STATE OF MARYLAND

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Optimal Structure of the	**)**	
Electric Industry of Maryland	**)**	**Case No. 9063**

REBUTTAL TESTIMONY OF

JONATHAN WALLACH

ON BEHALF OF

THE OFFICE OF PEOPLE'S COUNSEL

Resource Insight, Inc.

NOVEMBER 3, 2006

I. Introduction

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: Are you the same Jonathan F. Wallach that submitted direct testimony in this proceeding?

A: Yes.

Q: What is the purpose of your rebuttal testimony?

A: On October 3, 2006, a number of parties to this proceeding submitted direct testimony asserting that implementation of portfolio planning would harm consumers and competitive markets. Specifically, parties claim that acquisition of longer-term contracts or generation assets will: (1) yield prices that diverge from "prevailing" market prices; (2) undermine the competitive wholesale generation market and development of demand resources; (3) create stranded costs; and (4) potentially increase utilities' cost of capital. This rebuttal testimony addresses each of these claims.

In addition, Dr. Jonathan Lesser, on behalf of Baltimore Gas and Electric ("BGE"), estimates what BGE's rates would have been if Maryland's electric industry had not been restructured, and then compares those hypothetical rates against actual and projected BGE SOS prices. This rebuttal testimony critiques and corrects a number of unrealistic assumptions in Dr. Lesser's analysis.

People's Counsel is also sponsoring direct and rebuttal testimony from Ms. Barbara Alexander.

Q: Please summarize your findings and conclusions.

A: A number of parties to this proceeding have made unsubstantiated, inaccurate, or inconsequential claims regarding the impact on consumers and markets of including longer-term contracts or assets in SOS resource portfolios. Parties have offered no evidence to support the allegation that prices for short-term contracts more closely track prevailing market rates. In fact, a comparison of monthly contract pricing and prevailing retail price offers shows that monthly prices move in opposite directions to retail pricing trends.

Contrary to some parties' claims, longer-term contracts or generation investments neither undermine competitive markets, nor pose a significant risk of stranded costs in the future. Longer-term contracts or assets can co-exist with other physical and financial products that comprise competitive wholesale markets; utility procurement of such assets through a competitive process will not impair the liquidity of these other products. Moreover, as part of a larger and broader resource portfolio, longer-term contracts or assets are unlikely to cause the portfolio as a whole to be uneconomic.

Parties' concerns regarding the potential financial impact of longer-term contracting appear theoretically valid, yet may be of little practical consequence. Regardless, this risk should be addressed by subjecting all potential resource plans to comprehensive testing of financial impacts.

Dr. Lesser's comparison of hypothetical regulated rates and BGE SOS prices is not particularly relevant to this proceeding. Dr. Lesser's analysis of what rates would have been if BGE continued to operate as a vertically integrated utility provides little indication as to what rates might be if the Commission were to implement a portfolio planning and procurement process such as recommended by Ms. Alexander. Moreover, Dr. Lesser's analysis relies on a number of unrealistic assumptions and inputs; correcting for these improbable assumptions reverses Dr. Lesser's primary finding that consumers would pay higher rates in the future under regulation than under the current SOS procurement process.

II. Impact of Longer-Term Contracts and Generation Investments

Q: Please summarize parties' direct testimony in this proceeding with regard to the procurement of longer-term contracts or generation assets for the purposes of serving SOS load.

A: The testimony of a number of parties to this proceeding is that reliance on longer-term contracts or generation assets is harmful to consumers and the competitive wholesale and retail generation markets. Specifically, parties claim that acquisition of longer-term contracts or generation assets will: (1) yield prices that diverge from "prevailing" market prices; (2) undermine the competitive wholesale generation market and development of demand resources; (3) create stranded costs; and (4) potentially increase utilities' cost of capital.

Q: What do these parties recommend with regard to procurement of supply resources for SOS load?

A: Based on their assessments of the impact of longer-term resources, these parties recommend that SOS load continue to be supplied through short-term full-requirements contracts with terms ranging from as short as one month to up to three years.

Q: In general, do these parties accurately characterize the impact of longer-term contracting or asset investment?

A: No. As I discuss specifically below, these claims regarding the harm from longer-term contracting or investment are for the most part unsubstantiated and inaccurate.

Generally, these claims appear to arise from a mistaken premise: that the outcome of a portfolio-planning process will necessarily be a requirement to procure only longer-term contracts or assets. For example, in response to discovery, BGE characterizes the outcome of a portfolio-planning process as a "… <u>requirement</u> that utilities, as the providers of SOS service, purchase all or a significant part of their supplies on the basis of long-term bilateral contracts…."[1]

In fact, as described more fully in Ms. Alexander's testimony, portfolio planning is a process whereby utilities determine the least-cost mix of resources of varying types and durations and then acquire such resources through a dynamic and competitive process. In other words, portfolio procurement entails utilities acting like other buyers in competitive markets, procuring the mix of resources that serves their customers' interests in paying reasonable and stable SOS prices.

Q: Please summarize parties' comments with regard to the divergence between contract pricing and market pricing.

A: A number of parties assert that prices for longer-term contracts (or generation assets) are more likely to diverge from "prevailing" market prices than prices for short-term contracts. For example, PSC Staff witness Phillip E. VanderHeyden

[1] BGE response to OPC Data Request No. 2, Item No. 20. Emphasis in original.

claims that: "The longer the contract, the more opportunity for SOS rates to diverge from market rates."[2] Mr. VanderHeyden then goes on to claim that procurement of monthly contracts "… would mitigate the risk that SOS is priced significantly differently than prevailing market offers."[3]

Charles S. Griffey, on behalf of the Retail Energy Supply Association, similarly supports his proposal for procurement of monthly contracts by noting that "… monthly priced SOS will allow for competitive entry by avoiding the disconnect between SOS and market prices that can occur over the duration of long-term contracts."[4]

Q: What do these parties mean when they refer to prevailing "market rates" or "market prices"?

