customers.  
12 People's Counsel is also sponsoring testimony in this proceeding by David  
13 Effron regarding the calculation of CWC revenue requirements and by Steven  
14 Hill regarding the return component of the Administrative Charge and the cost  
15 to finance SOS-related cash working capital.

16 **Q: Please summarize your conclusions and recommendations.**

17 A: The Company's proposals regarding the components of the Administrative  
18 Charge are unreasonable and economically harmful to residential ratepayers. As  
19 discussed in detail by OPC witness Hill, the Company's proposal to recover a  
20 return over and above the return on the SOS-related cash working capital is  
21 economically inefficient. Mr. Hill also finds that the revenues the Company is  
22 seeking to recover through the proposed CWC component of the Administrative  
23 Charge would substantially exceed the Company's actual cost to finance CWC  
24 balances. Moreover, the Company's proposal to not refund to consumers the  
25 revenues collected through this separate CWC component appears to run  
26 contrary to the provisions of Senate Bill 1, as modified by a 2008 settlement

1 agreement between the Company, the State of Maryland, and the Commission  
2 (“2008 Settlement Agreement”).<sup>2</sup> Finally, as discussed below, the  
3 Administrative Adjustment, as continued under the Company’s proposal, bears  
4 no relation to actual SOS-related costs and serves no purpose other than to  
5 arbitrarily and unreasonably increase the price paid by residential customers for  
6 Standard Offer Service.

7 To address these problems with the Company’s filing, and taking into  
8 account the recommendations of OPC witnesses Effron and Hill, I recommend  
9 the following:

- 10 • Adopt the Company’s proposal to replace the fixed rate for the  
11 incremental-cost component with a rate set to recover actual, verifiable,  
12 prudently incurred incremental costs. In addition, adopt the Company’s  
13 proposal to use the current SOS true-up process every four months to: (1)  
14 review and assess the prudence of the prior period’s spending on  
15 incremental costs; (2) reconcile incremental-cost revenues against actual  
16 costs; and (3) reset the rate for the upcoming period.
- 17 • Continue to set the rate for the uncollectible-cost component as part of  
18 distribution rate cases. In addition, starting with the Company’s next  
19 distribution rate case, adjust the uncollectible rate to reflect SOS-related  
20 late payment revenues.
- 21 • Adopt the Company’s proposal to implement a separate component of the  
22 Administrative Charge to recover SOS-related cash working capital  
23 revenue requirements. Set CWC revenue requirements based on the  
24 Company’s cost of short-term debt. As part of the current SOS true-up

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<sup>2</sup> Chapter 5, Acts 2006 Special Session and Chapter 133, Acts 2008. The 2008 Settlement Agreement is attached hereto as Attachment JFW-1.

1 process, update the rate for the CWC component as appropriate to reflect  
2 changes in wholesale SOS supply costs, revised estimates of net lag days,  
3 or approved changes to the assumed finance rate.

- 4 • Limit the return component to recovery of the return on SOS-related cash  
5 working capital, with the rate of return on CWC balances set at the  
6 difference between the Company's overall cost of capital and the short-  
7 term debt rate. Allow no other costs or other deemed return to be recovered  
8 through the return component.
- 9 • Pursuant to the 2008 Settlement Agreement, continue in 2015 and 2016 to  
10 refund to residential ratepayer the revenues collected through both the  
11 return and the CWC components of the residential Administrative Charge.
- 12 • Eliminate the Administrative Adjustment.

13 I further recommend that the rates for each component of the  
14 Administrative Charge for residential SOS customers be set initially as shown in  
15 Table 1.

16 **Table 1. Recommended Initial Administrative Charge**

Incremental Cost	0.08 mills/kWh
Uncollectible Cost	1.70 mills/kWh
Cash Working Capital	0.02 mills/kWh
Return	0.93 mills/kWh
Administrative Charge	2.73 mills/kWh

17 The incremental-cost rate shown in Table 1 is set at the actual incremental  
18 cost per kilowatt-hour of SOS sales in 2014. The uncollectible-cost rate is set at  
19 the rate established in Case No. 9355. Finally, the recommended initial rates for  
20 CWC revenue requirements and for the return component are derived by OPC  
21 witness Effron.

