

PAULA M. CARMODY  
PEOPLE'S COUNSEL  
  
THERESA V. CZARSKI  
DEPUTY PEOPLE'S COUNSEL

## STATE OF MARYLAND



ASSISTANT PEOPLE'S COUNSEL  
CYNTHIA GREEN-WARREN  
WILLIAM F. FIELDS  
PETER SAAR  
GARY L. ALEXANDER  
ANNE JOHNSON  
RON HERZFELD  
FRANCIS D. HARTNETT  
RICHARD S. GRATZ

## OFFICE OF PEOPLE'S COUNSEL

6 Saint Paul Street, Suite 2102  
Baltimore, Maryland 21202  
(410) 767-8150 (800) 207-4055  
FAX (410) 333-3616  
[WWW.OPC.STATE.MD.US](http://WWW.OPC.STATE.MD.US)

August 17, 2010

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

### **Re: Case No. 9221**

Dear Ms. Romine:

Enclosed please find an original and seventeen (17) copies of the Reply Testimony of Mr. Steven Hill, Mr. Jonathan Wallach and Mr. David J. Effron on behalf of the Office of People's Counsel in the above-referenced case. A copy has been provided to all parties of record.

If you have any questions, please do not hesitate to contact me.

Very truly yours,

*/electronic signature/*

William F. Fields

Senior Assistant People's Counsel

WFF/mcm

Enclosure

cc: All Parties of Record

BEFORE THE  
PUBLIC SERVICE COMMISSION  
OF MARYLAND

IN THE MATTER OF )  
A REQUEST BY BALTIMORE GAS AND ELECTRIC )  
COMPANY TO REVISE RECOVERY OF STANDARD ) Case No. 9221  
OFFER SERVICE RELATED CASH WORKING )  
CAPITAL REVENUE REQUIREMENT )

DIRECT TESTIMONY OF STEPHEN G. HILL

ON BEHALF OF

THE OFFICE OF PEOPLE'S COUNSEL

AUGUST 17, 2009

DIRECT TESTIMONY OF STEPHEN G. HILL  
Case No. 9221  
BALTIMORE GAS & ELECTRIC STANDARD OFFER SERVICE  
ADMINISTRATIVE CHARGE PROCEEDING

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1 **I. INTRODUCTION / SUMMARY**

2 Q: PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.

3 A: My name is Stephen G. Hill. I am self-employed as a financial consultant, and principal  
4 of Hill Associates, a consulting firm specializing in financial and economic issues in  
5 regulated industries. My business address is P.O. Box 587, Hurricane, West Virginia,  
6 25526 (e-mail: [hillassociates@gmail.com](mailto:hillassociates@gmail.com)).

7

8 Q: BRIEFLY, WHAT IS YOUR EDUCATIONAL BACKGROUND?

9 A: After graduating with a Bachelor of Science degree in Chemical Engineering from  
10 Auburn University in Auburn, Alabama, I was awarded a scholarship to attend Tulane  
11 Graduate School of Business Administration at Tulane University in New Orleans,  
12 Louisiana. There I received a Master's Degree in Business Administration. More  
13 recently, I have been awarded the professional designation, "Certified Rate of Return  
14 Analyst" by the Society of Utility and Regulatory Financial Analysts. This designation is  
15 based upon education, experience and the successful completion of a comprehensive  
16 examination. I have also served on the Board of Directors of that national organization. A  
17 detailed account of my educational background and occupational experience appears in  
18 Appendix A attached to this testimony.

19

20 Q: HAVE YOU TESTIFIED BEFORE THIS OR OTHER REGULATORY  
21 COMMISSIONS?

22 A: Yes, I have appeared previously before this Commission. In addition, over the past 29  
23 years, I have testified on cost of capital, corporate finance and capital market issues in

1 more than 250 regulatory proceedings before the following regulatory bodies: the West  
2 Virginia Public Service Commission, the Texas Public Utilities Commission, the Arizona  
3 Corporation Commission, the Oklahoma State Corporation Commission, the Public  
4 Utilities Commission of the State of California, the Pennsylvania Public Utilities  
5 Commission, the Washington Utilities and Transportation Commission, the Public  
6 Utilities Commission of the State of Minnesota, the State of Connecticut Department of  
7 Public Utility Control, the Ohio Public Utilities Commission, the Insurance  
8 Commissioner of the State of Texas, the North Carolina Insurance Commissioner, the  
9 Massachusetts Department of Public Utilities, the Rhode Island Public Utilities  
10 Commission, the City Council of Austin, Texas, the Texas Railroad Commission, the  
11 Missouri Public Service Commission, the South Carolina Public Service Commission, the  
12 Public Utilities Commission of the State of Hawaii, the New Mexico Corporation  
13 Commission, the State of Maine Public Utilities Commission, the Georgia Public Service  
14 Commission, the Public Service Commission of Utah, the Illinois Commerce  
15 Commission, the Kansas Corporation Commission, the Indiana Utility Regulatory  
16 Commission, the Virginia Corporation Commission, the Montana Public Service  
17 Commission, the Public Service Commission of Wisconsin, the Vermont Public Service  
18 Board, the Federal Communications Commission and the Federal Energy Regulatory  
19 Commission. I have also testified before the West Virginia Air Pollution Control  
20 Commission regarding appropriate pollution control technology and its financial impact  
21 on the company under review and have been an advisor to the Arizona Corporation  
22 Commission on matters of utility finance.

1 Q: ON BEHALF OF WHOM ARE YOU TESTIFYING IN THIS PROCEEDING?

2 A: I am testifying on behalf of the Office of People's Counsel (OPC).

3

4 Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?

5 A: In this proceeding, I have been retained by the OPC to review, analyze and comment on  
6 the financial/rate of return aspects of the proposed change in the ratemaking treatment of  
7 cash working capital (CWC) for the standard offer service (SOS) function of the electric  
8 utility distribution operations of Baltimore Gas & Electric Company (BGE, the  
9 Company). In addition, I will comment on the appropriateness of the "return" allowance  
10 included in what is termed the "Administrative Charge" (as defined in the Settlement  
11 Agreement<sup>1</sup>).

12

13 Q: PLEASE SUMMARIZE YOUR TESTIMONY AND FINDINGS CONCERNING THE  
14 COMPANIES' CASH WORKING CAPITAL AND THE RETURN PORTION OF THE  
15 ADMINISTRATIVE CHARGE.

16 A: According to the Direct Testimony of BGE witness Pino, the original settlement  
17 regarding cash working capital and the Administrative Charge related to SOS service  
18 expired, for residential service, in May of 2010. According to Mr. Pino, the cash working  
19 capital requirement associated with offering SOS service changed when the Company's  
20 supplier, PJM, changed its billing cycle to weekly from monthly. As a result, the  
21 Companies request that their incremental CWC-related costs be recovered as an

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

1 additional SOS supply costs passed on to customers, and recovered as part of the  
2 Administrative Charge. In addition, the Company proposes that additional  
3 Administrative Charge items (incremental costs and uncollectibles) be recovered as a  
4 pass-through of actual costs and, finally that the overall Administrative Charge be  
5 allowed to “float”, with the currently allowed level of \$0.004/kWh serving as a “floor”.  
6 Or, in other words, the Administrative Charge would be allowed to flex to be equal to  
7 verifiable costs but would not go below \$0.004/kWh.

8 As discussed in the testimony of Jonathan Wallach, the OPC believes that CWC-  
9 related costs should be recovered in their entirety in a charge that will be trued-up  
10 annually. However, with regard to the return aspect of the Administrative Charge, my  
11 testimony shows that the “return” established in the original settlement (1.5 mills/kWh),  
12 which the Company want to maintain is unnecessary, economically inefficient, and  
13 allows the Company to earn a return that exceeds its cost of capital. As such, a  
14 continuation of that fixed “return” allowance in the Administrative Charge would  
15 unnecessarily enrich stockholders at ratepayer expense, would be unfair to ratepayers in  
16 these difficult economic times and would not promote the balancing of utility and  
17 ratepayer interests. The “return” component of the SOS-related Administrative Charge  
18 should be replaced by the CWC component.<sup>2</sup>

19 The other aspect of my testimony addresses the cost rate to be applied to the  
20 CWC balances in order to determine the charges to be included in rates. Cash working  
21 capital is a regulatory construct in which the amount of monies necessary to finance the

---

<sup>2</sup> The need to eliminate the “return” charge included in the SOS Administrative Charges is, as discussed in more detail subsequently, is *not* mitigated by the fact that BGE, currently, is required to return those monies to ratepayers. Rather, those monies should not be collected from ratepayers in the first place.

1       shortfall between the payment of expenses and the receipt of ratepayer monies to meet  
2       those expenses is assumed to be a rate base “asset” and is allowed to earn a return at a  
3       rate equal to the utility’s overall cost of capital.

4             Although the CWC “asset” construct is short-term in nature, because it arises  
5       from an on-going requirement, it is assumed, for regulatory purposes, that the cost of  
6       those monies is equal to the long-term pre-tax overall cost of capital of the utility. That  
7       ratemaking assumption is very generous to the utility because, even though the shortfall  
8       between the payment of expenses and the receipt of ratepayer funds to pay those  
9       expenses is continuing, it is difficult to reason that any savvy financial manager would  
10      issue common equity to pay power costs that will be covered by receipts from ratepayers  
11      within 30 days. That is, short-term assets (such as the CWC construct at issue in these  
12      proceedings) are most economically financed with similar-term (short-term) liabilities,  
13      which, because the lag between incurring the expense and receiving the payment is 26 to  
14      32 days<sup>3</sup>, would be short-term debt—not the average mix of capital used to fund the  
15      entire utility rate base.

16            However, the regulatory tradition in Maryland for allowing a return on the CWC  
17      “asset” is the use of the Companies’ overall cost of capital and recommends the  
18      continuance of that practice for the cash working capital as traditionally billed by PJM—  
19      i.e., monthly. However, for the *incremental* costs associated with the change in PJM’s  
20      billing cycle from monthly to weekly (an even shorter-term issue), we recommend that a  
21      short-term debt cost rate be assigned to that portion of the CWC “asset.”

22            OPC witness David Effron provides a calculation of the CWC costs for residential

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<sup>3</sup> Castagnera Direct, pp. 8 and 9.



ratepayers for BGE using the overall cost of capital to calculate the costs as traditionally applied to the monthly billing by PJM, and a short-term debt cost rate applied to the incremental CWC due to the change to monthly billing. As shown in the Chart below, while the OPC-recommended CWC costs allow the Companies to earn a fair return on their CWC “assets” (i.e., meeting the financing costs of their power supply revenue lag), they are more economically efficient and impart a lower cost to ratepayers.

Table I.

OPC and Companies’ Recommended CWC Costs  
\$/MWh

Residential	OPC	Company <sup>4</sup>
	\$0.58	\$1.27

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<sup>4</sup> Company Residential CWC data from Castagnera Direct Testimony. p. 9.

**II. ADMINISTRATIVE “RETURN” CHARGE**

Q. IN SECTION 7-510 OF THE MARYLAND PUBLIC UTILITY COMPANIES

ARTICLE, PARAGRAPH (C)(3)(ii)(2) REQUIRES THAT ELECTRIC COMPANIES

PROVIDE TRADITIONAL UTILITY SERVICE (TERMED “STANDARD OFFER

SERVICE”) AT A PRICE THAT PERMITS RECOVERY OF PRUDENTLY

INCURRED COSTS AND A REASONABLE RETURN. DOES THAT

REQUIREMENT NECESSITATE A SEPARATE “RETURN” CHARGE BE

INCLUDED IN THE SOS ADMINISTRATIVE CHARGE?

A. No, it does not. An explicit additional “return” charge included in the SOS

Administrative Charge is unnecessary because the Companies and their stockholders are

already receiving appropriate, full compensation for the risks pertaining to the provision

of utility service in the return that is allowed in their distribution utility rate proceedings.

Moreover, the Settlement Agreements related to the provision of SOS for BGE expired in

mid-year 2010, and this proceeding provides the opportunity for a Commission review of

the appropriateness of any administrative “return” charge. That “return” portion of the

Administrative Charge for SOS service, the previously agreed upon 1.5 mills per kWh,

should be discontinued.

Q. ISN’T IT TRUE THAT, AS OF JUNE 1, 2010, BGE IS PROHIBITED (FOR A PERIOD

OF TIME) FROM RETAINING ANY “RETURN” PORTION OF THE

ADMINISTRATIVE CHARGE?

A. Yes, that is correct.

1

2 Q. THEN YOUR SUGGESTION THAT THE COMMISSION NOT ALLOW THE  
3 COLLECTION OF A "RETURN" COMPONENT IN THE ADMINISTRATIVE  
4 CHARGE WILL HAVE NO AFFECT WHATSOEVER ON RESIDENTIAL RATES,  
5 CORRECT?

6 A. Yes, that is also correct.

7

8 Q. WHY, THEN, ARE YOU MAKING THE RECOMMENDATION THAT AN  
9 EXPLICIT "RETURN" CHARGE BE ELIMINATED FROM THE SOS  
10 ADMINISTRATIVE CHARGE THAT IS COLLECTED FROM RATEPAYERS?

11 A. First, as explained below, an explicit "return" charge is unnecessary and uneconomic.  
12 Second, while it is true that the Company is currently required to return those charges  
13 collected to ratepayers, at some point that requirement will cease and, if not disallowed,  
14 BGE could, eventually, retain those monies.