A: These parties do not precisely define what they mean by either "prevailing" or "market prices." As best as I can discern from their testimony and responses to discovery, these parties are referring to current price offers by competitive retail suppliers for any product offered.

Q: According to these parties, what drives the divergence between longer-term contract prices and prevailing retail price offers?

A: Although not stated explicitly, these parties appear to believe that the extent of price divergence depends on how often SOS contracts are re-priced through the procurement process. According to this logic, competitive retail prices change frequently, reflecting changes in underlying wholesale market prices for the product being offered (e.g., a one-year contract for full-requirements service.) In

[2] *Direct Testimony of Phillip E. VanderHeyden*, Case No. 9063, October 3, 2006, p. 15.

[3] *Id.*

[4] *Direct Testimony of Charles S. Griffey*, Case No. 9063, October 3, 2006, p. 11.

contrast, the price of a longer-term SOS contract is set once at the time of procurement, reflecting underlying wholesale market prices at that point in time, and fixed for the duration of the contract.[5] Thus, price divergence is driven by the fact that underlying wholesale market prices can and will vary considerably over time.

Following this line of reasoning, the shorter the term of the SOS contract, the lower the risk of price divergence. Since, for example, monthly SOS contracts have to be procured on a monthly basis, SOS would be re-priced each month, more closely tracking changes in the wholesale market prices underlying retail price offers.

Q: Have these parties offered any evidence to support this alleged divergence between longer-term contract prices and prevailing price offers?

A: No.

Q: What does the experience with residential retail choice in Maryland indicate with regard to the impact of this alleged divergence on competitive entry?

A: Experience over the last six years does not support the contention that the alleged price divergence has been a barrier to competitive entry and the development of retail markets. In fact, trends in residential-customer migration appear to support the opposite conclusion.

Exhibit JFW-R1 shows monthly switching statistics for Potomac Electric Power Company ("PEPCo") residential customers from the start of retail choice in 2000 through September of this year. If, as Mr. Griffey contends, the alleged price divergence hinders competitive entry, then one would expect to see

[5] Although fixed for the term of the contract, prices for a multi-year SOS contract can vary by year and by season within each year.

increased migration to competitive supply whenever there was a significant re-pricing of residential SOS, since such re-pricing should decrease price divergence. Thus, one would expect increased migration after July of 2004, when PEPCo SOS switched from capped to market-based rates, and after June of the following two years, when SOS rates were re-priced to reflect procurement of new contracts in those years.

Instead, as indicated in Exhibit JFW-R1, the only period of increased switching was in the first two years of retail choice, when residential SOS was priced at capped rates. After reaching a peak of almost 16% in mid-2003, residential migration has steadily declined through all re-pricing periods.

Q: Would you expect a strong correlation between prices for shorter-term contracts, such as monthly contracts, and prevailing price offers?

A: No. A monthly contract is a different market product, with different market pricing dynamics, than those being offered by retail suppliers. There is no reason to expect that pricing of a monthly SOS contract would track that for a significantly longer-term retail offer for full-requirements service, since the underlying wholesale market prices for these two different products are unlikely to be strongly correlated.

Exhibit JFW-R2 illustrates how unlikely it is that monthly SOS contract prices will track prevailing price offers for competitive retail supply. Exhibit JFW-R2 graphs two data series. First, it shows actual price offers by Washington Gas Energy Services ("WGES") for residential customers in PEPCo's service territory between March 26 and September 6 of this year.[6]

[6] These price offers are provided in Attachment 1 to WGES response to OPC Data Request 2, Item No. 2. Between March 26 and September 6 of this year, WGES offered only one product to PEPCo residential customers; this product had a contract term that ended in June of 2008. Exhibit JFW-R2 shows price offers for non-time-of-use residential customers.

Second, Exhibit JFW-R2 shows a simulation of monthly SOS prices during this same period under a monthly procurement scheme, assuming that: (1) SOS contracts for delivery in one month (e.g., June) are procured the prior month (e.g., May); and (2) monthly SOS contracts are priced at PJM on-peak monthly forward prices prevailing at the time of procurement.[7]

As indicated in Exhibit JFW-R2, monthly SOS prices would not have tracked very closely with changes in WGES' retail price offers over the sample period. In fact, simulated monthly prices appear to trend in opposite directions from WGES' offers, rising when offers are falling, and vice versa.[8]

Q: Would evidence of strong correlation between monthly contract prices and retail price offers be a valid basis for adopting monthly procurement of SOS contracts?

A: No. As Ms. Alexander discusses in her rebuttal testimony, monthly procurement would expose consumers to unreasonable price volatility, and would be contrary to the objective to minimize volatility established in Senate Bill 1.

Q: What are parties' concerns with regard to the impact of longer-term contracting or asset investment on wholesale markets?

A: Some parties express a general concern that longer-term contracting or asset investment would undermine the wholesale generation or demand-response

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[7] As I noted in my direct testimony, contract prices for full-requirements service will reflect costs other than for on-peak forwards. However, changes in on-peak forward prices are primary drivers of movements in such contract prices. Thus, monthly forward prices provide a reasonable indication of movements in monthly SOS contract prices and of the correlation between monthly SOS prices and retail price offers.