1 **II. The Administrative Charge**

2 **Q: Please describe the 2003 Settlement in Case No. 8908.**

3 A: The 2003 Settlement resolved a number of key concerns at that time associated  
4 with the continued provision of a regulated standard offer service to residential  
5 customers, by establishing, among other things, the terms and conditions, the  
6 pricing mechanism, and the framework for competitive procurement of  
7 wholesale supply for residential SOS.

8 Specifically, the 2003 Settlement:

- 9 • Established the obligation of each of Maryland’s four investor-owned  
10 utilities to provide residential SOS after the end of each utility’s current  
11 rate-cap or rate-freeze transition period, and defined the period of time  
12 during which the obligation would continue.
- 13 • Established that wholesale supply for residential SOS would be procured  
14 through a competitive procurement process.
- 15 • Established that wholesale supply for residential SOS would consist of a  
16 portfolio of one-, two-, and three-year supply contracts, and specified the  
17 percentages of these one-, two-, and three-year contracts that would  
18 comprise the portfolio.
- 19 • Specified the components of the retail price for residential SOS.
- 20 • Established an “Administrative Charge” as one part of the retail price for  
21 residential SOS, set the rate for the Administrative Charge at 4 mills/kWh,  
22 and specified four individual components of the Administrative Charge:  
23 (1) incremental cost; (2) return; (3) uncollectible cost; and (4)  
24 Administrative Adjustment.



- 1 • Specified the rates for each of the four components of the Administrative  
2 Charge, and established mechanisms for recovering and re-setting such  
3 rates.
- 4 • Provided that residential customers could switch freely between SOS and  
5 competitive retail service without restriction.

6 The 2003 Settlement was intensively negotiated over many months by a  
7 large and diverse group of parties with competing interests. While each party  
8 may not have been satisfied with particular provisions of the 2003 Settlement,  
9 and would not have necessarily agreed to such provisions in isolation, the  
10 negotiated package as a whole apparently provided tangible benefits and served  
11 the interests of settling parties.

12 **Q: Please describe the structure of the Administrative Charge established in**  
13 **the 2003 Settlement for residential SOS.**

14 A: As noted above, the 2003 Settlement established an Administrative Charge as  
15 part of the retail price for residential SOS, and specified a rate of 4 mills/kWh  
16 for the Administrative Charge. The 2003 Settlement further specified that there  
17 would be four components to the Administrative Charge: (1) incremental cost;  
18 (2) return; (3) uncollectible cost; and (4) Administrative Adjustment.

19 The 2003 Settlement set the rate for the incremental-cost component at 0.5  
20 mills/kWh, and further specified that this rate would remain fixed over the term  
21 of the agreement. Incremental costs were defined in the 2003 Settlement to  
22 exclude both SOS-related cash working capital, which was deemed to be  
23 collected through the return component, and SOS-related uncollectible costs.

24 The 2003 Settlement set the rate for the return component at 1.5  
25 mills/kWh. As with the incremental-cost component, the return rate was fixed  
26 for the term of the agreement. As noted above, the return component was

1 defined as the sole means for recovery of cash working capital. Consequently,  
2 recovery of SOS-related CWC revenue requirements was limited to 1.5  
3 mills/kWh, regardless of the actual magnitude of those revenue requirements.

4 The rate for SOS-related uncollectible costs was initially set at 1.1  
5 mills/kWh for BGE. The Settlement Agreement then provided for changes to  
6 that initial rate in subsequent distribution rate cases. The Company never  
7 requested a change in the uncollectible-cost rate until this proceeding.

8 Finally, the 2003 Settlement established the rate for the Administrative  
9 Adjustment as the remainder of the 4 mills/kWh Administrative Charge after  
10 subtracting the rates for the incremental-cost, return, and uncollectible-cost  
11 components. Thus, over the term of the Settlement Agreement, the  
12 Administrative Adjustment for BGE was set at 0.9 mills/kWh, which is equal to  
13 4 mills less 0.5 mills for incremental cost, less 1.5 mills for return, and less 1.1  
14 mills for SOS-related uncollectible costs.