15

16 Q. CAN YOU EXPLAIN IN MORE DETAIL WHY A SEPARATE "RETURN" CHARGE  
17 INCLUDED IN THE ADMINISTRATIVE CHARGES ASSOCIATED WITH SOS  
18 SERVICE IS UNNECESSARY?

19 A. Yes, there are many reasons why a separate "return" charge in the SOS Administrative  
20 Charges is unnecessary. First, the term "return" applied to that particular portion of the  
21 Administrative Charge is a misnomer; it's not really a return at all. There can be no  
22 return, in a financial sense, unless there is an investment on which the return can be  
23 earned. In the service of procuring purchased power for customers that do not contract

1 for their own supply, there is no investment base on which any actual return can be  
2 earned. It is simply a service. What has been termed the “return” portion of the  
3 Administrative Charge as a result of the settlement of Case No. 8909 is simply an  
4 additional charge passed on to ratepayers and is not a return on any plant investment  
5 whatsoever.

6 As set out in Bluefield, one of the seminal U.S. Supreme Court decisions that have  
7 governed the determination of allowed returns for utilities, the “return” to be allowed is  
8 proportional to the investment in utility property undertaken.

9 A public utility is entitled to such rates as will permit it to  
10 earn a return upon the *value of the property* which it  
11 employs for the convenience of the public equal to that  
12 generally being made at the same time and in the same  
13 general part of the country on investments in other business  
14 undertakings which are attended by corresponding risks  
15 and uncertainties; but it has no constitutional right to profits  
16 such as are realized or anticipated in highly profitable  
17 enterprises or speculative ventures. The return should be  
18 reasonably sufficient to assure confidence in the financial  
19 soundness of the utility, and should be adequate, under  
20 efficient and economical management, to maintain and  
21 support its credit, and enable it to raise the money  
22 necessary for the proper discharge of its public duties.  
23 (*Bluefield Water Works and Improvement Co. v. Public*  
24 *Service Comm’n*, 262 U.S. 679, 692 (1923). Emphasis  
25 added.)  
26

27 Second, “standard offer service,” which is defined in § 7-510(c)(2) as “electricity  
28 purchased from a customer’s electric company,” cannot exist in the abstract. As defined  
29 in the Statute, SOS is just electricity, and, therefore, cannot be transported, sold, or used  
30 unless it is delivered through the transmission and distribution assets of the customer’s  
31 utility. As such, SOS service is simply standard utility service—power purchased by the  
32 utility for delivery to its customers. SOS service is, then, inextricably tied to the

1 provision of utility service. It is not a stand-alone service that has risks different and  
2 apart from the provision of normal utility service—it *is* utility service.

3 Third, because buying and delivering purchased power to customers is a routine  
4 utility function, the risks attendant to that function and the return necessary to properly  
5 compensate investors for those risks are accounted for in the returns allowed in the  
6 Company's rate cases. As noted in the above cite from *Bluefield*, the return allowed  
7 regulated utilities should be similar to that earned by firms with corresponding risks.  
8 That requirement is also echoed in the *Hope*<sup>5</sup> decision, which also is a fundamental  
9 reference cited as a benchmark for the determination of an appropriate utility return. An  
10 analysis and review of the cost of capital of sample groups of similar-risk utilities is the  
11 procedure used by this Commission in determining the appropriate overall return to be  
12 allowed in setting utility rates in Maryland as well as in all other regulatory jurisdictions  
13 in the U.S. with which I am familiar.

14 For example, in BGE's most recent fully-adjudicated rate case<sup>6</sup>, in order to  
15 estimate the cost of capital for their distribution operations, the Companies' cost of  
16 capital witness used a sample groups that consisted of natural gas utilities followed by  
17 Value Line (e.g., AGL Resources, Laclede Group, New Jersey Resources, and UGI  
18 Corp.). Purchasing energy supplies (natural gas for gas distributors and electric power  
19 for electric companies) and delivering it to customers is a normal part of business for  
20 these types of companies. That is, the energy supply activity termed SOS in this  
21 jurisdiction is simply business-as-usual for most utilities.

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<sup>5</sup> *FPC v. Hope Natural Gas Company*, 320 US 591 (1944)

<sup>6</sup> Case No. 9036, cited in the testimony of BGE witness Castagnera.

1           Also, for the gas companies used in the sample group selected by BGE as similar  
2           in risk to its Maryland distribution operations, on average, only 64% of the revenues are  
3           generated by regulated gas utility operations.<sup>7</sup> The rest of the revenues are derived from  
4           operationally riskier unregulated operations such as energy trading. Therefore, the risks  
5           of the companies used to estimate the cost of equity for BGE's distribution operations in  
6           Maryland is arguably higher than that appropriate for a pure-play distributor like BGE.  
7           In that regard, the equity return awarded BGE would overstate the cost of capital for the  
8           Company's distribution operations.

9           In addition, in the current, on-going BGE rate case (Case No. 9230) the Company  
10          uses a sample of electric utilities that supply power to their customers through a mix of  
11          their own generation assets and purchased power as a similar-risk proxy group to BGE's  
12          distribution operations.<sup>8</sup> On average, the electric companies used to estimate the cost of  
13          equity in BGE's current rate proceeding derive about 40% of their total power supply  
14          from purchased power, according to the most recent Value Line reports on each of those  
15          companies.

16          Therefore, the risks attendant to supplying "standard offer service" in Maryland is  
17          accounted for in the cost of capital determined in the distribution rate proceedings  
18          because that type of activity (purchasing energy for customer use) is a normal part of the  
19          utility function for the companies that are included in the similar risk sample groups from  
20          which the cost of capital is estimated. Including any additional charge, such as the so-

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<sup>7</sup> Data from AUS Utility Reports, June 2010: AGL Resources (63%), Atmos Energy (61%), Laclede Group (54%), New Jersey Resources (40%), NICOR (81%), Northwest NG (97%), Piedmont NG (86%), South Jersey Industries (54%), Southwest Gas (85%), UGI Corp. (32%), and WGL Holdings (50%).

<sup>8</sup> Case No. 9239, Exhibit WEA-2, p. 1. (ALLETE, Alliant Energy, Consolidated Edison, Dominion Resources, Duke Energy, Entergy, Exelon, PG&E, SCANA, Sempra Energy, Vectren Corp, Wisconsin Energy, Xcel Energy)

1 called “return” charge that was included in the SOS Administrative Charges as a result of  
2 the settlement, would amount of double-recovery of any attendant SOS risk-related  
3 charges, would constitute over-recovery of the utility’s cost of capital and, finally, would  
4 unnecessarily enrich stockholders at ratepayer expense.  
5

6 Q. ISN’T THE PROVISION OF SOS SERVICE RISKIER THAN THE POWER  
7 PURCHASES OF OTHER UTILITIES BECAUSE THE MARYLAND UTILITIES  
8 HAVE TO PURCHASE ALL OF THE POWER NEEDS OF THEIR CUSTOMERS  
9 THAT UTILIZE SOS SERVICE, NOT JUST PART OF IT?

10 A. No. First, with regard to electric utilities, the power they provide to their customers that  
11 is not purchased is provided by their own generation. As this Commission is aware,  
12 generation risk is greater than distribution and transmission risk, and a firm that supplies  
13 some of its supply from its own generation and some from purchased power would have  
14 greater investment risk than a pure distribution company like BGE.

15 Second, there are specific risk-reducing measures at play here in Maryland that  
16 tend to minimize the risk of providing SOS for distribution companies. This Commission  
17 pre-approves the two-year purchased power plans that will provide the SOS energy for  
18 the distributors under its purview. While this pre-approval process does not guarantee  
19 that there would never be any non-recovery of purchased power costs due to imprudence  
20 on the part of the Companies, it must be considered to lower the risk of that possibility  
21 compared to those companies whose power purchases are not subject to such regulatory  
22 review. In addition, the electric distributors in Maryland are not at risk for the revenue  
23 impact of usage shortfalls. Revenues from SOS customers are reconciled against

1 payments to SOS suppliers, and distribution utilities are held harmless from default of an  
2 SOS supplier. These factors also lower the risks of supplying SOS service in Maryland.

3 Third, the recommendations being made by OPC witness Wallach in this  
4 proceeding to collect actual SOS-related incremental costs in an annual proceeding rather  
5 than collect a fixed amount of costs that may or may not meet actual costs (as existed  
6 during the settlement period), lowers the operational risk of SOS service. By recovering  
7 actual incremental costs and cash working capital costs based on the most recent “test  
8 year” actuals, the Companies are not subject to the risks that may have existed during the  
9 settlement period when the recovery of costs was limited to a fixed amount.

10  
11 Q. ARE THERE OTHER FACTORS THAT THIS COMMISSION SHOULD CONSIDER  
12 IN ASSESSING THE NEED FOR A SEPARATE “RETURN” CHARGE IN THE SOS  
13 ADMINISTRATIVE CHARGES TO BE ASSESSED IN THESE PROCEEDINGS?

14 A. Yes. As I have noted, the provision of SOS is a service, and that service entails a cost. It  
15 is a cost of doing business and the prudent costs of doing utility business should be  
16 included in the rates that customers pay. That is true for line worker’s salaries; for utility  
17 office expenses like paper clips; and for expenses like purchased power. Also, just as  
18 regulation allows no “return” adder to the salary of a line worker or to the price of a  
19 paper clip, there should be no “return” adder to the cost of power purchased to provide  
20 standard utility service—SOS.

21  
22 Q. IS THERE ANY ASPECT OF “RETURN” THAT SHOULD BE CONSIDERED IN  
23 THE SOS ADMINISTRATIVE CHARGES?



1   A. Yes. Because it is standard regulatory procedure to create a hypothetical rate base  
2       “asset” for the purposes of determining an allowance for cash working capital, there is an  
3       asset on which a legitimate return can be earned—and a charge included in the SOS  
4       Administrative Charge for that return. The only appropriate return associated with  
5       standard offer service, then, is that related to cash working capital, which I will address in  
6       the next section of my testimony.

7

8

**II. CASH WORKING CAPITAL RETURN**

Q. WHY DOES A NEED FOR WORKING CAPITAL ARISE?

A. When a business has to pay expenses prior to the receipt of sales from customers, a need for “working capital” arises. That is capital must be raised to provide the monies to pay the expenses incurred in providing the product prior to the time that the product is sold. For utilities, and particularly in this instance with the provision of SOS service, the power must be purchased prior to the time that customers pay for that power, and the purchase of the power must be financed over a relatively short-term period.

Q. ARE UTILITIES THE ONLY TYPE OF COMPANIES THAT EXPERIENCE A LAG BETWEEN THE PAYMENT OF EXPENSES AND THE RECEIPT OF CUSTOMER MONIES?

A. No. Practically any business would have to have funds available to finance short-term cash needs such as working capital. For example, car dealers would have to pay the factory for an automobile when it arrives on their lot and would have to finance that purchase until the car is sold. However, utilities have a considerable advantage over competitive firms when it comes to working capital—they can explicitly include the charges for financing a short-term revenue short-fall in the price of their product. A non-regulated firm may or may not be able to recover those costs, depending on the competitive price of the product. Certainly, for competitive firms, there is no automatic inclusion of working capital financing costs included in the price of the product. Therefore, although utility regulation is designed to emulate the results that would obtain

1 under competition, there are instances in which utilities, due to the important nature of  
2 the service they provide, are provided certain “allowances” that competitive firms do not  
3 enjoy—cash working capital is one of those allowances.  
4

5 Q. HOW IS A CASH WORKING CAPITAL “ALLOWANCE” CONSTRUCTED?

6 A. In order to provide the utility with an estimated cost of financing its short-term working  
7 capital needs, the average time between the payment of expenses and the receipt of  
8 ratepayer monies is calculated in a lead-lag study. That time difference (usually, a  
9 number of days) is multiplied by the average daily expenses to be financed (in the case of  
10 SOS service, that is the daily cost of the SOS supply). The product of those two  
11 estimates, the net revenue lag days and the daily commodity costs per kWh, provides an  
12 estimate of the amount of working capital necessary to provide the SOS service.  
13

14 Q. HOW IS THE COST OF THAT WORKING CAPITAL DETERMINED?

15 A. In order to calculate an increase to rates that will cover the utility’s working capital  
16 financing costs, the amount of working capital determined in the lead-lag study is  
17 assumed to be a rate base “asset.” Then, to calculate the cost of financing the working  
18 capital, the utility’s pre-tax overall cost of capital is applied to the hypothetical rate base  
19 “asset” to determine the amount to be included in rates.  
20

21 Q. YOU HAVE NOTED THAT THE NEED TO FINANCE CASH WORKING CAPITAL  
22 IS RELATIVELY SHORT-TERM IN NATURE. WHY DOES THE COMPANY  
23 ASSUME THAT SUCH FINANCING WOULD BE ACCOMPLISHED WITH THE

1 SAME MIX OF CAPITAL THAT FINANCIES THE UTILITY'S PLANT  
2 EQUIPMENT, WHICH ARE LONG-LIVED ASSETS?

3 A. As noted by Company witness Castagnera on page 2 of his Direct Testimony, the  
4 rationale for the use of the overall weighted-average cost of capital as the cost rate for  
5 financing the working capital "asset" is that the need for financing is re-occurring in  
6 nature. That is, although there are ratepayer monies flowing into the company after about  
7 a month, there are power costs to be paid for which revenues will not be realized for  
8 another month.