[8] This apparent negative correlation is confirmed with the calculation of the correlation coefficient for these two data series; the correlation coefficient indicates a weak, but negative correlation between these two data series.

markets. Specifically, parties claim that longer-term contracts or investments by utilities would create a barrier to entry by new merchant generation in PJM. For example, according to Michael M. Schnitzer, testifying on behalf of Constellation Energy Commodities Group:

> A decision by a utility to put a new plant in rate base or to enter into long-term contracts will require some form of regulated cost recovery. But who would want to build a merchant plant when the possibility exists that a competing developer could get a long-term contract with assured cost recovery? A return to rate base construction would fundamentally undermine wholesale competition. It will discourage future market-based investment in new capacity.[9]

Mark D. Case, on behalf of BGE, further argues that longer-term contracts will undermine the development of demand resources:

> Wholesale market pricing disrupted by quasi-regulated generation will have the same negative effect on demand resources as it will have on merchant generation. The ability for new demand resources to compete in a market with quasi-regulated generation resources will be diminished and result in less or even no further development, even though demand response services may be the most economically efficient resources to deploy.[10]

Q: Does Mr. Schnitzer reasonably characterize the impact of longer-term contracting or asset investment on the merchant-generation market?

A: No. Mr. Schnitzer mischaracterizes competitive market dynamics when he claims that longer-term contracts or asset investment will stifle development of merchant generation. As with other competitive markets, long-term contracts can co-exist with pure merchant plays in wholesale generation markets, with market participants taking hedged (i.e., contractual) or speculative (i.e.,

[9] *Direct Testimony of Michael M. Schnitzer*, Case No. 9063, October 3, 2006, p. 14.

[10] *Direct Testimony of Mark D. Case*, Case No. 9063, October 3, 2006, p. 19.

merchant) positions depending on the extent of their risk aversion. According to Mr. Case:

> … [A] workably competitive wholesale market provides market discipline for all types of contractual arrangements and there can be many types of contractual arrangements between buyers and sellers. The terms, conditions, length of any contract will depend on the risks that the buyers and sellers are willing to bear, the different expectations of all market players as to future price trends, the price responsiveness of demand in the market, as well as the creativity of buyers and sellers in negotiating contracts that meet their respective needs.[11]

Mr. Schnitzer asks: "[W]ho would want to build a merchant plant when the possibility exists that a competing developer could get a long-term contract with assured cost recovery?"[12] The answer is: In a competitive market, someone would choose to build a merchant plant if they believe they could maximize their profit by selling into the spot market, and are willing to assume spot-price risk. The fact that other market participants choose to hedge that risk with longer-term contracts or investments should have little bearing on that decision.

Q: What is the basis for Mr. Case's assertion that longer-term contracts will undermine merchant generation and development of demand resources?

A: In response to discovery, Mr. Case argues that:

> If … there is a <u>requirement</u> that utilities, as the providers of SOS service, purchase all or a significant part of their supplies on the basis of long-term bilateral contracts, then the market discipline provided by a workably competitive wholesale spot market will be eroded….[13]

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[11] Response to OPC Data Request No. 2, Item No. 20.

[12] In fact, as I discussed in my direct testimony in this proceeding, the more-pertinent question in today's wholesale generation market is: Who would want to finance or invest in new generation without the long-term revenue assurance associated with a longer-term contract for the output of that asset?

[13] Response to OPC Data Request No. 2, Item No. 20. Emphasis in original.

In essence, Mr. Case appears to be arguing that excessive reliance on longer-term contracts will substantially reduce the amount of generation traded in the spot market, severely eroding the value of spot-market prices as a revenue source for merchant generation and as a competitive benchmark for valuing demand resources.

Q: Is this a valid argument?

A: No. As noted above, the premise of this argument is not valid, since a resource portfolio such as that envisioned by Ms. Alexander to be in compliance with SB1 will not consist entirely or in large part of longer-term contracts or assets. Moreover, regardless of the extent of that reliance on longer-term resources, it is not reasonable to presume that such resources will not be offered into PJM's spot energy markets. In fact, PJM's market rules require resources to be offered into the day-ahead market in order to be counted toward a load-serving entity's capacity obligation. Finally, even if such resources were not offered into PJM's spot markets, the impact on liquidity in markets that typically clear 80-90 gigawatts of generation per hour is likely to be negligible.

Q: What concerns do parties raise concerning stranded costs?

A: Some parties express the concern that the costs of a longer-term contract or generation investment may eventually be stranded, i.e., that the cost of the contract may exceed the contract's market value. According to Mr. Schnitzer: "Long-term contracts also create the potential for a new round of stranded costs, as we have seen in California."[14] In essence, the concern is that utilities may enter into a longer-term contract or investment commitment based on

[14] Schnitzer direct, p. 14.

expectations about future market-price trends, only to find that market prices fall below expected levels.

Q: Is the potential for stranded costs a significant concern?

A: This concern is not significant enough to exclude longer-term contracts or generation assets from the menu of resource options to be evaluated as part of the portfolio-planning process.

Three considerations temper such concerns. First, a longer-term contract or investment will be one of several resources in a much-larger, diversified resource portfolio. This diversification hedges the risk of any one contract or investment becoming stranded, and increases the likelihood that the portfolio as a whole will be economic over the long term.

Second, a narrow focus on the risk of stranded costs fails to capture the insurance value of a longer-term contract or investment. Whether or not a contract is ultimately economic over its term, it can provide a long-term hedge against market-price risk, providing insurance against the harm of unanticipated price volatility.