15 **Q: Please describe the treatment of revenues associated with the**  
16 **Administrative Adjustment.**

17 A: The 2003 Settlement provided that all revenues associated with the  
18 Administrative Adjustment would be returned to residential distribution  
19 customers, regardless of whether they were SOS customers or were served by a  
20 competitive retail supplier.

21 This treatment of Administrative Adjustment revenues – collection from  
22 residential SOS customers, and refund to all residential distribution customers –  
23 gives rise to cross-subsidization of switching customers by SOS customers,  
24 since customers that switch to competitive retail supply will not be charged the  
25 Administrative Adjustment, but will be credited a portion of the revenues.

1 **Q: Please describe the current treatment of revenues associated with the**  
2 **return component of the residential Administrative Charge.**

3 A: Pursuant to the provisions of Senate Bill 1, as modified by the 2008 Settlement  
4 Agreement, the Company refunds all revenues collected through the return  
5 component. Moreover, pursuant to the Commission's ruling in Order No. 81423  
6 in Case No. 9099, return revenues are refunded back to all residential ratepayers  
7 regardless of whether they are SOS customers or are served by a competitive  
8 retail supplier. As with the treatment of Administrative Adjustment revenues,  
9 the refund of residential SOS-related return revenues to all residential  
10 distribution customers gives rise to cross-subsidization of switching customers  
11 by SOS customers.

12 **Q: Please describe the Company's proposals regarding the structure and**  
13 **pricing of the Administrative Charge for residential SOS.**

14 A: The Company proposes a number of changes to the current design for the  
15 residential Administrative Charge. First, BGE proposes to replace the fixed rate  
16 for the incremental-cost component with a rate set to recover actual incremental  
17 costs. Second, the Company proposes to discontinue setting the uncollectible-  
18 cost rate in distribution rate cases and, instead, to set the rate every four months  
19 as part of the current SOS true-up process. Third, starting on January 1, 2017  
20 (i.e., at the expiration of the return refund provisions of Senate Bill 1), BGE  
21 proposes to replace the fixed rate of 1.5 mills/kWh for the return component  
22 with a rate set at the equivalent of 2% of the generation portion of the prevailing  
23 residential SOS price. Prior to January 1, 2017, the Company proposes to retain  
24 the current rate of 1.5 mills/kWh for the return component. Fourth, under the  
25 Company's proposal, cash working capital would no longer be deemed to be

1 recovered through the return component, and would instead be recovered in a  
2 new, separate component of the residential Administrative Charge.<sup>3</sup>

3 Finally, the Company proposes to replace the existing fixed rate of 4  
4 mills/kWh for the residential Administrative Charge with a rate that varies to  
5 reflect actual costs for all components other than the return component.  
6 However, BGE further proposes a minimum rate of 4 mills/kWh, with the  
7 Administrative Adjustment set at the difference between 4 mills/kWh and the  
8 sum of the rates for incremental costs, return, uncollectible costs, and cash  
9 working capital. Under the Company's proposal, the rate for the Administrative  
10 Adjustment would be set at zero, so long as the sum of the rates for incremental  
11 costs, return, uncollectible costs, and cash working capital exceeded 4  
12 mills/kWh. However, if the sum of the rates for incremental costs, return,  
13 uncollectible costs, and cash working capital were to fall below 4 mills/kWh,  
14 then the rate for the Administrative Adjustment would be set at the difference  
15 between 4 mills/kWh and that sum. Thus, the rate for the Administrative  
16 Adjustment would be adjusted to ensure that the rate for the Administrative  
17 Charge is never less than 4 mills/kWh.

18 I discuss below the Company's proposals for each of the components of  
19 the Administrative Charge.

20 **Q: Has BGE specified the rates for the residential Administrative Charge or**  
21 **the individual components of the residential Administrative Charge that**  
22 **would be in effect initially under its proposal?**

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<sup>3</sup> As discussed below in Section V, under the Company's proposal, the revenues collected under this new CWC component would no longer be subject to the refund provisions of Senate Bill 1.

1 A: No. The Company did not propose initial rates in its direct filing and declined to  
2 do so in response to discovery from OPC.<sup>4</sup> Instead, the Company provided  
3 indicative rates based on costs incurred in 2014. These are shown below in  
4 Table 2.

