STATE OF MARYLAND

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Commission's	**)**	
Investigation into Default Service for	**)**	**Case No. 9056**
Type II Standard Offer Service Customers	**)**	

REPLY TESTIMONY OF

JONATHAN WALLACH

ON BEHALF OF

THE MARYLAND OFFICE OF PEOPLE'S COUNSEL

Resource Insight, Inc.

APRIL 28, 2006

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

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

Q: Please summarize your professional education and experience.

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

Over the last twenty-five years, I have advised clients on a wide range of economic, planning, and policy issues including: electric-utility restructuring; wholesale-power market design and operations; transmission pricing and policy; market valuation of generating assets and purchase contracts; power-procurement strategies; integrated resource planning; cost allocation and rate design; and energy-efficiency program design and planning.

My resume is attached as Exhibit JFW-1.

Q: Please summarize your experience with regard to the issue of electric restructuring in Maryland.

A: In 1997, I co-authored a major study of electric-utility restructuring in Maryland for the Office of People's Counsel ("OPC"). Since then, I have advised and testified on behalf of OPC in most of the major proceedings relating to Maryland's restructuring process. I assisted OPC during settlement negotiations, and testified in support of such settlements, in Case Nos. 8794, 8795, and 8797 (regarding electric restructuring), 8890 (regarding the proposed merger of Potomac Electric Power and Delmarva Power & Light), and 8908 (regarding procurement of Standard Offer Service ["SOS"].) I also testified in Case Nos.

8852 (regarding Potomac Electric Power Company's proposed fees for electricity-supplier services), 8994 and 8995 (regarding determination of the residential SOS Administrative Charge), and 8985 (regarding Southern Maryland Electric Coop's SOS procurement plan). Most recently, I testified in Case No. 9052 regarding proposals to transition Baltimore Gas & Electric's residential customers to market-based SOS rates. Finally, on OPC's behalf, I have monitored the SOS procurement process in every year since its inception.

Q: On whose behalf are you testifying?

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

Q: What is the purpose of your testimony?

A: Pursuant to the Commission's Order No. 80608 of February 17, 2006, parties filed direct testimony or comments regarding the provision of Type II SOS after May of 2007. This testimony responds to filings by the Retail Energy Supply Association ("RESA") and Washington Gas Energy Services ("WGES"; collectively, "Retailers".) In particular, this testimony addresses Retailers': (i) mistaken impressions of the nature of competitive markets; (ii) mischaracterizations of the structure and performance of Maryland's retail market; and (iii) misguided proposals for reform of the retail market.

Q: Do you have any general observations regarding Retailers' filings?

A: Yes. Retailers' assessment of the current SOS structure leaves the impression that they support customers' right to choose, so long as that right does not extend to the choice of a reasonable utility-provided SOS. The fact that customers have freely chosen to remain on SOS – apparently maximizing their welfare by doing so – is seen by Retailers not as a beneficial outcome of a competitive market, but as a sign of market failure. In other competitive markets, competitors would respond to such customer trends by developing and offering competitive, value-added products. In this case, Retailers instead propose that SOS be modified to force customers off SOS and onto "competitive" services that such customers had previously deemed to be unappealing. Restricting choice in this fashion can only be seen as a reduction in economic benefits to customers and, thus, as contrary to goals of the Electric Choice and Competition Act of 1999 and the broader public interest. Likewise, implementing Retailers' proposals to restrict choice in this fashion would inappropriately elevate Retailers' private interests above the public interest.

The primary goal of electric restructuring is not to maximize customer migration for migration's sake or for the purposes of increasing suppliers' market shares and profits, but to allow consumers the opportunity to choose those supply options that maximize their welfare. If retail suppliers offer competitively priced, value-added products, consumers will "vote with their feet" and move from SOS to retail supply. Standard Offer Service should be structured to provide economic benefits to those consumers who cannot or will not choose unregulated retail supply.

Q: How do consumers and producers benefit under competitive markets?

A: Competitive markets allow consumers to freely choose from among a wide variety of producers those products that maximize their welfare. Competitive markets minimize barriers to entry for competing firms, providing the opportunity for such firms to profit through product innovation, risk-taking, and competitive pricing. Firms survive in competitive markets by inducing consumers to choose their products over those of their competitors; they induce consumer choice by offering products that provide greater value to consumers than their competitors' products.