Finally, any concern about a "new round of stranded costs" in Maryland needs to be weighed against the possibility that, contrary to some parties' expectations in 1998 and unlike in California, there may not actually have been a first round of stranded costs in this State.[15] One indication of this possibility is provided by the 1998 testimony of Paul Chernick on behalf of OPC in Case No.

[15] Mr. Schnitzer's reference to the California experience is ironic, since the State entered into over-priced contracts in response to the exercise of market power, and since, in turn, the ability to exercise market power was partly due to the fact that the California Commission severely limited the utilities' ability to enter into longer-term contracts at the outset of restructuring. See, for example, Federal Energy Regulatory Commission, *Order Proposing Remedies for California Wholesale Electric Markets*, 93 FERC ¶ 61,121, November 1, 2000.

8794 regarding BGE's stranded costs. Based on a forecast of market prices, Mr. Chernick found that the market value of BGE's generation portfolio exceeded the portfolio's expected costs. In other words, based on his market-price forecast, Mr. Chernick found that BGE's portfolio produced stranded benefits, not stranded costs. It now turns out that market prices in PJM in the eight years since Mr. Chernick's analysis have been substantially higher than were forecasted by Mr. Chernick for this same period of time. Thus, the experience in PJM over the past eight years indicates that Mr. Chernick may have in fact underestimated the market value of BGE's assets and thus the true magnitude of stranded benefits.[16]

Q: Please discuss parties' claims regarding the potential impact of longer-term contracts on utilities' cost of capital.

A: According to BGE and PEPCo, credit agencies will treat a portion of longer-term contract payments as equivalent to debt for the purposes of determining debt leverage on a utility's balance sheet and for deriving interest coverage ratios. As a result, utility procurement of longer-term contracts, by increasing imputed debt leverage, could lead to a ratings downgrade or require an offsetting increase in equity to restore credit quality. In either case, BGE and PEPCo assert, contract procurement would increase the utility's overall cost of capital.

Q: Is this a valid concern?

A: This appears to be a valid theoretical concern. However, the actual financial impact may not be significant, since such contracts might represent only a small portion of a utility's total SOS portfolio.

[16] Mr. Chernick's underestimate of actual market prices would be offset by any underestimate of actual prices for fuel burned by BGE's assets.

Q: How should this risk be addressed?

A: This risk should be addressed as part of a comprehensive economic and financial evaluation of various portfolio plans. The financial impact of longer-term contract obligations should be weighed against the financial risks associated with reliance on shorter-term contracts, such as the potential financial impact of substantial deferrals of large price increases.

III. BGE Analysis of Regulated Rates

Q: Please describe Dr. Lesser's analysis of regulated rates.

A: Dr. Lesser believes that "[t]he claim that Maryland consumers would be better off had restructuring never occurred is central to the matter under consideration in this proceeding."[17] In order to test the validity of this "central" claim, Dr. Lesser undertook an analysis of what BGE residential rates would have been between 2000 and 2006, and what they would be in the next three years, if BGE's generation function had not been restructured in 1999. Comparing these hypothetical regulated rates against his forecast of SOS rates for the next three years, Dr. Lesser concludes that "… BGE residential customers are better off with competitive procurement than they would have been under regulation, notwithstanding the result of the 2006 RFP process."[18]

[17] *Direct Testimony of Jonathan A. Lesser*, Case No. 9063, October 23, 2006, p. 34.

[18] *Id*.

Q: Do you agree that the issue of whether consumers would have been better off under continued regulation is central to this proceeding?

A: No.[19] As Ms. Alexander discusses in her testimony, the central issue in this proceeding is how to establish a procurement process for residential SOS customers that complies with the mandates in SB1. The focus of this proceeding should be on the concrete issue of how to move forward with a procurement process that achieves the “best price” with minimum price volatility, not on speculative ruminations as to how consumers would have fared if the electric restructuring statute had never become law.

Q: Are the results of Dr. Lesser’s analysis relevant to the consideration of the likely costs of an SB1-compliant resource portfolio?

A: These results are not particularly relevant to this case. Dr. Lesser’s projection of costs for BGE’s generation assets that were transferred to Constellation Power provides little indication as to what the costs might be for a portfolio of resources compiled under a portfolio planning and procurement process such as recommended by Ms. Alexander. It is unlikely that an SB1-compliant portfolio would bear any resemblance to that assembled by BGE over the last fifty years, spanning a period of momentous change in generation technology, industry structure, and regulatory practice.

Q: Notwithstanding the issue of relevance, are the results of Dr. Lesser’s analysis reliable?

A: No. A number of unrealistic assumptions and data inputs seriously impair the reliability of his results.

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[19] Nor is it even clear who Dr. Lesser believes is making this claim. As far as I am aware, no party to this proceeding filed testimony contending that consumers would have been better off without electric restructuring.

Dr. Lesser's methodological approach is problematic in two respects. First, the analysis assumes that non-generation-related costs would be greater without restructuring than with restructuring. Specifically, the analysis assumes that distribution and transmission rates, and thus underlying costs, would have risen from 1999 levels at the general rate of inflation in the absence of restructuring, but would be constant at 1999 levels with restructuring.[20] It is not reasonable to assume lower T&D costs for the with-restructuring case, since restructuring of the generation function would not directly affect non-generation-related costs.[21] Nor is it reasonable to assume that T&D *cost* increases will necessarily translate into T&D *rate* increases, since rate changes depend on earned rates of return, cost of capital, and other factors in addition to cost of service.[22]

Second, Dr. Lesser assumes that, in the absence of restructuring, BGE would not have been able to purchase power from the PJM wholesale market in order to meet load growth. Dr. Lesser supports this assumption by arguing that "… it is not reasonable to assume that the PJM market would have developed the way it did had restructuring not occurred."[23] Instead, even though PJM has

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[20] The fact that the restructuring settlement agreement reduced and froze residential distribution *rates* is not relevant to the impact of generation restructuring on distribution *costs*. Dr. Lesser's analysis unrealistically assumes that T&D rates after the end of the rate freeze would be higher in the absence of restructuring, as if the underlying T&D costs would have been greater in the absence of restructuring.