9 While that logic is not untrue—the need for financing cash working capital is  
10 certainly an ongoing cost of doing business—that does not change the fact that the  
11 financing need itself is short-term in nature. It would not be economically efficient for a  
12 company to issue long-term capital such as common equity, preferred stock or even long-  
13 term debt to finance power purchases for 30 to 40 days. The more common practice in  
14 corporate finance is to match the duration of assets and liabilities.<sup>9</sup> That is, short-term  
15 assets are usually financed by short-term liabilities and, because the yield curve is  
16 normally upward-sloping, short-term liabilities have a lower cost than long-term  
17 liabilities. Therefore, the current practice of applying a pre-tax overall cost of capital to  
18 the working capital "asset" is a ratemaking procedure that is generous to utilities in that it  
19 probably imparts a higher cost to ratepayers of financing working capital than is actually  
20 incurred by the utilities.

21  

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<sup>9</sup> J.R. Graham, C.R. Harvey, "The Theory and Practice of Finance: Evidence from the Field," *Journal of Financial Economics* 61 (MY 2001), pp. 187-243.

1 Q. DO YOU RECOMMEND, THEN, THAT THE COST RATE TO BE APPLIED TO  
2 THE WORKING CAPITAL “ASSET” BE CHANGED IN THIS PROCEEDING TO A  
3 SHORT-TERM DEBT COST RATE?

4 A. Not entirely; no. The “prime mover” with regard to CWC charges in this proceeding is  
5 the change in billing for power purchases initiated by PJM, the Company’s wholesale  
6 power supplier. PJM changed its billing procedures from a monthly cycle to a weekly  
7 cycle. While that change in billing cycles—the change from one month to one week—is  
8 entirely short-term in nature, that difference causes a substantial shift in the calculation of  
9 net lag days. Power bills must be paid sooner, while customer revenue collection cycles  
10 are unchanged.

11 Because the *incremental* change in the net lag days related to the change in PJM  
12 billing cycle is due to a short-term timing difference, OPC recommends that the cost rate  
13 of that *incremental* change in cash working capital be set equal to a short-term debt cost  
14 rate. However, because the use of the overall cost of capital as the cost rate for cash  
15 working capital has been used by this Commission in the past, we recommend that the  
16 return allowed on the cash working capital asset that arises from a monthly billing cycle  
17 (that which existed prior to PJM’s change in billing) be the overall cost of capital of the  
18 utility, as it was prior to the change in billing.

19 Therefore, the calculation of the return on CWC will be a two-step process. First,  
20 the net lag days appropriate for a monthly PJM billing cycle will be calculated and  
21 multiplied by the appropriate commodity cost to determine the size of the working capital  
22 asset. Then that amount will be multiplied by the pre-tax overall cost of capital. To that  
23 amount will be added the cost of short-term debt times the product of the revenue lag

1 difference between the weekly and monthly PJM billing and the appropriate commodity  
2 cost. The total of those two calculations will determine the appropriate return on cash  
3 working capital that will be added to rates in order to provide the Companies a return on  
4 their CWC “assets.”

5 This procedure provides a balance between the interests of the Company and that  
6 of its ratepayers. The Company recovers its costs as it previously did for the monthly  
7 billing cycle. As noted above, it is reasonable to believe that, through the use of a pre-tax  
8 overall cost of capital cost rate, those costs may be somewhat over-recovered. With the  
9 *incremental* change from monthly to weekly billing, the Company is allowed to recover a  
10 short-term debt cost rate on those newly-created “assets” because it is related to the  
11 timing difference between one month and one week billing. The Companies are able to  
12 recover a reasonable cost of short-term capital on these monies and the ratepayers are  
13 able to realize a smaller increase in their cost of financing the Companies’ working  
14 capital.

15  
16 Q. FOR PURPOSES OF THIS CALCULATION, WHAT SHORT-TERM DEBT COST  
17 RATE DO YOU RECOMMEND?

18 A. For purposes of determining the incremental portion of the cash working capital costs, I  
19 recommend using the prime rate of interest as published by the Federal Reserve in its  
20 weekly Statistical Release H.15. The August 9, 2010 publication indicates that the  
21 current Prime Rate (the rate that commercial banks charge for short-term loans to  
22 businesses) is 3.25%. This rate of interest is generous for the utilities and probably  
23 overstates their actual short-term capital costs. For example, that same edition of the

Federal Reserve's H.15 indicates that the current six-month LIBOR (London Interbank Offering Rate) is 0.70%—a rate on which Commercial Paper and credit facility borrowing are often based. That often-used measure of short-term interest rates is much lower than the 3.25% Prime Rate, currently. Again, in my view, pricing the Companies' incremental CWC financing costs at the current prime rate of interest (3.25%) is beneficial to both the Companies and its ratepayers.

Q. HAVE YOU PERFORMED THE CASH WORKING CAPITAL CALCULATIONS YOU DESCRIBE?

A. I have not. Those calculations were performed by OPC witness David Effron. The results of those calculations are shown below.

OPC and Companies' Recommended CWC Costs  
\$/MWh

Residential	OPC	Company <sup>10</sup>
	\$0.58	\$1.27

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

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<sup>10</sup> Company Residential CWC data from Castagnera Direct Testimony. p. 9.

**ATTACHMENT SH-1**  
**APPENDIX A**  
**STEPHEN G. HILL RESUME**



## EDUCATION AND EMPLOYMENT HISTORY

### STEPHEN G. HILL

#### EDUCATION

Auburn University - Auburn, Alabama - Bachelor of Science in Chemical Engineering (1971); Honors - member Tau Beta Pi national engineering honorary society, Dean's list, candidate for outstanding engineering graduate; Organizations - Engineering Council, American Institute of Chemical Engineers

Tulane University - New Orleans, Louisiana - Masters in Business Administration (1973); concentration: Finance; awarded scholarship; Organizations - member MBA curriculum committee, Vice-President of student body, academic affairs

Continuing Education - NARUC Regulatory Studies Program at Michigan State University

#### EMPLOYMENT

West Virginia Air Pollution Control Commission (1975)

Position: Engineer ; Responsibility: Overseeing the compliance of all chemical companies in the State with the pollution guidelines set forth in the Clean Air Act.

West Virginia Public Service Commission-Consumer Advocate (1982)

Position: Rate of Return Analyst ; Responsibility: All rate of return research and testimony promulgated by the Consumer Advocate; also, testimony on engineering issues, when necessary.

Hill Associates (1989)

Position: Principal; Responsibility: Expert testimony regarding financial and economic issue in regulated industries.

#### PUBLICATIONS

“The Market Risk Premium and the Proper Interpretation of Historical Data,”  
Proceedings of the Fourth NARUC Biennial Regulatory Information Conference,  
Volume I, pp. 245-255.

“Use of the Discounted Cash Flow Has Not Been Invalidated,” Public Utilities  
Fortnightly, March 31, 1988, pp. 35-38.

“Private Equity Buyouts of Public Utilities: Preparation for Regulators,” National  
Regulatory Research Institute, Paper 07-11, December 2007.

#### MEMBERSHIPS

American Institute of Chemical Engineers; Society of Utility and Regulatory Financial  
Analysts (Certified Rate of Return Analyst, Member of the Board of Directors)

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

<b>In the Matter of a Request by</b>	)	
<b>Baltimore Gas and Electric Company for</b>	)	<b>Case No. 9221</b>
<b>Recovery of Standard Offer Service Related</b>	)	
<b><u>Cash Working Capital Revenue Requirement</u></b>	)	

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

Resource Insight, Inc.

**AUGUST 17, 2010**

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Exhibit JFW-1	Professional Qualifications of Jonathan F. Wallach
Attachment JFW-1	2008 Settlement Agreement
Attachment JFW-2	BGE Response to OPC Data Request 3-3
Attachment JFW-3	BGE Response to OPC Data Request 3-1

1    **I.    Introduction and Summary**

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

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

5    **Q:    Please summarize your professional education and 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 last twenty-nine years, I have advised clients on a wide range of  
12               economic, planning, and policy issues including: electric-utility restructuring;  
13               wholesale-power market design and operations; transmission pricing and policy;  
14               market valuation of generating assets and purchase contracts; power-  
15               procurement strategies; integrated resource planning; cost allocation and rate  
16               design; and energy-efficiency program design and planning.

17               My resume is attached as Exhibit JFW-1.

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

20   A:    I have advised and testified on behalf of the Office of People's Counsel  
21           ("OPC") in most of the major proceedings relating to Maryland's restructuring  
22           process since 1997. During that time, I assisted OPC during settlement  
23           negotiations, and testified in support of the settlement agreement that  
24           established the Administrative Charge, in Case No. 8908. I also testified in Case

1 Nos. 8994 and 8995 regarding derivation of the uncollectible-cost component of  
2 the Administrative Charge for Potomac Electric Power Company and Delmarva  
3 Power and Light Company. Finally, I testified in Case No. 9099 regarding the  
4 Commission's investigation of residential SOS rates, including the  
5 Administrative Charge.

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

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

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

9 A: On March 29, 2010, Baltimore Gas and Electric Company ("BGE"; "the  
10 Company") filed in this proceeding a request to increase the recovery of cash  
11 working capital ("CWC") costs from residential Standard Offer Service ("SOS")  
12 customers. On May 20, 2010, the Commission, ruling on a request by OPC,  
13 issued Order No. 83347 expanding the scope of the investigation to encompass  
14 all elements of the Administrative Charge for residential SOS. In response, the  
15 Company filed on June 25, 2010 the Testimony of William B. Pino regarding  
16 the Company's proposals for the structure and pricing of the Administrative  
17 Charge and the Testimony of Robert G. Castagnera supporting the Company's  
18 request for an increase in SOS-related CWC costs.

19 This testimony responds to the Company's proposals regarding the  
20 Administrative Charge and CWC costs for residential SOS customers. People's  
21 Counsel is also sponsoring testimony in this proceeding by David Effron  
22 regarding the calculation of CWC costs and Steven Hill regarding the return  
23 component of the Administrative Charge and the cost to finance SOS-related  
24 cash working capital.

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

2   A: In Order No. 83347 establishing this proceeding, the Commission found that the  
3       structure and component values of the Administrative Charge for residential  
4       SOS were negotiated as part of a larger settlement package that balanced the  
5       competing interests of settling parties. As a result, the Commission concluded  
6       that approving a change to one component without assessing the reasonableness  
7       of the other components could “adversely alter this balance to the detriment of  
8       the ratepayers and significant benefit to the Company.”<sup>1</sup>

9       In addition, the Commission found in Order No. 83347 that BGE now has  
10      actual cost data for the components of the Administrative Charge. The  
11      Commission therefore concluded that “any changes needed to any of the  
12      components may be determined using this actual data, rather than changing one  
13      component using actual data while maintaining the other components at a fixed  
14      rate....”<sup>2</sup>

15      The Company has made a reasonable attempt to conform to the  
16      Commission’s directives in Order No. 83347 by proposing rates for components  
17      of the residential Administrative Charge that are based on actual costs.  
18      However, the Company’s proposals to maintain the rate for the return  
19      component at 1.5 mills/kWh and to establish a separate component for the  
20      recovery of CWC costs upsets the balance of competing interests achieved in the  
21      Settlement Agreement in Case No. 8908.<sup>3</sup> Moreover, the Company’s proposal to

---

<sup>1</sup> Order No. 83347, Case No. 9221, May 20, 2010, p. 2.

<sup>2</sup> *Id.*, p. 3.

<sup>3</sup> The “Settlement Agreement” refers to the Settlement Agreement, which was filed on November 15, 2002, and adopted pursuant to Order No. 78400, issued April 29, 2003, in Case No. 8908.

1 not refund to consumers the revenues collected through this separate CWC  
2 component appears to run contrary to the provisions of Senate Bill 1, as  
3 modified by a 2008 settlement agreement between the Company, the State of  
4 Maryland, and the Commission (“2008 Settlement Agreement”).<sup>4</sup>

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

- 8 • Adopt the Company’s proposal to replace the fixed rate for the  
9 incremental-cost component with a rate set to recover actual, verifiable,  
10 prudently incurred incremental costs. Establish an annual proceeding to:  
11 (1) review and assess the prudence of the prior year’s spending on  
12 incremental costs; (2) reconcile incremental-cost revenues against actual  
13 costs; and (3) reset the rate for the upcoming year.
- 14 • Limit the return component strictly to recovery of the return on SOS-  
15 related cash working capital. Allow no other costs or other deemed return  
16 to be recovered through the return component.
- 17 • Replace the fixed rate for the return component with a rate set to recover  
18 all SOS-related CWC costs. As part of the annual proceeding for  
19 incremental costs, update the return rate as appropriate to reflect revisions  
20 to estimates of CWC costs due to changes in wholesale SOS supply costs  
21 or approved changes to the Company’s cost of capital.
- 22 • Continue to set the rate for the uncollectible-cost component as part of  
23 distribution rate cases. However, adopt the Company’s proposal in this  
24 proceeding to set the rate at 1.59 mills/kWh, so long as the Company can

---

<sup>4</sup> Chapter 5, Acts 2006 Special Session and Chapter 133, Acts 2008. The 2008 Settlement Agreement is attached hereto as Attachment JFW-1.

1 show that this rate for SOS-related uncollectible costs and its estimate of  
2 distribution-related uncollectible costs in Case No. 9230 were derived in a  
3 consistent fashion.

- 4 • Eliminate the Administrative Adjustment.