5 **Table 2. Indicative Administrative Charge Based on 2014 Costs**

Incremental Cost	0.08 mills/kWh
Uncollectible Cost	1.67 mills/kWh
Cash Working Capital	0.95 mills/kWh
Return	1.50 mills/kWh
Administrative Adjustment	0.00 mills/kWh
<b>Administrative Charge</b>	<b>4.20 mills/kWh</b>

6 **III. Incremental Costs**

7 **Q: What does BGE propose for the incremental-cost component of the**  
8 **Administrative Charge for residential SOS?**

9 A: According to Mr. Pino, the Company proposes to replace the existing fixed rate  
10 of 0.5 mills/kWh with a rate that is set to recover actual, verifiable, and  
11 prudently incurred incremental costs. The Company further proposes to use the  
12 current SOS true-up process every four months to: (1) review and assess the  
13 prudence of the prior period's spending on incremental costs; (2) reconcile  
14 incremental-cost revenues against actual costs; and (3) reset the rate for the  
15 upcoming period.

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<sup>4</sup> For example, OPC Data Request No. 1-9(b) requested the Company's proposed initial rate for the incremental-cost component of the residential Administrative Charge. In response, BGE stated that "the Company is not proposing a fixed rate of recovery for incremental costs. The Company is proposing to recover the actual incremental costs as part of the Administrative Charge." Copies of all responses to OPC data requests cited herein are provided as Attachment JFW-2.

1 **Q: Is the Company’s proposal for the incremental-cost component reasonable?**

2 A: Both the proposal to replace the current fixed rate with a rate set to recover  
3 actual, verifiable, prudently incurred costs and the proposal for verifying and  
4 reconciling incremental costs appear reasonable.

5 **Q: What do you propose for the initial rate for the incremental-cost  
6 component of the Administrative Charge for residential SOS?**

7 A: I recommend setting the initial rate at the actual incremental cost per kilowatt-  
8 hour of SOS sales incurred in 2014. According to the Company’s response to  
9 OPC Data Request No. 1-9(b), the actual incremental cost for residential SOS in  
10 2014 was 0.08 mills/kWh.

#### 11 **IV. Uncollectible Costs**

12 **Q: What is the Company’s proposal with regard to the uncollectible-cost  
13 component of the Administrative Charge for residential SOS?**

14 A: The Company proposes to discontinue the process established under the 2003  
15 Settlement, whereby the rate for SOS-related uncollectible costs is set as part of  
16 a distribution rate case. Instead, BGE proposes that the rate be set “in the normal  
17 SOS cost recovery process.”<sup>5</sup>

18 **Q: Should the current process for setting the uncollectible-cost rate be  
19 discontinued?**

20 A: No. It makes sense to continue setting the rate for SOS-related uncollectible  
21 costs in distribution rate cases. This process allows for full evidentiary review of  
22 the Company’s methods for unbundling uncollectible costs into distribution and

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<sup>5</sup> *Direct Testimony of William B. Pino on Behalf of Baltimore Gas and Electric Company*, Case No. 9221, January 21, 2015, p. 6, line 4.

1 SOS-related portions, and provides a record for the Commission to rely on to  
2 ensure that uncollectible costs are unbundled in a consistent manner and that the  
3 distribution and SOS-related portions are appropriately reflected in base rates  
4 and the Administrative Charge, respectively.

5 Another reason for continuing to set the uncollectible rate in distribution  
6 rate cases is that the process would allow for an unbundling of late-payment  
7 revenues into distribution and SOS-related portions and for the SOS-related  
8 portion to be reflected as a credit to the rate for the uncollectible component of  
9 the residential Administrative Charge. Currently, all late-payment revenues from  
10 residential SOS customers are functionalized as distribution revenues for the  
11 purposes of distribution ratemaking.<sup>6</sup> This treatment of SOS-related late-  
12 payment revenues gives rise to cross-subsidization of switching customers by  
13 SOS customers, since the distribution rates charged to customers that switch to  
14 competitive retail supply are reduced to reflect late-payment revenues collected  
15 from SOS customers. Moreover, this treatment is inconsistent with the treatment  
16 of supply-related late-payment revenues in the determination of the discount rate  
17 for the purchase of receivables (“POR”) from competitive retail suppliers. For  
18 the purposes of setting the POR discount rate, BGE nets late-payment revenues  
19 from uncollectible costs in the calculation of the discount rate for residential  
20 customers taking competitive retail service.<sup>7</sup>

21 **Q: What do you recommend with respect to uncollectible-cost component of**  
22 **the residential Administrative Charge?**

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<sup>6</sup> See the Company’s response to OPC Data Request No. 1-8(c).

