STATE OF MARYLAND

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of Baltimore Gas and Electric	**)**	
Company's Proposal to Implement a Rate	**)**	
Stabilization Plan Pursuant to Section 7-548 of the	**)**	**Case No. 9099**
Public Utility Companies Article and the	**)**	
Commission's Inquiry into Factors Impacting	**)**	
Wholesale Electricity Prices	**)**	

SURREBUTTAL TESTIMONY OF

JONATHAN WALLACH

ON BEHALF OF

THE OFFICE OF PEOPLE'S COUNSEL

Resource Insight, Inc.

APRIL 16, 2007

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 filed direct testimony in this proceeding?

A: Yes.

Q: On whose behalf are you testifying?

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

Q: What is the purpose of your surrebuttal testimony?

A: On April 6, 2007, Baltimore Gas and Electric ("BGE") filed reply testimony by Dr. Jonathan Lesser. As part of that reply testimony, Dr. Lesser commented on my direct testimony regarding Commission Issue Nos. 7, 8, and 10. This surrebuttal testimony responds to those comments.

In addition, Dr. Lesser's reply testimony commented on my direct and rebuttal testimony in Case No. 9063. I do not respond to these comments in this surrebuttal testimony. There is no need to re-litigate these issues in the instant proceeding, as the record in Case No. 9063 provides ample evidence of the shortcomings in Dr. Lesser's testimony in that case.

However, as he did in Case No. 9063, Dr. Lesser attributes to me (and then disputes) positions, findings or recommendations that never appear in my direct testimony in this proceeding. Moreover, Dr. Lesser repeatedly mischaracterizes my direct testimony through selective quotation or by simply ignoring those portions of my testimony that inconveniently contradict his assertions. This surrebuttal testimony attempts to correct these misrepresentations in Dr. Lesser's reply testimony.

Q: What professional experience did you draw on in formulating the findings and conclusions of your direct testimony in this proceeding?

A: In general, I drew on my 25 years of experience advising clients on matters relating to electric-utility restructuring, participating in the formulation of market designs for wholesale-power markets in the Northeast, and assisting in the procurement of power to serve retail load. In particular, I relied on my experience:

- Participating in the development of the Maryland SOS procurement process, and monitoring its implementation over the last four years.
- Participating in the FERC settlement negotiations regarding the design of the Reliability Pricing Model ("RPM").
- Participating in the FERC settlement negotiations regarding development of scarcity-pricing rules.
- Appearing at various FERC technical conferences on capacity-market design.
- Representing OPC at various PJM stakeholder meetings regarding wholesale-power market design and transmission-expansion issues.

Q: What is Dr. Lesser's response to your direct testimony on Commission Issue No. 7.

A: Dr. Lesser accuses me of engaging in "hindsight" analysis when I state that, as a result of divestiture of BGE's generation assets, the "cost basis for residential generation rates changed from the average cost of BGE's assets in 1999 to the market price for short-term full-requirements contracts in 2006." In addition, Dr. Lesser disputes my findings regarding the effect of developments in PJM's spot markets on commodity costs and risk premiums for short-term full-requirements contracts procured in 2006.

Q: Did you engage in hindsight analysis to support your statement regarding the change in cost basis between 1999 and 2006?

A: I neither engaged in hindsight, foresight, or any other kind of analysis, since this is a statement of fact. It is a fact that residential generation rates in 1999 were based on the average cost of BGE's generation portfolio. It is also a fact that, by design of the settlement agreements in Case Nos. 8794 and 8908, BGE's generation assets were divested in 2000 and that residential generation rates starting in 2006 would be based on the market prices of short-term full-requirement contracts procured to serve residential load in lieu of those divested assets. Thus, it is simply a statement of fact that the cost basis for residential generation rates changed from average generation cost in 1999 to contract market prices in 2006.

Q: What is Dr. Lesser's response to your assessment of wholesale-market developments?

A: Dr. Lesser contends that, contrary to my findings: (1) natural gas is decreasingly on the margin in PJM; (2) congestion costs are not a significant driver of spot-price trends; (3) capacity-market restructuring could not have affected prices for contracts procured in 2006, since RPM was not in place at the time of procurement; and (4) prices for contracts procured in 2006 could not have been affected by scarcity-pricing rules, since scarcity pricing never triggered in 2006.

Q: Is Dr. Lesser correct in his finding that there has been a decreasing reliance on natural gas as the marginal fuel since 2000?

A: No. According to PJM's Market Monitoring Unit, the percentage of time that natural-gas units were marginal grew from 18% in 2000 to 25% in 2006.[1] While the percentage spiked to a maximum in 2003 and 2004, it then dropped back to 2002 levels in 2005 and then increased again in 2006.

Q: What is the basis for Dr. Lesser's claim that congestion costs are not a significant driver of spot-price trends?