[21] Indeed, if any differential were to be assumed, it would be greater transmission costs with restructuring, reflecting the additional investment in transmission upgrades to support increased wholesale transactions.

[22] See, for example, OPC's petition of September 3, 1998 in Case No. 8804, which argues for a reduction in BGE's rates due to over-earnings. The findings in this petition would support an assumption of a decrease in BGE's rates in the absence of restructuring.

[23] Lesser direct, p. 35

been awash in excess capacity since 1999 and wholesale-market prices have consequently been at depressed levels, he assumes that all load growth from 1999 is met with investment in new gas-fired combined-cycle capacity at prices that far exceed actual wholesale-market price levels.[24]

This assumption is unrealistic. PJM has operated as a tight power pool, providing BGE access to wholesale economy-energy purchases and sales, for many decades. The PJM system was restructured to create a competitive wholesale market in 1997, with market-based pricing implemented in 1999; it was this restructuring, not that of BGE's generation function, along with subsequent trends in fuel prices, capacity additions, and regional expansion, that determined wholesale market prices after 1999. Whether or not its generation had been restructured in 2000, BGE would have had access to wholesale power from this glutted market, just as it had as part of the PJM power pool for all those years.

Finally, Dr. Lesser unreasonably assumes that fuel prices for BGE's coal and nuclear assets would have increased at spot-price escalation rates, as if coal and nuclear fuel requirements were purchased predominantly on the spot market and not through a combination of contract and spot purchases, as had been actual practice prior to the divestiture of BGE's assets.[25] This assumption yields unrealistically high fuel-price growth rates. For example, Dr. Lesser projects a doubling of nuclear fuel prices between 1999 and 2005, when, according to data

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[24] According to PJM, investment in new combined-cycle generation would not have been economic relative to wholesale market prices from 2000 to 2005. See PJM Interconnection, LLC, *2005 State of the Market Report*, March 8, 2006, Table 3-13, p. 131.

[25] For a description of BGE's fuel contracts as of 1998, see *Testimony of Bruce A. Barnaba*, Case No. 8520V, January 2, 1998.

published by the Energy Information Administration, actual industry-wide average growth over that same period was less than 25%.

Q: Did you correct for these improbable assumptions?

A: Yes. I corrected each of these assumptions as follows:[26]

- I revised the analysis so that it simulates and compares only the generation portions of SOS and hypothetical regulated rates. By so doing, I effectively assume that T&D costs would be the same in both the restructuring and continued-regulation scenarios.
- In the continued-regulation scenario, I assume that load growth after 1999 would be served with purchases from the PJM wholesale market at actual or forward market prices for energy (as adjusted for congestion and load shape) and capacity.
- I assume that coal and nuclear fuel prices escalate at industry-wide average rates, as reported by the Energy Information Administration.

Q: How do these corrections affect the results of Dr. Lesser's analysis?

A: With these corrections, Dr. Lesser's analysis finds that residential generation rates in 2007 through 2009 would be lower under continued regulation than under the current SOS procurement approach. In other words, correcting the unrealistic assumptions discussed above reverses Dr. Lesser's primary finding that consumers would pay higher rates in the future under regulation than under the current SOS procurement process.