<sup>7</sup> For example, see *Compliance Filing for Annual Re-calculation of Discount Rate for Baltimore Gas and Electric Company’s Electric Purchase of Receivables Program and Request for Commission Resolution on Negative Discount Rates*, March 23, 2015, Mail Log No. 165522.

1 A: I recommend that the initial rate for the uncollectible-cost component be set at  
2 1.70 mills/kWh, as established in Case No. 9355.<sup>8</sup> Moreover, I recommend that  
3 the uncollectible-cost rate continue to be set as part of distribution rate cases in  
4 the future. In such future cases, SOS-related late-payment revenues should be  
5 netted from uncollectible costs to determine the uncollectible-cost rate.

6 **Q: Does your proposed initial rate for uncollectible costs reflect an adjustment**  
7 **for SOS-related late-payment revenues?**

8 A: No. It would not be appropriate to reduce the uncollectible rate established in  
9 Case No. 9355 to reflect SOS-related late-payment revenues, since such  
10 revenues were counted as distribution revenues in the distribution cost of service  
11 in Case No. 9355.

## 12 **V. Cash Working Capital**

13 **Q: What is SOS-related cash working capital?**

14 A: The Company pays the bills from wholesale SOS suppliers prior to receiving the  
15 revenues from SOS customers to cover those payments. Cash working capital is  
16 the short-term capital the Company needs to fund payments during the period  
17 that revenue recovery lags bill payments.

18 **Q: How is cash working capital currently reflected in the residential**  
19 **Administrative Charge?**

20 A: As noted above in Section II, CWC revenue requirements are currently deemed  
21 to be recovered through the return component.

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<sup>8</sup> See the Company's response to OPC Data Request No. 1-7(f). In comparison, actual uncollectible costs in 2014 amounted to 1.67 mills/kWh. See the Company's response to OPC Data Request No. 1-7(b).



1 **Q: How does BGE propose to revise this treatment of CWC revenue**  
2 **requirements?**

3 A: Under the Company's proposal, CWC revenue requirements would no longer be  
4 deemed to be recovered through the return component. Instead, CWC revenue  
5 requirements would be recovered in a new, separate component of the  
6 residential Administrative Charge.

7 Moreover, according to Mr. Vahos, BGE proposes to apply the most-  
8 recently authorized rate of return to determine the return on CWC balances to be  
9 recovered through this new CWC component. Using data on CWC balances for  
10 2014, Mr. Vahos estimates that the Company's proposal would yield a rate of  
11 0.95 mills/kWh for the proposed CWC component.<sup>9</sup>

12 **Q: Is this a reasonable approach for setting the rate for CWC revenue**  
13 **requirements?**

14 A: According to OPC witness Hill, it would be more appropriate to use a short-term  
15 debt rate rather than the overall cost of capital to calculate SOS-related CWC  
16 revenue requirements. Based on Mr. Hill's recommendations to use a short-term  
17 debt rate of 0.28%, OPC witness Effron calculates a rate for residential CWC  
18 revenue requirements of 0.02 mills/kWh based on 2014 balances.

19 **Q: Under the Company's proposal, what would be the total charge to**  
20 **residential SOS customers for return and CWC revenue requirements?**

21 A: Based on Mr. Vahos's calculation using CWC balances for 2014, the  
22 Company's proposal would increase the total charge to consumers for return and

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<sup>9</sup> Prepared Supplemental Direct Testimony of David M. Vahos on Behalf of Baltimore Gas and Electric Company, Case No. 9221, April 22, 2015, Exhibit DMV-2.