A: Dr. Lesser estimates that congestion costs in the BGE zone amounted to approximately $3/MWh in 2006. He further claims that this amounts to about 3% of total SOS prices, and therefore cannot be considered to be a significant driver of price trends.

Q: Is Dr. Lesser's claim reasonably supported?

A: No. Dr. Lesser under-estimates the actual 2006 BGE congestion price by a factor of two. According to the 2006 State of the Market Report, the average congestion adder to the Western Hub day-ahead price for the BGE zone was $5.46/MWh.[2]

Moreover, Dr. Lesser's comparison of the congestion adder to the total SOS rate is irrelevant to the question as to the impact of congestion costs on spot prices. According to the 2006 State of the Market Report, the average

[1]For 2000 data, see PJM Interconnection, LLC, *2004 State of the Market Report*, March 8, 2005, Table 2-25, p. 70. For 2006 data, see PJM Interconnection, LLC, *2006 State of the Market Report*, March 8, 2007, Table 2-30, p. 56.

[2]*Id.*, Table 7-6, p. 274.

2006 day-ahead spot price for the BGE zone was $55.51/MWh.[3] Congestion costs – at $5.46/MWh – thus constituted almost 10% of the total BGE zonal spot price, an amount that I consider to be significant.

Q: Is it true, as Dr. Lesser claims, that anticipated changes to the capacity market would not have affected bid prices for contracts procured in 2006?

A: No. In the winter of 2005/06, BGE procured multi-year contracts that extended beyond the 2007 implementation date for the RPM construct. Thus, contract prices for deliveries starting on June 1, 2007 likely reflected market expectations regarding the impact of the RPM construct.

Such market expectations likely also affected bid prices for contracts procured in the winter of 2006/07. As I noted in my direct testimony, and as confirmed in the reply testimony of Mr. Marc Overdyk on behalf of Coral Power, forward prices for capacity increased by almost an order of magnitude between 2006 and 2007, again reflecting market expectations regarding the impact of RPM implementation in 2007.[4]

Q: Does Dr. Lesser make any other representations regarding your assessment of the impact of RPM implementation?

A: Yes. Dr. Lesser asserts that:

> Mr. Wallach believes that generating capacity will be forthcoming without any incentive for developers to build such capacity. In other words, he wants others to develop generating capacity that provides system reliability without having to pay for it.[5]

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[3] *Id.*, Table 2-53, p. 87.

[4] *Reply Testimony of Marc Overdyk*, Case No. 9099, April 6, 2007, p. 4.

[5] *Reply Testimony of Jonathan A. Lesser*, Case No. 9099, April 6, 2007, p. 11.

Q: What is the basis for Dr. Lesser's claim regarding your beliefs in this regard?

A: There is no basis for Dr. Lesser's claim regarding my position on the appropriate compensation for developers, since I did not discuss this issue directly or tangentially anywhere in my direct testimony.

Q: Have you ever taken the position in testimony or otherwise that you want "others to develop generating capacity … without having to pay for it?"

A: No.

Q: Why does Dr. Lesser disagree with your finding that PJM's scarcity-pricing rules may have affected prices for contracts procured in 2006?

A: Dr. Lesser apparently misunderstood the point I was making about the impact of the scarcity-pricing rules. As I stated in my direct testimony, implementation of scarcity-pricing rules increased "the *risk* of higher prices and greater price volatility during high-load hours." (Emphasis added.) In other words, bidders in the Winter, 2005/06 procurement were undoubtedly aware that PJM had filed the scarcity-pricing settlement agreement with FERC in November of 2005, and were likely cognizant of its impact on price risk for SOS supply obligations following its implementation in March of 2006.

What these bidders could not have foreseen from their vantage point in the winter of 2005/06 is that, as Dr. Lesser points out, the scarcity-pricing rules would not trigger in 2006. Instead, such bidders would have had to assess the risk of a triggering event, and would then have priced that risk in their price offers for contracts starting in July of 2006.

Q: Does Dr. Lesser have any other comments regarding your assessment of the impact of scarcity-pricing rules?

A: Yes. Dr. Lesser states that: "Mr. Wallach refuses to acknowledge there is a cost to providing system reliability and that customers who want reliable electric service cannot obtain that reliability free of charge."[6]

Q: Is there a reason why you did not "acknowledge there is a cost to providing system reliability"?

A: Yes. I did not acknowledge that fact, because it bears absolutely no relevance to the question of how scarcity-pricing rules affect offer prices for contracts procured in 2006.

Q: What is Dr. Lesser's response to your direct testimony on Commission Issue No. 8?