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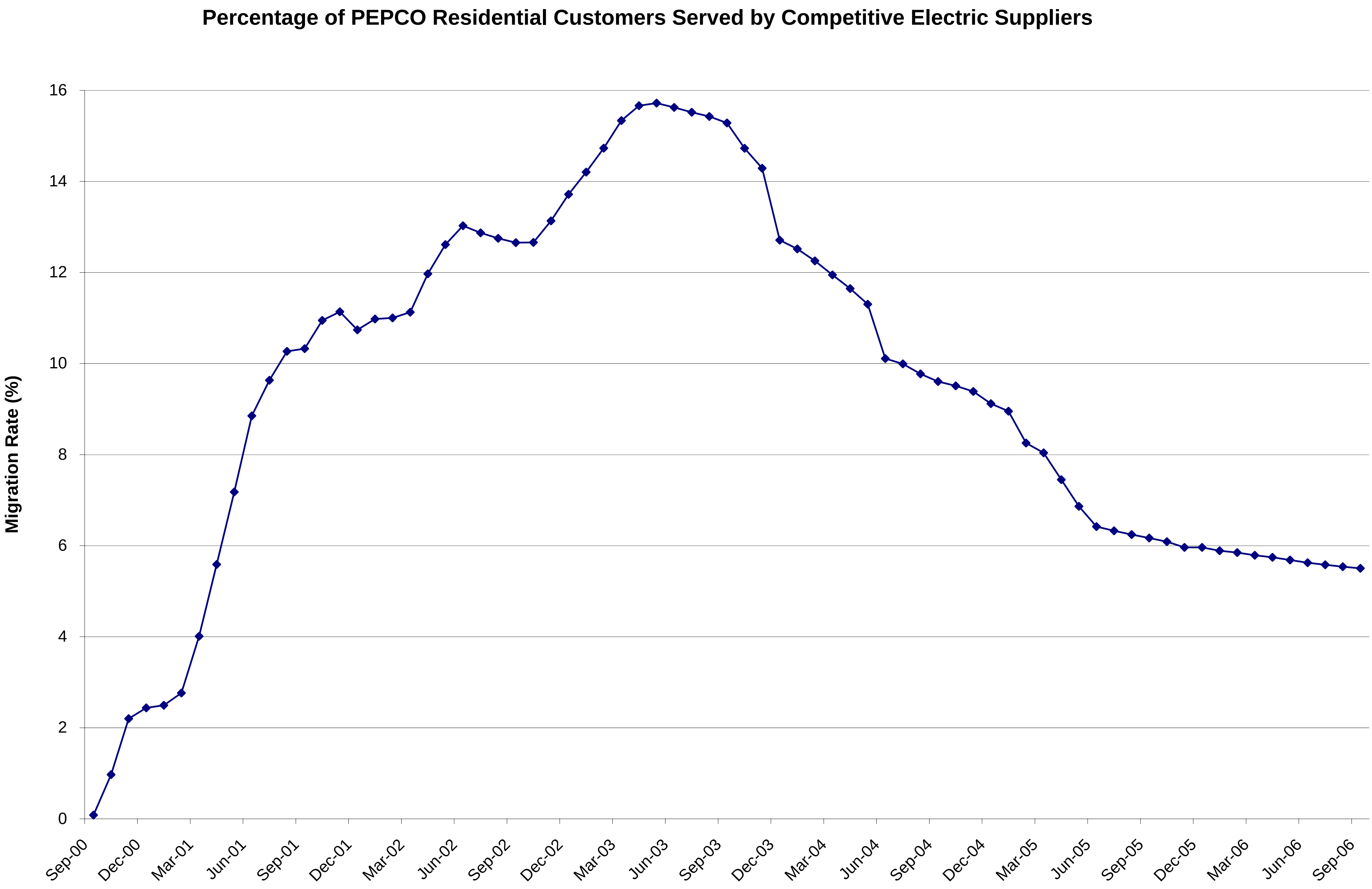
[26] I also corrected a few less-significant calculation errors in Dr. Lesser's model. For example, in his calculation of SOS generation rates for 2007 and beyond, Dr. Lesser mistakenly assumed that a mix of one-, two-, and three-year contracts would be procured in each year. In fact, per the terms of the settlement agreement in Case No. 8908, only one-year contracts will be procured in 2007, one- and two-year contracts will be procured in 2008, and only one-year contracts will be procured in 2009.

The impact of these corrections is shown in Exhibit JFW-R3, which mimics Dr. Lesser's Exhibit BGE-JAL-3 for the corrected simulations of the two scenarios. As indicated in Exhibit JFW-R3, Dr. Lesser's corrected simulation projects SOS generation rates to exceed regulated generation rates by about 20%-30% between 2007 and 2009.

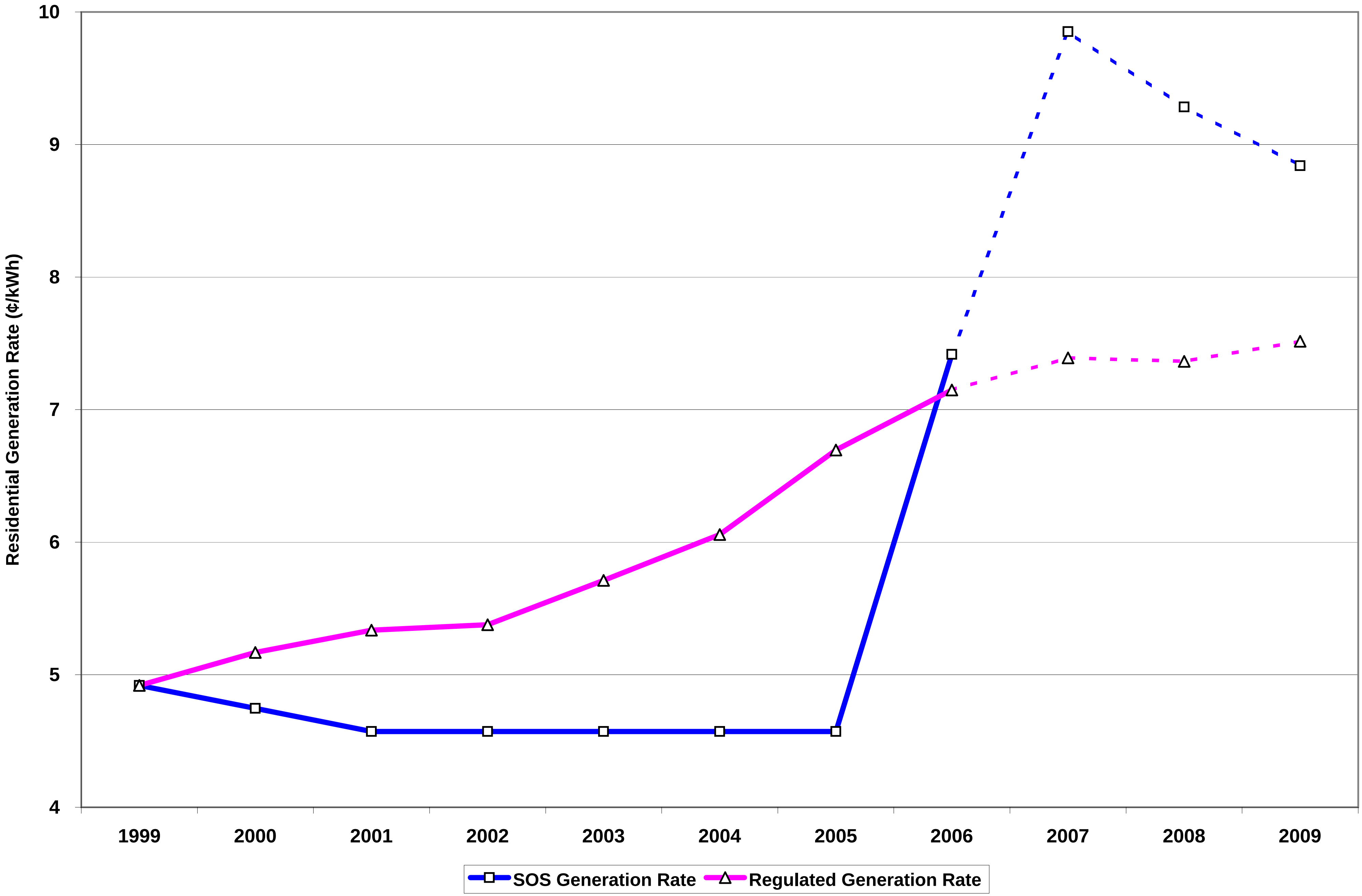
Q: Does this conclude your testimony?