1 CWC revenue requirements from the current rate of 1.5 mills/kWh to 2.45  
2 mills/kWh in 2015 and 2016.<sup>10</sup>

3 **Q: Under the Company's proposal, would all of the return and CWC revenues**  
4 **be refunded to residential ratepayers pursuant to the provisions of Senate**  
5 **Bill 1 and the 2008 Settlement Agreement?**

6 A: No. The Company proposes to retain all revenues recovered through the new  
7 CWC component. Thus, under the Company's proposal, only 1.5 mills of the  
8 total 2.45 mills charge for return and CWC revenue requirements would be  
9 refunded to residential ratepayers.

10 **Q: Is the Company's proposal to retain CWC revenue requirements**  
11 **consistent with the provisions of Senate Bill 1 and the 2008 Settlement**  
12 **Agreement?**

13 A: I have been advised by People's Counsel that the Company's proposal runs  
14 contrary to the provisions of Senate Bill 1, as modified by the 2008 Settlement  
15 Agreement. These provisions require the Company to refund to consumers all  
16 revenues collected through the return component of the Administrative Charge  
17 through December 31, 2016. That obligation to refund return revenues extends  
18 to cash working capital revenue requirements, since, at the time that Senate Bill  
19 1 was signed into law and that BGE entered into the 2008 Settlement  
20 Agreement, the return component was defined (pursuant to the 2003 Settlement)  
21 to include the full amount of CWC revenue requirements, no matter the  
22 magnitude of those revenue requirements. The Company's proposal in this  
23 proceeding to establish a separate charge for the CWC revenue requirements

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<sup>10</sup> As noted above in Section II, BGE proposes to continue charging for return at 1.5 mills/kWh through the remaining term of the 2008 Settlement Agreement. Thus, the total charge for return and CWC proposed by BGE for 2015 and 2016 would be 2.45 mills/kWh.

1 and to not refund the revenues from this separate charge therefore is contrary to  
2 the provisions of Senate Bill 1 and the obligation that BGE accepted as part of  
3 the 2008 Settlement Agreement.

4 **Q: What do you recommend with respect to the recovery of CWC revenue**  
5 **requirements?**

6 A: I recommend adoption of the Company's proposal for a separate component of  
7 the residential Administrative Charge to recover SOS-related CWC revenue  
8 requirements. Based on calculations by OPC witness Effron, I also recommend  
9 that the rate for the CWC component of the residential Administrative Charge  
10 be set initially at 0.02 mills/kWh.

11 In addition, I recommend that CWC revenues be reconciled as part of the  
12 current SOS true-up process. Specifically, such revenues should be reconciled  
13 against a revenue amount based on actual wholesale supply costs and any  
14 changes in estimated net lag days during the preceding period.

15 I further recommend that, as part of the current SOS true-up process, the  
16 rate for the CWC component be updated as appropriate to reflect changes in  
17 wholesale SOS supply costs, changes in estimated net lag days, or approved  
18 changes to the assumed finance rate.

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

## 23 **VI. Return**

24 **Q: What does the Company propose for the return component of the**  
25 **Administrative Charge?**

1 A: According to Mr. Pino, starting on January 1, 2017 (i.e., at the expiration of the  
2 return refund provisions of Senate Bill 1), BGE proposes to replace the fixed  
3 rate of 1.5 mills/kWh for the return component with a rate set at the equivalent  
4 of 2% of the generation portion of the prevailing residential SOS price. Prior to  
5 January 1, 2017, the Company proposes to retain the current rate of 1.5  
6 mills/kWh for the return component.<sup>11</sup> In all years, BGE proposes to collect a  
7 “return” through the return component that is in addition to the return on SOS-  
8 related cash working capital recovered through the proposed CWC component.

9 **Q: Should the Company be allowed to collect a return in excess of the return  
10 on cash working capital?**

11 A: No. According to OPC witness Hill, it would be economically inefficient to  
12 provide BGE any additional “return” beyond the return on SOS-related cash  
13 working capital. Accordingly, Mr. Hill recommends that the Company’s return  
14 be limited strictly to the return on SOS-related cash working capital.