5 I further recommend that the rates for each component of the  
6 Administrative Charge for residential SOS customers be set initially as follows:

7

Incremental Cost	0.13 mills/kWh
Uncollectible Cost	1.59 mills/kWh
Return	0.58 mills/kWh
<hr/>	
Administrative Charge	2.30 mills/kWh

8 The incremental-cost and uncollectible-cost rates shown above are as  
9 proposed by BGE in this proceeding. The recommended rate for the return  
10 component is set at the return on cash working capital derived by OPC witness  
11 Effron.

## 12 **II. The Administrative Charge**

13 **Q: Please describe the Settlement Agreement in Case No. 8908.**

14 A: The Settlement Agreement resolved a number of key concerns at that time  
15 associated with the continued provision of a regulated standard-offer service to  
16 residential consumers, by establishing, among other things, the terms and  
17 conditions, the pricing mechanism, and the framework for competitive  
18 procurement of wholesale supply for residential SOS.

19 Specifically, the Settlement Agreement:

- 20 • Established the obligation of each of Maryland's four investor-owned  
21 utilities to provide residential SOS after the end of each utility's current



1 rate-cap or rate-freeze transition period, and defined the period of time  
2 during which the obligation would continue.

- 3 • Established that wholesale supply for residential SOS would be procured  
4 through a competitive procurement process.
- 5 • Established that wholesale supply for residential SOS would consist of a  
6 portfolio of one-, two-, and three-year supply contracts, and specified the  
7 percentages of these one-, two-, and three-year contracts that would  
8 comprise the portfolio.
- 9 • Specified the components of the retail price for residential SOS.
- 10 • Established an “Administrative Charge” as one part of the retail price for  
11 residential SOS, set the rate for the Administrative Charge at 4 mills/kWh,  
12 and specified four individual components of the Administrative Charge:  
13 (1) incremental cost; (2) return; (3) uncollectible cost; and (4)  
14 Administrative Adjustment.
- 15 • Specified the rates for each of the four components of the Administrative  
16 Charge, and established mechanisms for recovering and re-setting such  
17 rates.
- 18 • Provided that residential customers could switch freely between SOS and  
19 competitive retail service without restriction.

20 The Settlement Agreement was intensively negotiated over many months  
21 by a large and diverse group of parties with competing interests. While each  
22 party may not have been satisfied with particular provisions of the Settlement  
23 Agreement, and would not have necessarily agreed to such provisions in  
24 isolation, the negotiated package as a whole apparently provided tangible  
25 benefits and served the interests of settling parties.

1   **Q: Please describe the structure of the Administrative Charge established in**  
2   **the Settlement Agreement for residential SOS.**

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

9           The Settlement Agreement set the rate for the incremental-cost component  
10   at 0.5 mills/kWh, and further specified that this rate would remain fixed over the  
11   term of the agreement. Incremental costs were defined in the Settlement  
12   Agreement to exclude both SOS-related CWC costs, which were deemed to be  
13   collected through the return component, and SOS-related uncollectible costs.

14           The Settlement Agreement set the rate for the return component at 1.5  
15   mills/kWh. As with the incremental-cost component, the return rate was fixed  
16   for the term of the agreement. As noted above, the return component was  
17   defined as the sole means for recovery of SOS-related CWC costs.  
18   Consequently, recovery of SOS-related CWC costs was limited to 1.5  
19   mills/kWh, regardless of the actual magnitude of CWC costs.

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

24           Finally, the Settlement Agreement established the rate for the  
25   Administrative Adjustment as the remainder of the 4 mills/kWh Administrative  
26   Charge after subtracting the rates for the incremental-cost, return, and

1 uncollectible-cost components. Thus, over the term of the Settlement  
2 Agreement, the Administrative Adjustment for BGE was set at 0.9 mills/kWh,  
3 which is equal to 4 mills less 0.5 mills for incremental cost, less 1.5 mills for  
4 return, and less 1.1 mills for SOS-related uncollectible costs.

5 **Q: Please describe the treatment of revenues associated with the**  
6 **Administrative Adjustment.**

7 A: The Settlement Agreement provided that all revenues associated with the  
8 Administrative Adjustment would be returned to residential distribution  
9 customers, regardless of whether they were SOS customers or were served by a  
10 competitive retail supplier.

11 This treatment of Administrative Adjustment revenues – collection from  
12 residential SOS customers, and refund to all residential distribution customers –  
13 gives rise to slight cross-subsidization of switching customers by SOS  
14 customers, since customers that switch to competitive retail supply will not be  
15 charged the Administrative Adjustment, but will be credited a portion of the  
16 revenues.

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

19 A: Pursuant to the provisions of Senate Bill 1, as modified by the 2008 Settlement  
20 Agreement, the Company refunds all revenues collected through the return  
21 component. Moreover, pursuant to the Commission's ruling in Order No. 81423  
22 in Case No. 9099, return revenues are refunded back to all residential ratepayers  
23 regardless of whether they are SOS customers or are served by a competitive  
24 retail supplier. As with the treatment of Administrative Adjustment revenues,  
25 the refund of residential SOS-related return revenues to all residential

1 distribution customers gives rise to cross-subsidization of switching customers  
2 by SOS customers.

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

5 A: The Company proposes to restructure the Administrative Charge by adding a  
6 new component for SOS-related CWC costs. The Company also proposes to  
7 replace the existing fixed rate of 4 mills/kWh for the Administrative Charge  
8 with a rate that varies to reflect actual costs for all components other than the  
9 return component. However, BGE proposes a minimum rate of 4 mills/kWh  
10 regardless of how low actual costs fall.

11 Under the Company's proposal, the rate for the Administrative Adjustment  
12 would be set at zero, so long as the sum of the rates for incremental costs,  
13 return, uncollectible costs, and CWC costs exceeded 4 mills/kWh. However, if  
14 the sum of the rates for incremental costs, return, uncollectible costs, and CWC  
15 costs were to fall below 4 mills/kWh, then the rate for the Administrative  
16 Adjustment would be set at the difference between 4 mills/kWh and that sum.  
17 Thus, the rate for the Administrative Adjustment would be adjusted to ensure  
18 that the rate for the Administrative Charge is never less than 4 mills/kWh.

19 Finally, BGE proposes that the rate for the Administrative Charge be set  
20 initially at 4.5 mills/kWh and that rates for the individual components of the  
21 Administrative Charge be set at the following initial values:<sup>5</sup>

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<sup>5</sup> The Company provides its proposed initial rates in response to OPC DR 3-3. A copy of this response is attached hereto as Attachment JFW-2.

1

Incremental Cost	0.13 mills/kWh
Return	1.50 mills/kWh
Uncollectible Cost	1.59 mills/kWh
CWC Cost	1.28 mills/kWh
Administrative Adjustment	<u>0.00 mills/kWh</u>
	4.50 mills/kWh

2

I discuss below the Company's proposals for each of the components of

3

the Administrative Charge.

4 **III. Incremental Costs**

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

7 A: According to Mr. Pino, the Company proposes to replace the existing fixed rate  
8 of 0.5 mills/kWh with a rate that is set to recover actual, verifiable, and  
9 prudently incurred incremental costs. The Company further proposes an initial  
10 rate for incremental costs of 0.13 mills/kWh.

11 **Q: Is the Company's proposal for the incremental-cost component reasonable?**

12 A: Both the proposal to replace the current fixed rate with a rate set to recover  
13 actual, verifiable, prudently incurred costs and the proposal for an initial rate of  
14 0.13 mills/kWh appear reasonable.

15 **Q: Has the Company proposed a process for reconciling incremental-cost**  
16 **revenues against actual costs?**

17 A: Mr. Pino did not discuss how the Company proposes to reconcile revenues  
18 against actual costs or to reset the incremental-cost rate in the future to reflect  
19 actual costs.

1   **Q: What do you recommend with respect to a reconciliation process for the**  
2   **incremental-cost component of the Administrative Charge?**

3   A: I recommend that the Commission establish an annual proceeding for the  
4   purpose of setting the rate for the incremental-cost component of the  
5   Administrative Charge. These annual proceedings would provide the  
6   Commission the opportunity to:

- 7       • Audit and assess the prudence of the prior year's incremental costs.
- 8       • Determine the reasonableness of the Company's proposed allocation of  
9       incremental costs to SOS service types.
- 10      • Reconcile incremental-cost revenues against actual costs.
- 11      • Reset the rate for the upcoming year in order to recover expected spending  
12      in the next year and outstanding balances from prior years' reconciliations.

#### 13   **IV. Return**

14   **Q: What does the Company propose for the return component of the**  
15   **Administrative Charge?**

16   A: According to Mr. Pino, the Company proposes to continue charging ratepayers a  
17   fixed rate of 1.5 mills/kWh for the return component.

18   **Q: Should the Company be allowed to continue charging a fixed rate of 1.5**  
19   **mills/kWh for the return component of the Administrative Charge?**

20   A: No. According to OPC witness Hill, it is unnecessary and economically  
21   inefficient to provide BGE any additional "return" beyond the return on SOS-  
22   related cash working capital, since any risks associated with utility provision of  
23   standard-offer service are already accounted for in the equity returns allowed in  
24   distribution rate cases. Accordingly, Mr. Hill recommends that the Company's  
25   return be limited strictly to the return on SOS-related cash working capital.

1           Based on Mr. Hill's recommendations, I recommend that the return rate be  
2           set so that the return component recovers only that amount required to provide  
3           the Company with a reasonable return on SOS-related cash working capital.<sup>6</sup>  
4           The Company should not be allowed to recover any other costs or other deemed  
5           return through the return component of the Administrative Charge for residential  
6           SOS.

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

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

## 12   **V. Uncollectible Costs**

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

15   A: The Company proposes to discontinue the process established under the  
16      Settlement Agreement, whereby the rate for SOS-related uncollectible costs is  
17      set as part of a distribution rate case. Instead, BGE proposes that "the  
18      uncollectible cost of residential SOS be recovered on a pass-through basis,  
19      which is subject to the current SOS true-up process."<sup>7</sup>

20           The Company further proposes in this proceeding to increase the rate for  
21      the uncollectible-cost component from its current value of 1.10 mills/kWh to

---

<sup>6</sup> I provide my recommendations regarding the recovery of CWC costs in Section VII, below.

<sup>7</sup> BGE response to OPC DR 3-1. A copy of this response is attached hereto as Attachment JFW-3.

1 1.59 mills/kWh. However, BGE did not request this increase in its filing in Case  
2 No. 9230.<sup>8</sup>

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

5 A: No. It makes sense to continue setting the rate for SOS-related uncollectible  
6 costs in distribution rate cases. This process allows for full evidentiary review of  
7 the Company's methods for unbundling total uncollectible costs into distribution  
8 and SOS-related portions, and provides a record for the Commission to rely on  
9 to ensure that uncollectible costs are unbundled in a consistent manner and that  
10 the distribution and SOS-related portions are appropriately reflected in base  
11 rates and the Administrative Charge, respectively.

12 **Q: Are you suggesting that BGE be denied any change in the rate for the**  
13 **uncollectible-cost component until its next distribution rate filing?**

14 A: No. It would not be equitable to deny BGE recovery of known increases in  
15 uncollectible costs simply because the Commission rejected the Company's  
16 proposal to change the current process for setting the uncollectible-cost rate.  
17 Although I recommend that future changes be made solely as part of distribution  
18 rate cases, it seems reasonable to approve the Company's requested increase in  
19 this proceeding. However, I also recommend that the requested increase be  
20 approved provisionally, contingent on BGE showing through a compliance  
21 filing that its unbundling of SOS-related uncollectible costs in this proceeding is  
22 consistent with the unbundling of distribution-related uncollectible costs in Case  
23 No. 9230.

---

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



1   **VI. Administrative Adjustment**

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

3   A: The Company proposes to continue collection of the Administrative Adjustment  
4       whenever the sum of the rates for incremental costs, return, uncollectible costs,  
5       and CWC costs is less than 4 mills/kWh. The Company also proposes to  
6       continue crediting the amounts collected through the Administrative Adjustment  
7       to all residential distribution customers.

8   **Q: What was the purpose of the Administrative Adjustment in the Settlement**  
9       **Agreement?**

10   A: In comments and testimony in Case No. 8908, certain parties expressed the  
11       belief that, at least at the outset of competition, competitive retail suppliers  
12       would be at a competitive disadvantage to residential SOS in terms of the costs  
13       associated with supplying retail service. Specifically, some parties argued that  
14       utility incremental cost was not fully compensatory of the retailers' cost to  
15       provide retail service, and thus would impede retailer entry during the early  
16       stages of market development. In contrast, other parties argued that consumers  
17       should pay no more than incremental cost for providing a regulated service, and  
18       that charging more than incremental cost as part of the SOS price would distort  
19       price signals and be economically inefficient. The Administrative Adjustment  
20       was designed to balance these competing concerns by: (1) increasing the  
21       apparent price of providing the retail service against which competitive retailers  
22       would compete, and (2) providing for the refund to residential ratepayers of all  
23       revenues associated with the Administrative Adjustment.

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

25   A: No. After a decade of competition in the supply of electricity to consumers, the  
26       retail market is fully developed and mature. At this point, it is neither necessary

1 nor reasonable to charge SOS customers more than the actual cost of residential  
2 SOS – and to require that SOS customers subsidize customers served by retail  
3 suppliers in the process of crediting Administrative Adjustment revenues – in  
4 order to provide an artificial competitive edge to retail suppliers.

5 Accordingly, I recommend elimination of the Administrative Adjustment  
6 from the Administrative Charge for residential SOS.