Q: Do Retailers share this perspective on competitive markets?

A: Apparently not. For example, Retailers view the current fixed-price structure of Type II SOS – with its potential for "disconnection" from "market" prices – as a barrier to entry and the primary culprit for low migration rates, rather than as an opportunity to profit by offering more valuable pricing options.[1] According to RESA's witness James D. Steffes:

> This disconnection results in customers not being able to make rational decisions. Without willing buyers, competitive retail suppliers will not enter the market and retail competition can not take root.[2]

Mr. Steffes also argues that:

> … [G]iven the fixed-price basis of the SOS structure, consumers are prevented from making informed decisions about the use of their electricity. The end result is that the fixed-price SOS market structure fails to create a platform to promote sustained demand response and price responsiveness.[3]

Harry A. Warren, Jr., testifying on behalf of WGES, offers a similar perspective:

> The end result is that a very high priced service is now being offered to Type IIA customers. Commercial customers who want true market pricing, unburdened by high risk premiums, need to enter into contracts with competitive suppliers to receive it.[4]

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[1] WGES apparently does not believe that the current retail market creates barriers to entry or suffers from a lack of competition. According to the direct testimony of Harry A. Warren, Jr. (pp. 4-5): "Switching statistics show that retail electricity supply competition for commercial customers is healthy…. In addition to significant customer switching rates, Commission monthly enrollment reports show that many suppliers are active in the market."

[2] *Direct Testimony of James D. Steffes*, Case No. 9056, March 31, 2006, p. 11.

[3] *Id.*

[4] *Direct Testimony of Harry A. Warren, Jr.*, Case No. 9056, March 31, 2006, p. 3.

Q: Do these statements indicate that the current SOS structure stifles competition?

A: To the contrary, these descriptions highlight the opportunities available to competitors to profitably increase market share by offering products that "create a platform to promote sustained demand response and price responsiveness" or by structuring contracts that offer "true market pricing unburdened by high risk premiums."

Such opportunities exist whether wholesale prices increase or decline after SOS prices are locked in under the current SOS structure. Retail suppliers can capitalize on a declining-price environment simply by offering lower contract prices for the same product as provided under the current SOS structure. Even in a rising market, there may be opportunities to price competitively by reducing the migration-risk premium through minimum contract terms, early-termination fees, or efficient risk-management practices. In addition, there may be opportunities to offer value-added services, such as fixed pricing for longer terms than available under Type II SOS (to offset the risk of even higher prices when current SOS prices expire), real-time pricing and demand-response services, or account-management services.

Q: How do Retailers propose to modify the current structure for Type II SOS?

A: Retailers essentially propose to implement monthly pricing of Type II SOS as part of a transition to Hourly Price Service ("HPS") for Type II customers.

Each of the Retailers offer different arguments in support of their monthly and hourly pricing proposals. Citing substantial migration of Type III customers to unregulated retail supply, RESA asserts that implementation of monthly or hourly pricing will lead to significant entry of suppliers and an abundance of competitive offers. WGES argues that monthly pricing will reduce the "excessive premiums" embedded in current Type II pricing and "eliminate any misunderstanding by customers that it represents a fixed price alternative to competitive supply."[5]

Q: Do Retailers provide any compelling evidence that monthly or hourly pricing will provide economic benefits to customers?

A: No. The fact that Type III customers have migrated to retail supply in droves indicates that retail supply may provide benefits relative to the costs and risks imposed by HPS pricing. However, there is no evidence that retail supply would provide any benefits when measured against current Type II service.

As to WGES' argument, while implementation of monthly pricing may reduce risk premiums embedded in Type II pricing by wholesale suppliers of Type II service, the price reductions come at the cost of increased risk to customers of price volatility. In other words, the reduction in risk premium would be achieved by shifting price risk from wholesale suppliers to customers. There is no evidence that customers can bear such risks more efficiently than wholesale suppliers, and thus no evidence that such risk-shifting provides economic benefits to customers.

Q: Does this conclude your testimony?

A: Yes.

[5] Warren direct testimony, p. 4.