A: Dr. Lesser asserts that my corrections to his analysis in Case No. 9063 are unreasonable in three respects. First, Dr. Lesser states that: "Mr. Wallach assumes that, if electric markets had never been restructured, competitive wholesale generators would still have flocked to PJM to build new capacity, that PJM would have expanded as it did, and that BGE would have bought all of that surplus generation."[7] Second, according to Dr. Lesser: "In his CN 9063 testimony, Mr. Wallach also argued that higher T&D costs would not be translated into higher rates."[8] Third, Dr. Lesser alleges that: "Mr. Wallach

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[6]Lesser Reply, p. 11.

[7]*Id.*, pp. 12-13.

[8]*Id.*, p. 13.

argued that BGE's regulated price would decrease because the Company's earnings were too high."[9]

Q: As part of your corrections to Dr. Lesser's analysis, did you assume that PJM would still have been in surplus and that BGE would have had access to such surplus, even if BGE had not restructured?

A: Yes, for good reason. As in this proceeding, Dr. Lesser argued in Case No. 9063 that "… it is not reasonable to assume that the PJM market would have developed the way it did had restructuring not occurred."[10] As I discussed in my rebuttal in that case:

> 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.[11]

[9] *Id.*

[10] *Direct Testimony of Jonathan A. Lesser*, Case No. 9063, October 23, 2006, p. 35.

[11] *Rebuttal Testimony of Jonathan Wallach*, Case No. 9063, November 3, 2006, p. 17. A copy of this testimony was attached to my direct testimony in this proceeding.

Q: What is Dr. Lesser's response in this proceeding with regard to your assumption that BGE would access wholesale-market power to serve load?

A: Dr. Lesser claims that my assumption is contrary to BGE's planning assumptions at that time, as indicated in its 1999 Integrated Resource Plan ("IRP"):

> In other words, back in 1999, he assumes that BGE would not have followed the tenets of its last IRP, which stated the company would meet increased demand by building new combined-cycle units, but would have instead divined that there would be surplus energy available in the years ahead, provided by then non-existent capacity.[12]

Q: Is Dr. Lesser correct in his assertion that BGE's 1999 IRP provided for the building of new combined-cycle capacity to meet increased demand?

A: No. In fact, the 1999 IRP states quite clearly that BGE intended to rely on the PJM wholesale market to meet demand, consistent with my correction to Dr. Lesser's analysis and contrary to Dr. Lesser's claim.

According to the 1999 IRP filing:

> In light of the recent restructuring of the PJM Power Pool, the likelihood of retail competition in Maryland in the near future, and uncertainties of future regulatory structures, BGE's main resource planning objective is to serve the capacity needs of its customers while remaining flexible in the consideration of its future resource options. *Given this, the Company is not planning to commit to any long-term resources. At this time, BGE is planning to meet all additional capacity needs with short-term agreements in the competitive bulk power market.*[13]

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[12]Lesser Reply, p. 13.

[13]Baltimore Gas and Electric Company, "1999 Ten-Year Data Request of the Maryland Public Service Commission", June 30, 1999, response to Question No. 1. Emphasis added. Provided in response to OPC Data Request No. 1, Question No. 1. A copy of this response is attached.

There is no indication in BGE's 1999 IRP that the Company intended to meet increased demand by building new combined-cycle capacity.

Q: Did you correct Dr. Lesser's analysis because he assumed that higher transmission and distribution ("T&D") costs would translate into higher T&D rates?

A: No. I corrected Dr. Lesser's analysis because he unreasonably assumed that T&D costs (and rates) would be higher in the continued-regulation case than in the restructuring case.

As I stated in my rebuttal testimony in Case No. 9063:

> 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. 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. 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.[14]

I corrected for this unreasonable assumption by assuming that T&D costs and rates would be the same in both the restructuring and continued-regulation cases.

[14] *Id.*, p. 16.

Q: In your corrected analysis, did you assume that "BGE's regulated rates would decrease because the Company's earnings were too high", as Dr. Lesser alleges?

A: I made no such assumption in my corrections to Dr. Lesser's analysis. In a footnote to the section quoted above, I merely pointed out that OPC's petition of September 3, 1998 in Case No. 8804 (i.e., the precursor to the BGE restructuring case) argued for a reduction in BGE's rates due to over-earnings, and that the findings of this petition would support an assumption of a rate decrease in the absence of restructuring. However, I did not assume any decrease, due to over-earnings or any other factor, in the corrected analysis.

Q: What is Dr. Lesser's response to your direct testimony on Commission Issue No. 10?

A: Dr. Lesser repeats his objections to my assumptions regarding likely PJM market conditions in the absence of restructuring of BGE's generation function. My response with regard to Commission Issue No. 8 thus applies as well in this instance.

Q: Does this conclude your surrebuttal testimony?

A: Yes.

ATTACHMENT 1

Response to OPC Data Request No. 1, Question No. 1