## 7 **VII. CWC Costs**

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

9 A: The Company pays the bills from wholesale SOS suppliers prior to receiving the  
10 revenues from SOS customers to cover those payments. Cash working capital is  
11 the short-term capital the Company needs to fund payments during the period  
12 that revenue recovery lags bill payments. Cash working capital costs are the  
13 costs to finance that capital during the lag period.

14 **Q: Why is BGE requesting an increase in CWC costs for residential SOS**  
15 **customers?**

16 A: According to Mr. Castagnera, the lag period over which cash working capital  
17 must be financed has increased due to a change in the PJM settlement process  
18 that requires BGE to pay SOS suppliers on a weekly basis, rather than on a  
19 monthly basis under the old settlement process. Since ratepayers continue to be  
20 billed on a monthly basis, the lag between bill payments to SOS suppliers and  
21 revenue receipts from ratepayers has increased with the change in the PJM  
22 settlement process from a monthly to a weekly cycle.

23 Accounting for this increase in the lag period, and applying the Company's  
24 overall cost of capital to estimate the cost to finance cash working capital, BGE  
25 requests recovery of residential CWC costs at a rate of 1.28 mills/kWh.

1   **Q: Is the Company's proposed rate for residential CWC costs reasonable?**

2   A: According to OPC witness Hill, it is more appropriate to use a short-term debt  
3   rate rather than the overall cost of capital to calculate the cost to finance SOS-  
4   related cash working capital. However, in order to balance the interests of  
5   shareholders and ratepayers, Mr. Hill recommends that the short-term debt rate  
6   be applied solely to the incremental change in cash working capital due to the  
7   change in the PJM settlement cycle, and that the overall cost of capital be  
8   applied to the remainder of the cash working capital.

9         Based on Mr. Hill's recommendations to use a short-term debt rate of  
10   3.25% and to apply that rate to the incremental change in cash working capital  
11   due to the change in the PJM settlement cycle, OPC witness Effron calculates a  
12   rate for residential CWC costs of 0.58 mills/kWh.

13   **Q: How does BGE propose to recover CWC costs?**

14   A: According to Mr. Pino, the Company proposes that residential SOS-related  
15   CWC costs no longer be considered to be recovered through the return  
16   component. Instead, BGE proposes to recover this return on cash working  
17   capital through a new, separate component of the residential Administrative  
18   Charge. Thus, the Company proposes to increase the total charge to consumers  
19   for return from 1.5 mills/kWh to 2.78 mills/kWh.

20   **Q: How much of this total charge for return does BGE propose to refund to**  
21   **residential ratepayers?**

22   A: The Company proposes to refund only 1.5 mills of the total 2.78 mills charge for  
23   return.

24

1   **Q: Is the Company's proposal consistent with the provisions of Senate Bill 1**  
2       **and the 2008 Settlement Agreement?**

3   A: I have been advised by People's Counsel that the Company's proposal runs  
4       contrary to the provisions of Senate Bill 1, as modified by the 2008 Settlement  
5       Agreement. These provisions require the Company to refund to consumers all  
6       revenues collected through the return component of the Administrative Charge  
7       through December 31, 2016. That obligation to refund return revenues extended  
8       to the return on cash working capital, since, at the time that Senate Bill 1 was  
9       signed into law and that BGE entered into the 2008 Settlement Agreement, the  
10      return component was defined (pursuant to the Settlement Agreement in Case  
11      No. 8908) to include the full amount of the return on cash working capital, no  
12      matter the magnitude of that return. The Company's proposal in this proceeding  
13      to establish a separate charge for the return on cash working capital and to not  
14      refund the revenues from this separate charge therefore is contrary to the  
15      provisions of Senate Bill 1 and the obligation that BGE accepted as part of the  
16      2008 Settlement Agreement.

17   **Q: What do you recommend with respect to the recovery of residential SOS-**  
18       **related CWC costs?**

19   A: I recommend that the current fixed rate for the return component be replaced  
20       with a rate that is set to recover the return on residential SOS-related cash  
21       working capital. Based on calculations by OPC witness Effron, I also  
22       recommend that the return rate be set initially at 0.58 mills/kWh.

23           Finally, I recommend that, as part of the annual proceeding for incremental  
24       costs, the rate for the return component be updated as appropriate to reflect  
25       revisions to estimates of SOS-related CWC costs due to changes in wholesale  
26       SOS supply costs or approved changes to the Company's cost of capital.

27

1    **Q: Do you recommend that return revenues be reconciled against actual SOS-**  
2    **related CWC costs as part of the update of the return rate?**

3    A: Reconciliation is not appropriate in this instance, since there are no “actual”  
4    CWC costs against which revenues can be reconciled. Instead, as discussed by  
5    OPC witness Hill, cash working capital is a regulatory construct whose costs are  
6    determined by applying a finance rate deemed appropriate by the Commission.  
7    Reconciliation in this case, then, would not be against actual costs to finance  
8    cash working capital, which Mr. Hill indicates would most likely be financed  
9    with short-term debt, but against a cost derived using a pre-determined rate of  
10   return.

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

12   A: Yes.

## Exhibit JFW-1

Qualifications of  
**JONATHAN F. WALLACH**

Resource Insight, Inc.  
5 Water Street  
Arlington, Massachusetts 02476

### SUMMARY OF PROFESSIONAL EXPERIENCE

- 1990–Present* **Vice President, Resource Insight, Inc.** Provides research, technical assistance, and expert testimony on electric- and gas-utility planning, economics, regulation, and restructuring. Designs and assesses resource-planning strategies for regulated and competitive markets, including estimation of market prices and utility-plant stranded investment; negotiates restructuring strategies and implementation plans; assists in procurement of retail power supply.
- 1989–90* **Senior Analyst, Komanoff Energy Associates.** Conducted comprehensive cost-benefit assessments of electric-utility power-supply and demand-side conservation resources, economic and financial analyses of independent power facilities, and analyses of utility-system excess capacity and reliability. Provided expert testimony on statistical analysis of U.S. nuclear plant operating costs and performance. Co-wrote *The Power Analyst*, software developed under contract to the New York Energy Research and Development Authority for screening the economic and financial performance of non-utility power projects.
- 1987–88* **Independent Consultant.** Provided consulting services for Komanoff Energy Associates (New York, New York), Schlissel Engineering Associates (Belmont, Massachusetts), and Energy Systems Research Group (Boston, Massachusetts).
- 1981–86* **Research Associate, Energy Systems Research Group.** Performed analyses of electric utility power supply planning scenarios. Involved in analysis and design of electric and water utility conservation programs. Developed statistical analysis of U.S. nuclear plant operating costs and performance.

### EDUCATION

BA, Political Science with honors and Phi Beta Kappa, University of California, Berkeley, 1980.

Massachusetts Institute of Technology, Cambridge, Massachusetts. Physics and Political Science, 1976–1979.

### PUBLICATIONS

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## EXPERT TESTIMONY

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- 1994 **Vt. PSB** on behalf of the Vermont Department of Public Service. Docket No. 5270-CV-1 and 5270-CV-3. Testimony and rebuttal testimony discusses rate and bill effects from DSM spending and sponsors load shapes for measure- and program-screening analyses.
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**Wisconsin PSB** Docket No. 6630-CE-302, Glacier Hills Wind Park certificate, Citizens Utility Board of Wisconsin. Direct and Surrebuttal, October 2009.

Reasonableness of proposed wind facility.

**PUC of Ohio** Case No 09-906-EL-SSO, standard-service-offer bidding for three Ohio electric companies, Office of the Ohio Consumers' Counsel. Direct, December 2009.

Design of auctions for SSO power supply. Implications of migration of First-Energy from MISO to PJM.

2010     **PUC of Ohio** Case No 10-388-EL-SSO, standard-service offer for three Ohio electric companies, Office of the Ohio Consumers' Counsel. Direct, July 2010.

Design of auctions for SSO power supply.

**ATTACHMENT JFW-1**  
**2008 SETTLEMENT AGREEMENT**

## EXECUTION VERSION

### SETTLEMENT AGREEMENT

This Settlement Agreement (the "*Settlement Agreement*" or the "*2008 Settlement Agreement*") resolves pending litigation and other disputed matters between, on the one hand, Constellation Energy Group, Inc. ("*CEG*"), Baltimore Gas and Electric Company ("*BGE*"), and Calvert Cliffs Nuclear Power Plant, Inc. ("*CCNPP*") (collectively, the "*Company*") and, on the other hand, the State of Maryland, the Public Service Commission of Maryland ("*PSC*"), and the State officials who have been named in their official capacity as Defendants in pending litigation identified below (collectively, the "*State*"). Specifically, this Agreement provides for the settlement and release of all claims by and against all parties in *Baltimore Gas and Electric Company, et al. v. Michael E. Busch, et al.*, Case Number 1:08-CV-00565-AMD, filed in the United States District Court for the District of Maryland (the "*Federal Action*") and in *State of Maryland v. Constellation Energy Group, Inc., et al.*, Case Number 24C08001529, filed in the Circuit Court for Baltimore City, Maryland (the "*State Action*"; jointly, the "*Pending Litigation*") and sets forth certain agreements between the Company and the State on certain other matters. All parties acknowledge and agree that the terms of this Settlement Agreement are subject to the enactment of legislation as contemplated herein, and fulfillment of the other terms and conditions contemplated hereby. Subject to the foregoing, the parties agree to the following:

1. Calvert Cliffs decommissioning

Except as set forth in the Required Legislation (as hereinafter defined), Baltimore Gas and Electric Company ("*BGE*") ratepayers shall no longer bear any financial obligation with regard to the decommissioning of Calvert Cliffs Nuclear Power Plant Units 1 and 2 and related facilities. In accordance with Senate Bill 1, BGE will continue to collect \$18,661,980 annually from all customers through December 31, 2016 and will credit \$18,661,980 annually to all residential ratepayers through December 31, 2016. Other than the foregoing, all responsibility for the appropriate funding and oversight of the funding for the nuclear decommissioning of the Calvert Cliffs facility shall be borne by the Company and determined exclusively in accordance with federal law and the requirements promulgated by the U.S. Nuclear Regulatory Commission.

2. BGE Electric Rate Credit

a. BGE shall credit to its Maryland residential electric customers a total of \$187 million in the form of a one-time bill credit to residential customers - expected to be distributed no later than December 31, 2008, subject to passage of legislation required in Section 6 of this Settlement Agreement.

## EXECUTION VERSION

b. The credit shall be paid in an equal amount per BGE residential electric customer.

### 3. POLR Margin

a. As provided in the CN 8908 Phase I Settlement Agreement, BGE collection of the residential Provider of Last Resort ("POLR") margin shall resume and continue from June 1, 2008 through May 31, 2010, without rebate to residential customers.

b. Effective June 1, 2010 through December 31, 2016, the POLR margin to residential customers shall be suspended.

### 4. Resolution of Ongoing Proceedings

In negotiating this Agreement, the parties have discussed, considered and addressed the Pending Litigation and issues relating to the 1999 Settlement and the relationship among BGE, CEG and other affiliates of CEG. As part of this Settlement Agreement, the PSC shall close the ongoing proceedings and investigations in Case Nos. 9137 and 9099. In addition, the Required Legislation shall, upon enactment, eliminate the Commission's obligation to prepare final reports specific to BGE, CEG and/or any affiliate(s) of CEG or the 1999 Settlement Agreement. The parties also acknowledge that all cases and investigations relating to the terms or performance of the 1999 Settlement by BGE, CEG or their respective affiliates are satisfied and fully released as a result of the 2008 Settlement Agreement.

### 5. Securitization Fees

In the Circuit Court for Baltimore City are currently pending two petitions for judicial review filed by BGE (Case No. 24-C-07-010043/AA) and RSB BondCo LLC (Case No. 24-C-08-000690/AA) challenging the December 14, 2007 Letter Order of the PSC rejecting BGE's request to recover \$4.1 million in legal and financial advisor fees related to the issuance of Rate Stabilization Bonds. BGE, on its own behalf and as Servicer and Administrator for RSB BondCo LLC, and the PSC agree to request remand of the actions for judicial review to the PSC in order for the PSC to modify its prior order so as to allow recovery of the \$4.1 million through an adjustment to the Financing Credit under Commission Order No. 81182. The modification to the Financing Credit will be made at the time of the next semi-annual true-up of the Financing Credit. The \$4.1 million will be recovered over a period of one year.

### 6. Legislation

## EXECUTION VERSION

As a condition precedent to the terms expressed in the other sections of this Settlement Agreement, Sections 6-101 and 6-105 of the Public Utility Companies Article and Senate Bill 1 and Senate Bill 400 shall each be amended and enacted exactly as set forth in Exhibit A (excepting bill format) to this Settlement Agreement (the "*Required Legislation*"). In addition, no legislation shall have been enacted in the 2008 General Assembly session which is inconsistent with the terms and conditions of this Settlement Agreement, including the proposed legislation identified on Exhibit B to this Settlement Agreement. Each of the parties hereto agrees that they shall ask the General Assembly to pass the legislation contained in Exhibit A to this Settlement Agreement.

### 7. Stay of Pending Litigation Followed by Dismissals

The parties to the Pending Litigation shall file consent motions to stay the Pending Litigation until such time as all of the Required Legislation is enacted and all other actions, including but not limited to any necessary PSC actions, are completed in order to fulfill the terms of this Settlement Agreement, or until June 30, 2008, if such legislation and other necessary actions are not enacted and completed by such date.