15 **Q: What do you recommend with regard to the return component of the  
16 residential Administrative Charge?**

17 A: Based on Mr. Hill’s recommendations, I recommend setting the rate for the  
18 return component at a level that provides the Company with a reasonable return  
19 on SOS-related cash working capital.<sup>12</sup> The Company should not be allowed to  
20 recover any other costs or other deemed return through the return component of  
21 the Administrative Charge for residential SOS.

22 Specifically, Mr. Hill recommends that the allowed return to BGE be  
23 derived by applying a rate of return to CWC balances that is set at the difference

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<sup>11</sup> See the Company’s response to OPC Data Request No. 1-15(a).

<sup>12</sup> I provide my recommendations regarding the recovery of CWC costs in Section V, above.

1 between the Company's overall cost of capital and the short-term debt rate. I  
2 then recommend that this allowed return on cash working capital be recovered  
3 through the return component. Accordingly, based on calculations by OPC  
4 witness Effron, I recommend that the rate for the return component of the  
5 residential Administrative Charge be set initially at 0.93 mills/kWh.

6 **Q: What do you propose with respect to the treatment of return revenues?**

7 A: Revenues collected through the return component should continue to be  
8 refunded in full to residential ratepayers through December 31, 2016, pursuant  
9 to the provisions of Senate Bill 1, as modified by the 2008 Settlement  
10 Agreement.

## 11 **VII. Administrative Adjustment**

12 **Q: What does BGE propose for the Administrative Adjustment?**

13 A: The Company proposes to continue collection of the Administrative Adjustment  
14 whenever the sum of the rates for incremental costs, return, uncollectible costs,  
15 and cash working capital is less than 4 mills/kWh. The Company also proposes  
16 to continue crediting the amounts collected through the Administrative  
17 Adjustment to all residential distribution customers.

18 **Q: What was the purpose of the Administrative Adjustment in the 2003  
19 Settlement?**

20 A: In comments and testimony in Case No. 8908, certain parties expressed the  
21 belief that, at least at the outset of competition, competitive retail suppliers  
22 would be at a competitive disadvantage to residential SOS in terms of the costs  
23 associated with supplying retail service. Specifically, some parties argued that  
24 utility incremental cost was not fully compensatory of the retailers' cost to

1 provide retail service, and thus would impede retailer entry during the early  
2 stages of market development. In contrast, other parties argued that consumers  
3 should pay no more than incremental cost for providing a regulated service, and  
4 that charging more than incremental cost as part of the SOS price would distort  
5 price signals and be economically inefficient. The Administrative Adjustment  
6 was designed to balance these competing concerns by: (1) increasing the  
7 apparent price of providing the retail service against which competitive retailers  
8 would compete, and (2) providing for the refund to residential ratepayers of all  
9 revenues associated with the Administrative Adjustment.

10 **Q: Why does BGE support a continuation of the Administrative Adjustment?**

11 A: According to Mr. Pino:

12 ... inclusion of an Administrative Adjustment in the Administrative Charge  
13 is necessary because there are costs incurred by retail suppliers that are not  
14 fully represented by the incremental costs recovered in the Administrative  
15 Charge. Therefore, eliminating the Administrative Adjustment would likely  
16 provide SOS a competitive advantage over retail suppliers, and would  
17 likely have a chilling effect on the competitive retail market.<sup>13</sup>

18 **Q: What is the basis for Mr. Pino's claim that the rate for the incremental-cost**  
19 **component does not fully reflect the costs incurred by competitive retail**  
20 **suppliers to provide supply service to residential customers?**

21 A: Mr. Pino has not offered any evidence to support his assertion that competitive  
22 retail suppliers' costs exceed those recovered through the incremental-cost  
23 component of the residential Administrative Charge.

24 **Q: Do you agree with Mr. Pino's claim that eliminating the Administrative**  
25 **Adjustment would provide SOS with a competitive advantage over**  
26 **competitive retail supply?**

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<sup>13</sup> Pino Direct, p. 12, ll. 5-11.