A: Yes.


Percentage of PEPCO Residential Customers Served by Competitive Electric Suppliers
Migration Rate (%)
0
2
4
6
8
10
12
14
16
Sep-00
Dec-00
Mar-01
Jun-01
Sep-01
Dec-01
Mar-02
Jun-02
Sep-02
Dec-02
Mar-03
Jun-03
Sep-03
Dec-03
Mar-04
Jun-04
Sep-04
Dec-04
Mar-05
Jun-05
Sep-05
Dec-05
Mar-06
Jun-06
Sep-06


Monthly SOS Contract Proxy Price vs. WGES Retail Price Offer
WGES Retail Price Offer (¢/kWh)
Monthly Contract Proxy Price (¢/kWh)
12.5
12.0
11.5
11.0
10.5
8.5
8.0
7.5
7.0
6.5
6.0
3/29/2006
4/18/2006
5/8/2006
5/28/2006
6/17/2006
7/7/2006
7/27/2006
8/16/2006
9/5/2006
WGES Retail Price Offer
Monthly Contract Proxy Price

SOS Generation Rates vs. Regulated Generation Rates for BGE Residential Customers



ATTACHMENT 1

1. BGE response to OPC Data Request No. 2, Item No. 20.
2. WGES response to OPC Data Request 2, Item No. 2.

TESTIMONY OF MARK D. CASE, ON BEHALF OF BGE

Page 18, lines 7-11. Please provide all memoranda, studies, reports, or other documentation relied on to support the claim that a long-term PPA will "undermine the development of the competitive wholesale market by reducing incentives for merchant expansion and diluting expected continued efficiency gains."

A.

No specific documents were relied on for the cited testimony. Instead, the basis is accepted economic theory regarding competitive markets which are not characterized by mandates for any party to sign long-term contracts. Specifically, a workably competitive wholesale power market provides market discipline for all types of contractual arrangements and there can be many types of contractual arrangements between buyers and sellers. The terms, conditions and length of any contract will depend on the risks that the buyers and sellers are willing to bear, the different expectations of all market players as to future price trends, the price responsiveness of demand in the market, as well as the creativity of buyers and sellers in negotiating contracts that meet their respective needs. In such markets, the prices for long-term bilateral contracts will be disciplined by price discovery in the spot market, and vice versa. As long as the wholesale spot market is "thickly" traded (i.e., there are sufficient trades to make it competitive), then the agreed upon prices of bilateral contracts will be influenced by those prices. If, on the other hand, there is a <u>requirement</u> that utilities, as the providers of SOS service, purchase all or a significant part of their supplies on the basis of long-term bilateral contracts, then the market discipline provided by a workably competitive wholesale spot market will be eroded for the following reasons. First, the spot market may become "thinly" traded, in which case too few trades will take place to establish a competitive benchmark. Second, to the extent that sellers know buyers cannot purchase from the spot market, or can only do so to a very limited extent, then sellers may be able to increase their relative market power, adversely affecting buyers. Third, by reducing the efficacy of the wholesale spot market, merchant development may be discouraged, since the wholesale market in which such generators operate will not be robust. As a result, less supply will be forthcoming in the future, thus creating upward pressure on prices as demand increases. In summary, long-term PPAs that are part of a central planning process are not conducive to the free and open operation of competitive markets.

WGES RESPONSE TO
MARYLAND OPC
DATA REQUEST NO. 2
CASE NO. 9063

1. *Please identify all the states in which the company has made retail electricity offers to residential customers and for each such state:*

a) Provide the time duration of contracts offered to residential customers;
b) Provide the number of residential customers being served currently;
c) Provide the percentage of customers of the residential customers the company has served for each length of contract offered to residential customers.

Response: WGES has made electricity offerings to residential customers in Maryland, the District of Columbia, Delaware, and Virginia.

(a) The contract durations for these offerings have ranged from several months to greater than two years.
(b) In the aggregate for both gas and electricity supply, WGES serves over 180,000 customers in the jurisdictions in which it is active of which over 100,000 are in Maryland. The numbers of customers are predominantly residential. The breakdown of customers by residential and commercial categories is commercially sensitive, confidential information that WGES does not disclose publicly. In addition, the Commission posts aggregate switching information on its web site based on the switching statistics provided by utilities. Supplier-specific switching data is not published by the Commission but is kept confidential.
(c) The percentage of residential customers served by WGES for each contract length category is commercially sensitive information that WGES does not disclose publicly.