Upon enactment of the Required Legislation and satisfaction of all conditions precedent in this Settlement Agreement, the parties and their affiliates, successors, assigns, attorneys, representatives, agents, directors, officers, employees and agents shall fully and mutually be released (collectively, the "*Released Parties*") from any and all claims relating to the 1999 Settlement Agreement that have been or could have been brought by or against any Released Party through and up to the date of this Settlement Agreement, including all claims that were or could have been brought in the Pending Litigation.

The parties hereby acknowledge (i) that all pending cases and investigations relating to the terms and implementation of the 1999 Settlement Agreement by BGE, CEG or their respective affiliates are satisfied and fully released as a result of this Settlement Agreement and (ii) that the terms of the 1999 Settlement Agreement and this 2008 Settlement Agreement collectively are final and binding subject only to the provisions of the Required Legislation.

The parties agree that they will seek jointly a stipulated judgment, in the form attached as Exhibit C, in the Federal Action, and will submit a stipulated dismissal with prejudice in the State Action.

Nothing in this paragraph shall be construed to limit the PSC's regulatory authority with regard to the regulation of the Maryland electricity markets,

## EXECUTION VERSION

customer choice, standard offer service, rates, rate design, or codes of conduct.

### 8. BGE Electric Distribution Rate Cases

a. The parties agree that the next BGE electric distribution rate case will occur such that any new rates would not be effective prior to October 1, 2009, and any increase awarded in this filing to the BGE electric distribution revenue made effective on or subsequent to October 1, 2009 would be capped at 5%. However, to the extent that changes to: (1) applicable laws or regulations and/or (2) orders implementing new standards are made that in either case would materially increase distribution costs of service prior to October 1, 2009, BGE may file with the Commission to collect such increased costs of service, and such a filing shall not be considered to violate this settlement. The Commission may permit recovery in the rate case contemplated by this paragraph (a) of an increase in excess of 5% to the extent such increase is in the public interest.

b. BGE agrees that any additional electric distribution rate cases filed subsequent to the one provided for in Section 8(a) of this Settlement Agreement would not be filed prior to August 1, 2010 and such rate cases shall not be subject to Section 8(a).

c. The foregoing will not cover gas rates, electric riders, FERC-approved transmission rates, SOS generation rates or tax increases.

d. The Required Legislation will include legislation authorizing BGE to implement, from June 1, 2008 until new base rates become effective pursuant to the next electric distribution rate case, the depreciation accrual methodology (covering electric and gas) recommended by the PSC Staff in Case No. 9096, as further set forth on Schedule A. This legislation will not affect the outcome of Case No. 9096, which remains pending, nor prejudice BGE's right to seek changes to these accruals, including but not limited to changes to the treatment of third party reimbursements, with such changes, if approved, to become effective in a future base rate case.

### 9. BGE Governance

a. CEG will cause the election of two new directors who meet the standards for independence set forth in the New York Stock Exchange Listing Standards, and who are neither employees nor directors of CEG or any CEG affiliate, to the BGE Board of Directors within six months after execution of the 2008 Settlement Agreement.

## EXECUTION VERSION

b. The BGE Board will hold quarterly in-person meetings.

10. Calvert Cliffs 3 Development

CEG will prioritize the development of a new nuclear plant at Calvert Cliffs over the development of a nuclear facility at any other site it controls, provided that all things are equal, including, but not limited to, regulatory approvals and acceptable financing.

11. Settlement Agreement

The parties agree to take all actions necessary to implement the terms of the 2008 Settlement Agreement and agree not to take any actions that are contrary to the 2008 Settlement Agreement and its implementation.

12. Choice of Law and Choice of Forum

This Settlement Agreement shall be deemed to be executed in the State of Maryland and subject to and construed in accordance with the laws of Maryland, without regard to its rules regarding conflict of law.

13. No Admission of Liability

This Settlement Agreement is the result of compromise and accord and shall not be considered an admission of liability or responsibility by any party.

14. Binding Nature

This Settlement Agreement shall be binding upon the parties, their successors, assigns, and any other persons claiming the right of any of the parties.

15. Amendment

This Settlement Agreement may be amended, supplemented or modified only by a written instrument duly executed by or on behalf of each party.

16. No Waiver

No party's failure to assert any rights or remedies available to it under this Settlement Agreement shall be considered a waiver of such right or remedy or any other right or remedy unless such waiver is contained in a writing signed by the party alleged to have waived its right or remedy.

## EXECUTION VERSION

17. No Third Party Beneficiary

The terms and provisions of this Settlement Agreement are intended solely for the benefit of the parties and their respective affiliates, successors, assigns, representatives, directors, officers, employees, agents and attorneys, and it is not the intention of the parties to confer third-party beneficiary rights, and this Settlement Agreement does not confer any such rights, upon any other person.

18. Construction

The parties agree that this Settlement Agreement is the product of negotiation between sophisticated parties and individuals, all of whom were represented by counsel, and each of whom had an opportunity to participate in and did participate in, the drafting of each provision hereof. Accordingly, ambiguities in this Settlement Agreement, if any, shall not be construed strictly or in favor of or against any party hereto but rather shall be given a fair and reasonable construction and shall not be construed against the drafter. The provisions of this Settlement Agreement are interdependent and not severable.

19. Counterpart Execution

This Settlement Agreement may be executed in two or more parts, and all counterparts shall constitute one and the same instrument.

20. Entire Agreement

This Settlement Agreement constitutes the entire agreement of the parties. There is no other settlement agreement, written or oral, express or implied, between or among the parties except for this Settlement Agreement. No other promises or representations have been made other than as expressed herein, and in executing this Settlement Agreement, the parties have not relied on any promise or representation other than as expressed herein. The terms of this provision are contractual and not a mere recital.

IN WITNESS WHEREOF, on this <sup>th</sup>22 day of March 2008, the undersigned hereby execute this Settlement Agreement.



EXECUTION VERSION

CONSTELLATION ENERGY GROUP, INC.

By: [Signature]  
Name: John P. Collins  
Title: Executive Vice President

BALTIMORE GAS AND ELECTRIC COMPANY

By: [Signature]  
Name: Thomas F. Brady  
Title: Chairman

CALVERT CLIFFS NUCLEAR POWER PLANT, INC.

By: [Signature]  
Name: Charles A. Berendes  
Title: Secretary

MICHAEL BUSCH, SOLELY IN HIS OFFICIAL CAPACITY AS SPEAKER OF THE  
MARYLAND HOUSE OF DELEGATES

\_\_\_\_\_

THOMAS V. MIKE MILLER, JR., SOLELY IN HIS OFFICIAL CAPACITY AS  
PRESIDENT OF THE MARYLAND SENATE

\_\_\_\_\_

MARTIN J. O'MALLEY, SOLELY IN HIS OFFICIAL CAPACITY AS GOVERNOR  
OF THE STATE OF MARYLAND

\_\_\_\_\_

## EXECUTION VERSION

## CONSTELLATION ENERGY GROUP, INC.

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

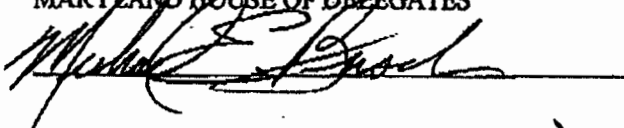
## BALTIMORE GAS AND ELECTRIC COMPANY

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

## CALVERT CLIFFS NUCLEAR POWER PLANT, INC.

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

MICHAEL BUSCH, SOLELY IN HIS OFFICIAL CAPACITY AS SPEAKER OF THE  
MARYLAND HOUSE OF DELEGATES



THOMAS V. MIKE MILLER, JR., SOLELY IN HIS OFFICIAL CAPACITY AS  
PRESIDENT OF THE MARYLAND SENATE



MARTIN J. O'MALLEY, SOLELY IN HIS OFFICIAL CAPACITY AS GOVERNOR  
OF THE STATE OF MARYLAND

\_\_\_\_\_

**EXECUTION VERSION**

**CONSTELLATION ENERGY GROUP, INC.**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**BALTIMORE GAS AND ELECTRIC COMPANY**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**CALVERT CLIFFS NUCLEAR POWER PLANT, INC.**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**MICHAEL BUSCH, SOLELY IN HIS OFFICIAL CAPACITY AS SPEAKER OF THE  
MARYLAND HOUSE OF DELEGATES**

\_\_\_\_\_

**THOMAS V. MIKE MILLER, JR., SOLELY IN HIS OFFICIAL CAPACITY AS  
PRESIDENT OF THE MARYLAND SENATE**

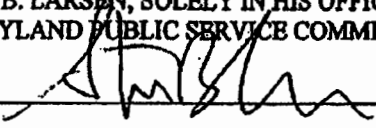
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**MARTIN J. O'MALLEY, SOLELY IN HIS OFFICIAL CAPACITY AS GOVERNOR  
OF THE STATE OF MARYLAND**

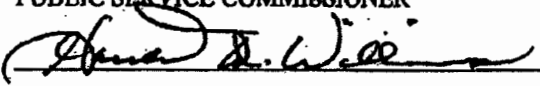
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EXECUTION VERSION

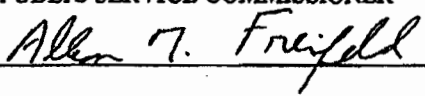
STEPHEN B. LARSEN, SOLELY IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF  
THE MARYLAND PUBLIC SERVICE COMMISSION

  
\_\_\_\_\_

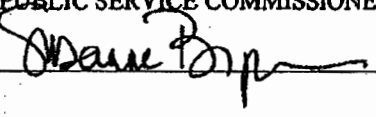
HAROLD D. WILLIAMS, SOLELY IN HIS OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER

  
\_\_\_\_\_

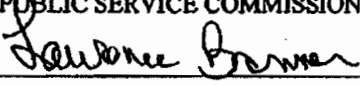
ALLEN M. FREIFELD, SOLELY IN HIS OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER

  
\_\_\_\_\_

SUSANNE BROGAN, SOLELY IN HER OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER

  
\_\_\_\_\_

LAWRENCE BRENNER, SOLELY IN HIS OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER

  
\_\_\_\_\_

THE STATE OF MARYLAND

By: \_\_\_\_\_  
Douglas F. Gansler  
Attorney General of Maryland

**EXECUTION VERSION**

**STEPHEN B. LARSEN, SOLELY IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF  
THE MARYLAND PUBLIC SERVICE COMMISSION**

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**HAROLD D. WILLIAMS, SOLELY IN HIS OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER**

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**ALLEN M. FREIFELD, SOLELY IN HIS OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER**

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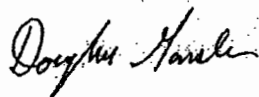
**SUSANNE BROGAN, SOLELY IN HER OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER**

---

**LAWRENCE BRENNER, SOLELY IN HIS OFFICIAL CAPACITY AS MARYLAND  
PUBLIC SERVICE COMMISSIONER**

---

**THE STATE OF MARYLAND**



By: \_\_\_\_\_  
Douglas F. Gansler  
Attorney General of Maryland

**EXHIBIT A  
EXECUTION VERSION**

(to be offered in the  
House Economic Matters and Senate Finance Committees)

**AMENDMENT TO HOUSE BILL NO. 1600 AND SENATE BILL NO. 997**  
**(First Reading File Bill)**

**Amendment No. 1**

Strike pages 1 through 4 in their entirety and replace them with the following:

**A BILL ENTITLED**

**AN ACT concerning**

**Public Service Commission – Nuclear Decommissioning, Electric Industry Restructuring  
and Acquisition and Financing Approvals**

FOR the purpose of clarifying certain provisions relating to the Commission's review of the acquisition of stock of certain public service companies; clarifying certain provisions regarding the manner in which certain persons may acquire gas and electric companies with the approval of the Public Service Commission; clarifying the process the Commission will follow in reviewing certain acquisitions; authorizing the Commission to issue subpoenas for certain purposes; defining certain terms; altering the terms of certain credits and charges by a certain public service company; repealing the requirement that the Public Service Commission conduct certain hearings and provide certain rate mitigations; directing the Commission to review its regulations on ring fencing and the code of conduct for certain public service companies; providing for an effective date; and generally relating to the regulation of public service companies by the Public Service Commission.

BY repealing and reenacting, with amendments,

Article – Public Utility Companies  
Section 3-109, 6-101(c) and 6-105.  
Annotated Code of Maryland  
(1998 Volume and 2007 Supplement)

BY repealing,

Chapter 5 of the Acts of the General Assembly of the Special Session of 2006, as amended by Chapter 549 of the Acts of the General Assembly of 2007

Section 5

BY repealing and reenacting, with amendments,

**EXHIBIT A  
EXECUTION VERSION**

Chapter 549 of the Acts of the General Assembly of 2007

Section 2

BY repealing and reenacting, with amendments,

Chapter 5 of the Acts of the General Assembly of the Special Session of 2006

Section 6

**SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND,**  
That the Laws of Maryland read as follows:

**Article – Public Utility Companies**

**3-109.**

(a) On the request of a party to a proceeding in which a hearing is requested or held, the Commission shall issue subpoenas to compel the attendance and testimony of witnesses and the production of documents at a hearing or deposition to be taken by the party.

(b) On its own motion, the commission may issue a subpoena to compel the attendance and testimony of witnesses and the production of documents at a hearing or deposition to be taken by the Commission.

(c) A subpoena shall be signed and issued by a commissioner or the Executive Secretary of the Commission.

(D) (1) THE COMMISSION IS GRANTED THE FULL AUTHORITY SET FORTH IN 42 UNITED STATES CODE § 16453(A) THROUGH (C), AS IT MAY BE AMENDED, AS IF SET FORTH IN THIS ARTICLE.