1 A: No. In fact, the current design of the residential Administrative Charge provides  
2 an artificial competitive advantage to competitive retail supply as a result of the  
3 subsidies provided to customers on competitive service from the treatment of  
4 return-refund, SOS-related late-payment, and Administrative Adjustment  
5 revenues.<sup>14</sup> Contrary to Mr. Pino’s claim, eliminating the Administrative  
6 Adjustment would likely lighten this subsidy “thumb on the scale” favoring  
7 competitive retail supply.

8 **Q: Would it be appropriate to use the Administrative Adjustment as a proxy**  
9 **for costs allegedly incurred by retail suppliers or to eliminate an alleged**  
10 **competitive advantage of SOS over competitive retail supply?**

11 A: No. By statute, Public Utilities Article §7-510(c)(3)(ii)(2), the Administrative  
12 Charge should be set to recover no more than a utility’s “verifiable, prudently  
13 incurred costs to procure or produce the electricity plus a reasonable return.”  
14 Artificially increasing the rate for the Administrative Charge beyond that  
15 required to recover actual, verifiable, and prudently incurred costs (plus a  
16 reasonable return) in an attempt to level the playing field or to more closely  
17 reflect retailers’ costs would be contrary to statute.

18 **Q: What did the Commission conclude in Order No. 86881 with regard to the**  
19 **Administrative Adjustment?**

20 A: In Order No. 86881, the Commission found as follows:

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<sup>14</sup> These subsidies artificially reduce the effective price paid by customers on competitive retail service.

1 In Order No. 85797 we stated that the PULJ should develop a record and  
2 make a finding regarding whether the Administrative Charge should  
3 continue to include an Administrative Adjustment. In his Proposed Order  
4 he noted his finding that “the inclusion of the administrative adjustment [is]  
5 the most troubling aspect of the settlement agreement.” Further he noted  
6 that it is “speculation” as to how large, if any, it needs to be. We believe  
7 that after a decade it is appropriate to examine this issue in more detail.  
8 Consequently, we direct the Companies to file an analysis that provides a  
9 basis for any SOS costs that may be included in present distribution rates.<sup>15</sup>

10 **Q: How did BGE respond to this directive?**

11 A: According to Mr. Vahos, the Company conducted a simplified functional-  
12 allocation analysis which divided 2014 distribution expenses for customer  
13 accounts, customer service and informational, and administrative and general  
14 into distribution-related and commodity-related portions.

15 **Q: Does BGE contend that its estimate of commodity-related distribution**  
16 **expenses represents SOS costs that are currently being recovered in**  
17 **distribution rates?**

18 A: No. To the contrary, Mr. Vahos asserts that these commodity-related  
19 distribution expenses are costs that were incurred to provide distribution service:

20 It is important to recognize that it is not BGE’s contention that any of these  
21 cost components would be avoided if the Company was not serving SOS  
22 load. Even if BGE were not the SOS provider, it would still need a call  
23 center, a billing department and a host of other services such as human  
24 resources and legal.<sup>16</sup>

25 In other words, the Company has functionalized these distribution costs as  
26 commodity-related for the purposes of complying with the Commission’s  
27 request, but does not believe that such costs were actually incurred for the  
28 purposes of providing standard offer service. Consequently, recovering such

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<sup>15</sup> Order No. 86881, Case Nos. 9226 and 9232, March 3, 2015, pp. 21-22. Emphasis added.

<sup>16</sup> Vahos Supplemental Direct, p. 15, ll. 10-13.



1 costs through the residential Administrative Charge would be contrary to Public  
2 Utilities Article §7-510(c)(3)(ii)(2).

3 **Q: Does the Administrative Adjustment continue to serve a useful purpose?**

4 A: No. The retail market has developed and matured over more than a decade of  
5 competition in the supply of electricity to consumers. Consequently, it is neither  
6 necessary nor reasonable to charge SOS customers more than the actual  
7 incremental cost of residential SOS – and to require that SOS customers  
8 subsidize customers served by retail suppliers in the process of crediting  
9 Administrative Adjustment revenues – in order to provide an artificial  
10 competitive edge to retail suppliers.

11 Accordingly, I recommend elimination of the Administrative Adjustment  
12 from the Administrative Charge for residential SOS.

13 **Q: Does this conclude your testimony?**

14 A: Yes.