2. *Identify every retail electricity offer to residential customers made by the company in Maryland since April 1, 2006.*

Response: See Attachment 1 for offerings posted on the WGES web site for customers on the Pepco and BGE systems. There were no residential postings on the Allegheny or Delmarva systems during this time.

3. *Please provide an example or scenario where procurement using three-year rolling contracts, where one-third of the load is purchased every year in a three year contract, produces more price volatility than a series of one-year contracts.*

Response: See Attachment 2 hypothetical scenarios.

4. *Page 5, lines 22-23. With regard to the reference to "prevailing wholesale supply market prices":*

ATTACHMENT 1

WASHINGTON GAS ENERGY SERVICES, INC.
RESIDENTIAL ELECTRICITY PRICING
APRIL 1, 2006 - OCTOBER 13, 2006

WEB SITE POSTINGS

All prices include 5.0% wind power.

PEPCO - MARYLAND

Effective Date					End Date
29-Mar-06	Residential	11.25	¢ per kWh		Jun-08
	Residential - RTM	11.15	¢ per kWh		Jun-08
5-Apr-06	Residential	11.35	¢ per kWh		Jun-08
	Residential - RTM	11.25	¢ per kWh		Jun-08
12-Apr-06	Residential	11.39	¢ per kWh		Jun-08
	Residential - RTM	11.35	¢ per kWh		Jun-08
19-Apr-06	Residential	11.89	¢ per kWh		Jun-08
	Residential - RTM	11.79	¢ per kWh		Jun-08
26-Apr-06	Residential	12.15	¢ per kWh		Jun-08
	Residential - RTM	12.05	¢ per kWh		Jun-08
5-May-06	Residential	11.85	¢ per kWh		Jun-08
	Residential - RTM	11.75	¢ per kWh		Jun-08
10-May-06	Residential	11.79	¢ per kWh		Jun-08
	Residential - RTM	11.69	¢ per kWh		Jun-08
17-May-06	Residential	11.69	¢ per kWh		Jun-08
	Residential - RTM	11.59	¢ per kWh		Jun-08
24-May-06	Residential	11.75	¢ per kWh		Jun-08
	Residential - RTM	11.65	¢ per kWh		Jun-08
31-May-06	Residential	11.35	¢ per kWh		Jun-08
	Residential - RTM	11.25	¢ per kWh		Jun-08
6-Jun-06	Residential	11.45	¢ per kWh		Jun-08
	Residential - RTM	11.35	¢ per kWh		Jun-08
14-Jun-06	Residential	11.25	¢ per kWh		Jun-08
	Residential - RTM	11.15	¢ per kWh		Jun-08
28-Jun-06	Residential	10.89	¢ per kWh		Jun-08
	Residential - RTM	10.75	¢ per kWh		Jun-08
7-Jul-06	Residential	10.85	¢ per kWh		Jun-08
	Residential - RTM	10.75	¢ per kWh		Jun-08
12-Jul-06	Residential	10.79	¢ per kWh		Jun-08
	Residential - RTM	10.65	¢ per kWh		Jun-08
19-Jul-06	Residential	10.79	¢ per kWh		Jun-08
	Residential - RTM	10.65	¢ per kWh		Jun-08
25-Jul-06	Residential	11.25	¢ per kWh		Jun-08
	Residential - RTM	11.09	¢ per kWh		Jun-08
2-Aug-06	Residential	11.79	¢ per kWh		Jun-08
	Residential - RTM	11.59	¢ per kWh		Jun-08
9-Aug-06	Residential	11.35	¢ per kWh		Jun-08
	Residential - RTM	11.15	¢ per kWh		Jun-08
16-Aug-06	Residential	11.39	¢ per kWh		Jun-08
	Residential - RTM	11.19	¢ per kWh		Jun-08
23-Aug-06	Residential	11.39	¢ per kWh		Jun-08
	Residential - RTM	11.19	¢ per kWh		Jun-08

30-Aug-06	Residential	11.59	¢ per kWh	Jun-08
	Residential - RTM	11.39	¢ per kWh	Jun-08
6-Sep-06	Residential	11.59	¢ per kWh	Jun-08
	Residential - RTM	11.39	¢ per kWh	Jun-08
******TERMS CHANGED******				
Effective Date				**Term/End Date**
12-Sep-06	Residential - R & RTM	10.7	¢ per kWh	1 - yr
	Residential - R & RTM	10.9	¢ per kWh	2 - yr
6-Oct-06	Residential - R & RTM	9.1	¢ per kWh	Jun-07
	Residential - R & RTM	10.2	¢ per kWh	1 - yr
	Residential - R & RTM	10.6	¢ per kWh	2 - yr
BGE - MARYLAND				
Effective Date				**Term/End Date**
15-Mar-06	Residential	12% Off Summer SOS		Jun-07
		3% Off Winter SOS		
******TERMS CHANGED******				
6-Sep-06	Residential	9.6	¢ per kWh	Jun-07
	Residential	10.3	¢ per kWh	1 - yr
	Residential	10.6	¢ per kWh	2 - yr
6-Oct-06	Residential	8.9	¢ per kWh	Jun-07
	Residential	9.9	¢ per kWh	1 - yr
	Residential	10.1	¢ per kWh	2 - yr