(2) NOTHING IN THE GRANT OF AUTHORITY UNDER PARAGRAPH (1) OF THIS SUBSECTION MAY BE CONSTRUED TO PREEMPT OR LIMIT ANY EXISTING AUTHORITY OF THE COMMISSION UNDER THIS ARTICLE.

(3) IN ADDITION TO ANY JURISDICTION GRANTED UNDER FEDERAL LAW TO ENFORCE THE PROVISIONS OF 42 UNITED STATES CODE § 16453, THE CIRCUIT COURTS OF MARYLAND SHALL HAVE JURISDICTION TO ENFORCE COMPLIANCE WITH THIS SUBSECTION.

**6-101.**

EXHIBIT A  
EXECUTION VERSION

(c) (1) This subsection does not apply to the formation of a holding company by a public service company in a corporate reorganization that involves an exchange of stock of the public service company for stock in the holding company.

(2) In this subsection, a company controlling a public service company is deemed a public service company of the same class as the controlled public service company.

(3) Without prior authorization of the Commission, a public service company may not take, hold, or acquire any part of the capital stock of a public service company that:

- (i) operates in Maryland; and
- (ii) is of the same class as the acquiring company.

(4) (i) Except as provided in subparagraph (ii) of this paragraph, a stock corporation may not take, hold, or acquire more than 10% of the total capital stock of a public service company that operates in Maryland unless:

- 1. the stock is acquired as collateral security; and
- 2. the Commission approves the acquisition.

(ii) The Commission may authorize a public service company of the same class to take, hold, or acquire more than 10% of the total capital stock of a public service company that operates in Maryland.

(5) A public service company may not be a party to a violation of this subsection.

(6) NOTWITHSTANDING THE PROVISIONS OF PARAGRAPH (2) OF THIS SUBSECTION, THE PROVISIONS OF SECTION 6-105 OF THIS ARTICLE SHALL APPLY AND THE PROVISIONS OF THIS SUBSECTION (C) SHALL NOT APPLY, TO THE ACQUISITION, OWNERSHIP OR DISPOSITION OF ANY CAPITAL STOCK OR VOTING SECURITIES OF A COMPANY THAT CONTROLS, DIRECTLY OR INDIRECTLY, A PUBLIC SERVICE COMPANY THAT IS A GAS AND ELECTRIC COMPANY.

(7) NOTWITHSTANDING ANY OTHER PROVISION OF THIS SUBSECTION, THE COMMISSION MAY AUTHORIZE, PURSUANT TO SECTION 6-105 OF THIS ARTICLE, THE TAKING, HOLDING OR ACQUIRING OF ALL OR ANY PART OF THE CAPITAL STOCK OF A GAS AND ELECTRIC COMPANY THAT OPERATES IN MARYLAND BY A STOCK CORPORATION OR A PUBLIC UTILITY WHICH IS NOT OF THE SAME CLASS AS THE GAS AND ELECTRIC COMPANY.



EXHIBIT A  
EXECUTION VERSION

- (a) In this section, "affiliate" has the meaning stated in § 7-501 of this article.
- (b) (1) The General Assembly finds that:
- (i) existing legislation requires the approval by the Commission of the acquisition by one public service company of another public service company's stocks and obligations, but does not require the Commission's approval of these acquisitions by persons not engaged in the public utility business in the State; and
- (ii) an attempt by a person not engaged in the public utility business in the State to acquire the power to exercise any substantial influence over the policies and actions of a public service company that provides electricity or gas in the State could result in harm to the customers of the public service company, including the degradation of utility services, higher rates, weakened financial structure, and diminution of utility assets.
- (2) The General Assembly declares that it is the policy of the State to regulate acquisitions by persons that are not engaged in the public utility business in the State of the power to exercise any substantial influence over the policies and actions of a public service company that provides electricity or gas in the State in order to prevent unnecessary and unwarranted harm to the customers of the public service company.
- (c) This section applies to the acquisition of an electric company, GAS AND ELECTRIC COMPANY, or a gas company that operates in Maryland.
- (D) (1) A GAS AND ELECTRIC COMPANY SHALL, CONTEMPORANEOUSLY WITH A FILING BY THE COMPANY OR WITHIN TEN DAYS AFTER A RECEIPT BY THE COMPANY, PROVIDE THE COMMISSION WITH A COPY OF ANY DOCUMENT, FILED OR RECEIVED BY THE COMPANY, THAT IS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, THE FEDERAL ENERGY REGULATORY COMMISSION, THE NUCLEAR REGULATORY COMMISSION, THE DEPARTMENT OF JUSTICE OR THE FEDERAL TRADE COMMISSION, OR ANY SUCCESSOR AGENCIES, REGARDING THE ACQUISITION OF VOTING SECURITIES OF SUCH PUBLIC SERVICE COMPANY OR ANY COMPANY THAT OWNS OR CONTROLS SUCH COMPANY.
- (2) THE COMMISSION SHALL PROVIDE THE COMPANY WITH THE SAME CONFIDENTIALITY AND OTHER PROTECTIONS PROVIDED BY THE FEDERAL AGENCY WHERE THE FILING WAS MADE.
- [(d)] (E) (1) Without prior authorization from the Commission, a person may not acquire, directly or indirectly, the power to exercise any substantial influence over the policies and actions of an electric company, GAS AND ELECTRIC COMPANY, or gas company, if the person would become an affiliate of the electric company, GAS AND ELECTRIC COMPANY, or gas company as a result of the acquisition.
- (2) IN THIS SUBSECTION A PERSON SHALL NOT HAVE ACQUIRED, DIRECTLY OR INDIRECTLY, THE POWER TO EXERCISE ANY SUBSTANTIAL

EXHIBIT A  
EXECUTION VERSION

INFLUENCE OVER THE POLICIES AND ACTIONS OF A GAS AND ELECTRIC COMPANY IF THE PERSON:

(I) AFTER ANY ACQUISITION OF VOTING INTERESTS OF A COMPANY THAT OWNS OR CONTROLS A GAS AND ELECTRIC COMPANY, DIRECTLY OR INDIRECTLY OWNS, CONTROLS OR HAS THE RIGHT TO VOTE, OR DIRECT THE VOTING OF NOT MORE THAN 20% OF THE OUTSTANDING VOTING INTERESTS OF A COMPANY THAT OWNS OR CONTROLS A GAS AND ELECTRIC COMPANY; AND

(II) THE PERSON DOES NOT HAVE THE RIGHT TO DESIGNATE MORE THAN 20% OF THE BOARD OF DIRECTORS OR OTHER GOVERNING BODY OF A COMPANY THAT OWNS OR CONTROLS A GAS AND ELECTRIC COMPANY.

(3) PARAGRAPH (2) OF THIS SUBSECTION MAY NOT BE CONSTRUED TO APPLY TO THE ACQUISITION OF ANY VOTING INTERESTS OF A GAS AND ELECTRIC COMPANY.

(4) IF A PERSON WHICH ACQUIRES VOTING SECURITIES OF A COMPANY THAT OWNS OR CONTROLS A GAS AND ELECTRIC COMPANY AS CONTEMPLATED BY PARAGRAPH (2) OF THIS SUBSECTION THEREAFTER ACTUALLY EXERCISES SUBSTANTIAL INFLUENCE OVER THE POLICIES AND ACTIONS OF A GAS AND ELECTRIC COMPANY, THE COMMISSION MAY ORDER COMPLIANCE WITH AND TAKE SUCH ACTIONS AUTHORIZED BY OTHER PROVISIONS OF THIS ARTICLE WITH RESPECT TO THE GAS AND ELECTRIC COMPANY.

[(e)] (F) An application for authorization under subsection (d) of this section must include detailed information regarding:

- (1) the applicant's identity and financial ability;
- (2) the background of the key personnel associated with the applicant;
- (3) the source and amounts of funds or other consideration to be used in the acquisition;
- (4) the applicant's compliance with federal law in carrying out the acquisition;
- (5) whether the applicant or the key personnel associated with the applicant have violated any State or federal statutes regulating the activities of public service companies;
- (6) all documents relating to the transaction giving rise to the application;
- (7) the applicant's experience in operating public service companies providing electricity;

EXHIBIT A  
EXECUTION VERSION

- (8) the applicant's plan for operating the public service company;
- (9) how the acquisition will serve the customers of the public service company in the public interest, convenience, and necessity; and
- (10) any other information that the Commission may specify by regulation or order.

[(f)] (G) (1) The Commission promptly shall:

(i) examine and investigate each application received under this section; and

(ii) undertake any proceedings necessary or convenient to review the application in accordance with Title 3 of this article and issue an order concerning the acquisition.

(2) The Commission shall consider the following factors in considering an acquisition under this section:

(i) the potential impact of the acquisition on rates and charges paid by customers and on the services and conditions of operation of the public service company;

(ii) the potential impact of the acquisition on continuing investment needs for the maintenance of utility services, plant, and related infrastructure;

(iii) the proposed capital structure that will result from the acquisition, including allocation of earnings from the public service company;

(iv) the potential effects on employment by the public service company;

(v) the projected allocation of any savings that are expected to the public service company between stockholders and rate payers;

(vi) issues of reliability, quality of service, and quality of customer service;

(vii) the potential impact of the acquisition on community investment;

(viii) affiliate and cross-subsidization issues;

(ix) the use or pledge of utility assets for the benefit of an affiliate;

(x) jurisdictional and choice-of-law issues; [and]

**EXHIBIT A  
EXECUTION VERSION**

(XI) WHETHER IT IS NECESSARY TO REVISE THE COMMISSION'S RING FENCING AND CODE OF CONDUCT REGULATIONS IN LIGHT OF THE ACQUISITION; AND

[(xi)] (XII) any other issues the Commission considers relevant to the assessment of acquisition in relation to the public interest, convenience, and necessity.

(3) (i) If the Commission finds that the acquisition is consistent with the public interest, convenience, and necessity, including benefits and no harm to consumers, the Commission shall issue an order granting the application.

(ii) The Commission may condition an order authorizing the acquisition on the applicant's satisfactory performance or adherence to specific requirements.

(4) If the Commission does not find that the acquisition is consistent with the public interest, convenience, and necessity, including benefits and no harm to consumers, the Commission shall issue an order denying the application.

(5) The applicant bears the burden of showing that granting the acquisition is consistent with the public interest, convenience, and necessity, including benefits and no harm to consumers.

(6) THE COMMISSION SHALL ISSUE ITS ORDER WITH RESPECT TO THE APPLICATION NO LATER THAN 180 DAYS AFTER THE FILING OF THE APPLICATION FOR AUTHORIZATION. FAILURE OF THE COMMISSION TO ISSUE AN ORDER WITHIN THE 180 DAY PERIOD SHALL BE DEEMED TO BE AN APPROVAL OF THE ACQUISITION BY THE COMMISSION, UNLESS THE COMMISSION FINDS, BASED ON GOOD CAUSE, THAT THE REVIEW PERIOD SHOULD BE EXTENDED 45 DAYS.

[(g)] (H) Nothing in this section prohibits dissemination by any party of information concerning the acquisition if the dissemination does not otherwise conflict with federal or State law.

**Chapter 5 of the Acts of the General Assembly of the Special Session of 2006,  
as amended by Chapter 549 of the Acts of the General Assembly of 2007**

[SECTION 5. AND BE IT FURTHER ENACTED, That:

The Public Service Commission shall:

(1) conduct hearings, including the use of any necessary outside experts and consultants, to reevaluate the general regulatory structure, agreements, orders, and other prior actions of the Public Service Commission under the Electric Customer Choice and Competition Act of 1999, including the determination of and allowances for stranded costs;

**EXHIBIT A  
EXECUTION VERSION**

(2) provide to residential customers of the Baltimore Gas and Electric Company funds for mitigation of rate increases resulting from any adjustment, in favor of those customers, to allowances for stranded costs for assets that were transferred from Baltimore Gas and Electric Company to an affiliate; and

(3) require that any funds for mitigating rates for residential electric customers under item (2) of this subsection must be in the form of a nonbypassable credit on the customer's bill, and may not be recovered subsequently from those customers in rates or otherwise.]

**Chapter 549 of the Acts of the General Assembly of 2007**

**SECTION 2. AND BE IT FURTHER ENACTED, That:**

(a) (1) Notwithstanding the reporting dates established under [Section 5(b) and] Section 7(c) of Chapter 5 of the Acts of the General Assembly of the First Special Session of 2006 prior to the amendment of those sections by this Act, the Public Service Commission shall initiate new proceedings to review and evaluate the requirements under [Section 5(b) and] Section 7 of Chapter 5 of the Acts of the General Assembly of the First Special Session of 2006, as amended by this Act.

(3) The review and evaluation shall include any orders that were issued by the Commission relating to the requirements of [those sections Section 5 and] Section 7 of Chapter 5 of the Acts of the General Assembly of the Special Session of 2006, prior to the amendment of those sections by this Act and may include review and evaluation of the open record for any case pending before the Commission relating to the requirements of those sections.

**Chapter 5 of the Acts of the General Assembly of the Special Session of 2006**

**SECTION 6. AND BE IT FURTHER ENACTED, That:**

(a) Starting JUNE 1, 2008, [January 1, 2007,] the investor-owned electric company incorporated in Maryland whose parent is involved in a merger on the effective date of this Act shall determine and apply THE FOLLOWING residential electric credits AND SUSPENSIONS [totaling \$38,661,980 each year] for THE SPECIFIED [a] periodS [of 10 years] to the bills of all residential electric customers of the electric company:[]

[(b) the credits shall be in the form of a nonbypassable credit OR SUSPENSION on a customer's bill, derived as follows:]

(1) for [a] THE period JUNE 1, 2010 TO DECEMBER 31, 2016, [of 10 years,] the electric company shall CEASE [suspect the] collectiNG [on of] the residential return

EXHIBIT A  
EXECUTION VERSION

component of the administrative charge collected by the electric company for providing standard offer service under § 7-501(c)(3) of the Public Utility Companies Article, which shall be deemed [a] AN ANNUAL CREDIT value of \$20 million; [and]

(2) for THE [a] period UNTIL DECEMBER 31, 2016, [of 10 years,] a credit of the \$18,661,980 annual nuclear decommissioning charge collected, without otherwise disturbing the agreement approved by the Maryland Public Service Commission in Order No. 75757, to be imputed as IF deposited[s] in the Nuclear Decommissioning Trust Fund and to be credited against residential electric customer bills[.]; AND

(3) A ONE TIME TOTAL CREDIT OF \$187 MILLION TO BE DIVIDED INTO EQUAL DOLLAR AMOUNTS AND CREDITED AGAINST RESIDENTIAL ELECTRIC CUSTOMER BILLS NO LATER THAN DECEMBER 31, 2008.

(B[c]) The ANNUAL nuclear decommissioning charge OF \$18,661,980 described in subsection (A[b])(2) of this section may not be altered during the [10-year] period of the (A)(2) credit, EXCEPT THAT FOR AMOUNTS COLLECTED AFTER JUNE 1, 2008 UNTIL DECEMBER 31, 2016 THE COMMISSION MAY AUTHORIZE A TRUE-UP BASED ON ACTUAL SALES VOLUMES ON A PROSPECTIVE BASIS ONLY AS PART OF AN ELECTRIC DISTRIBUTION BASE RATE CASE TO ENSURE THE ANNUAL COLLECTION OF \$18,661,980.

(C) THE ABOVE [R]residential electric customer credits AND SUSPENSIONS may not be recovered through electric rates.

(D) SO LONG AS THE PROVISIONS OF SUBSECTIONS (A)(1), (A)(2), (B) AND (E) REMAIN IN FULL FORCE AND EFFECT AND ARE IMPLEMENTED BY THE COMMISSION IN ACCORDANCE WITH THEIR TERMS, RATEPAYERS SHALL NOT BEAR ANY FINANCIAL OBLIGATION WITH REGARD TO THE DECOMMISSIONING OF CALVERT CLIFFS NUCLEAR POWER PLANT UNITS 1 AND 2 AND RELATED FACILITIES AND SHALL BE DEEMED TO HAVE PAID \$520 MILLION IN 1993 DOLLARS IN ACCORDANCE WITH THE AGREEMENT APPROVED BY THE MARYLAND PUBLIC SERVICE COMMISSION IN ORDER NO. 75757 AND ALL NUCLEAR DECOMMISSIONING RIGHTS AND OBLIGATIONS IN ACCORDANCE WITH THE AGREEMENT APPROVED BY THE MARYLAND PUBLIC SERVICE COMMISSION IN ORDER NO. 75757 SHALL BE DEEMED FULLY EXTINGUISHED AND SATISFIED.

(E) THE RESIDENTIAL RETURN COMPONENT OF THE ADMINISTRATIVE CHARGE FOR PROVIDING STANDARD OFFER SERVICE UNDER § 7-501(C)(3) OF THE PUBLIC UTILITY COMPANIES ARTICLE SHALL BE IN ACCORDANCE WITH ORDER NO. 78400 FOR THE PERIOD JUNE 1, 2008 TO MAY 31, 2010.

(F) UNTIL NEW BASE RATES BECOME EFFECTIVE PURSUANT TO THE NEXT ELECTRIC DISTRIBUTION RATE CASE FOR AN INVESTOR-OWNED GAS AND ELECTRIC COMPANY INCORPORATED IN MARYLAND, ANY SUCH GAS AND

EXHIBIT A  
EXECUTION VERSION

ELECTRIC COMPANY SHALL IMPLEMENT THE COMMISSION STAFF'S RECOMMENDED DEPRECIATION ACCRUALS SET FORTH ON SCHEDULE A TO THE SETTLEMENT AGREEMENT BY AND AMONG SUCH GAS AND ELECTRIC COMPANY AND THE COMMISSION, AMONG OTHER PARTIES, DATED ON OR ABOUT MARCH 27, 2008.

SECTION 2. AND BE IT FURTHER ENACTED, That the Public Service Commission shall review its regulations regarding ring fencing and code of conduct for electric companies, gas companies and gas and electric companies operating in Maryland.

SECTION 3. AND BE IT FURTHER ENACTED, That, notwithstanding the provisions of Article 1, § 23 of the Annotated Code of Maryland, the provisions of this Act are not severable, and if any provision of this Act or the application thereof to any person or circumstance is held invalid for any reason in a court of competent jurisdiction, no other provision or application of this Act may be given effect.

SECTION 4. AND BE IT FURTHER ENACTED, That this Act shall take effect June 1, 2008.

**Exhibit B**  
**EXECUTION VERSION**

SB 997 (in its form as of the day prior to the date of the 2008 Settlement Agreement)  
HB 1600 (in its form as of day prior to the date of the 2008 Settlement Agreement)



[Caption]

ORDER AND STIPULATED JUDGMENT

This matter is before the Court on the Joint Motion of all plaintiffs and defendants for the entry of a stipulated judgment.

WHEREAS on February 29, 2008, the State of Maryland filed a Complaint for Declaratory Judgment in the Circuit Court for Baltimore City (Case No. 24C08001529), naming as defendants Constellation Energy Group, Inc., Baltimore Gas and Electric Company, and Calvert Cliffs Nuclear Power Plant, Inc.;

WHEREAS on March 3, 2008, plaintiffs Baltimore Gas and Electric Company and Calvert Cliffs Nuclear Power Plant, Inc. filed a Complaint for Declaratory and Injunctive Relief in this action, naming as defendants the Speaker of the Maryland House of Delegates, the President of the Maryland Senate, the Governor of the State of Maryland, the Attorney General of the State of Maryland, and the Chairman and Commissioners of the Maryland Public Service Commission, all in their official capacities (collectively, the "Parties");

WHEREAS the Parties, together with Constellation Energy Group, Inc. (collectively, the "Settling Parties"), have entered into a Settlement Agreement dated March \_\_, 2008, resolving all issues in both actions, as well as other disputes between them (the "2008 Settlement Agreement");

WHEREAS under the 2008 Settlement Agreement, the Settling Parties mutually release one another and their affiliates, successors, assigns, attorneys, representatives, directors, officers, employees, and agents (collectively, the "Released Parties") from any and all claims relating to the settlement agreement as approved in Maryland Public Service Commission Order No. 75757

Exhibit C  
EXECUTION VERSION

(the "1999 Settlement Agreement") that have been or could have been brought by or against any Released Party through and up to the date of the 2008 Settlement Agreement, including all claims that were or could have been brought in the pending litigation referenced hereinabove;

WHEREAS the 2008 Settlement Agreement provides, and the Settling Parties agree, that all pending cases and investigations relating to the terms and implementation of the 1999 Settlement Agreement by Baltimore Gas and Electric Company, Constellation Energy Group, Inc., or their respective affiliates are satisfied and fully released as a result of the 2008 Settlement Agreement;

Now, therefore, upon the joint motion of the Parties and the showing of the Parties in support thereof, the Court Finds and Orders as follows:

1. The terms of the 1999 Settlement Agreement and the 2008 Settlement Agreement collectively are final and binding, subject only to the provisions of the Required Legislation (as such term is defined in the 2008 Settlement Agreement).
2. This Order and Stipulated Judgment constitutes a final, nonappealable judgment of the Court and operates to resolve all the claims that have been, or could have been, brought in this case against the Settling Parties or their affiliates, successors, assigns, attorneys, representatives, directors, officers, employees, and agents.
3. This case is hereby dismissed with prejudice, with each party to bear its own costs and fees.

SO ORDERED:

Date: \_\_\_\_\_

[Signature line for Judge]

**Exhibit Page 2**

**Comparison of Present and Proposed Depreciation Rates Showing Staff "Cost of Removal" Rate Separately from "Plant Only" Rate**

[illegible]

**Notes:**  
 (1) These have been adjusted for the 50% increased treatment of "old party" respondents.







**ATTACHMENT JFW-2**  
**BGE RESPONSE TO**  
**OPC DATA REQUEST NO. 3-3**

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

**Item No.: OPCDR3-3**

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

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

**RESPONSE:**

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

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

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



**ATTACHMENT JFW-3**  
**BGE RESPONSE TO**  
**OPC DATA REQUEST NO. 3-1**

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

**Item No.: OPCDR3-1**

Referencing page 4, lines 12 – 16 of the Testimony of William B. Pino, dated June 25, 2010 (“Mr. Pino’s Testimony”):

- a. Please state whether BGE is proposing that the rate for the uncollectible cost component of the residential Administrative Charge no longer be set as part of a distribution rate case.
  - i. Please begin your answer with either “yes,” “no” or “cannot state yes or no.”
  - ii. If your answer is wholly or partly in the affirmative, please provide a detailed explanation of how BGE proposes that the rate for uncollectible-cost component be established.
  - iii. If your answer is “cannot state yes or no,” please provide a detailed explanation for your answer.
- b. Please state a) the current rate for the uncollectible-cost component of the residential Administrative Charge; b) when the current rate was established; and c) the relevant case establishing the current rate.
- c. Please state whether, in PSC Case No. 9230, BGE is proposing to modify the current rate for the uncollectible-cost component of the residential Administrative Charge.
  - i. Please begin your answer with either “yes,” “no” or “cannot state yes or no.”
  - ii. If your answer is wholly or partly in the affirmative, please provide a detailed explanation of how BGE proposes to modify the current rate and the proposed rate.
  - iii. If your answer is “cannot state yes or no,” please provide a detailed explanation for your answer.

**RESPONSE:**

- a. Yes. BGE is proposing that the uncollectible cost of residential SOS be recovered on a pass-through basis, which is subject to the current SOS true-up process to ensure that no more or no less than actual costs are recovered.
- b. The current rate for the uncollectible cost component of the residential Administrative Charge is \$1.10/MWh. This rate was established in the phase I Settlement Agreement of Case No. 8908 and approved by the Commission on April 29, 2003 in Order No. 78400.

- c. In Case No. 9230, BGE is not proposing to modify the current rate for the uncollectible-cost component of the residential Administrative Charge.

**CASE NO. 9221**

**IN THE MATTER OF**

**BALTIMORE GAS AND ELECTRIC COMPANY**

**REQUEST TO REVISE RECOVERY  
OF STANDARD OFFER SERVICE RELATED  
CASH WORKING CAPITAL REVENUE REQUIREMENT**

**BEFORE THE MARYLAND PUBLIC SERVICE COMMISSION**

**REPLY TESTIMONY OF DAVID J. EFFRON  
ON BEHALF OF THE  
MARYLAND OFFICE OF PEOPLE'S COUNSEL**

**AUGUST 17, 2010**

**CASE NO. 9221**  
**REPLY TESTIMONY OF DAVID J. EFFRON**  
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**EXHIBITS AND ATTACHMENTS**

APPENDIX 1 – RESUME OF DAVID J. EFFRON

SCHEDULE DJE-1 – SOS CWC REVENUE REQUIREMENT

1    **I.        STATEMENT OF QUALIFICATIONS**

2    Q.        Please state your name and business address.

3    A.        My name is David J. Effron. My address is 12 Pond Path, North Hampton, New  
4               Hampshire, 03862.

5

6    Q.        What is your present occupation?

7    A.        I am a consultant specializing in utility regulation.

8

9    Q.        Please summarize your professional experience.

10   A.        I have analyzed numerous electric, telephone, gas and water rate filings in different  
11               jurisdictions. Pursuant to those analyses, I have prepared testimony, assisted attorneys in  
12               rate case preparation, and provided assistance during settlement negotiations with various  
13               utility companies.

14               I have testified in approximately two hundred cases before regulatory commissions  
15               in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky,  
16               Maine, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North  
17               Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, and  
18               Washington.

19               My other professional experience and educational background are summarized in  
20               Appendix 1 accompanying this testimony.

21

1    **II.    PURPOSE OF TESTIMONY**

2    Q.    On whose behalf are you testifying?

3    A.    I am testifying on behalf of the Maryland Office of People’s Counsel (or “OPC”).

4

5    Q.    What is the purpose of your testimony?

6    A.    Baltimore Gas and Electric Company (“BGE” or “the Company”) is requesting recovery

7        of the cash working capital (“CWC”) costs incurred to provide standard offer service

8        (“SOS”) in Maryland as part of the SOS supply costs that are recovered from customers.

9        The purpose of my testimony is to calculate the CWC revenue requirement for residential

10       customers, consistent with the recommendation of Mr. Hill and to convert that CWC

11       revenue requirement into a rate per kWh for residential customers

12

13   **III.   SOS CWC REVENUE REQUIREMENT**

14   Q.    Please explain your calculation of the SOS CWC revenue requirement.

15   A.    My calculation of the SOS CWC revenue requirement is shown on Schedule DJE-1. Mr.

16       Hill recommends that the return on the SOS CWC requirement under the previous monthly

17       power supply payment schedule of PJM Interconnection LLC (“PJM”) (the “base CWC”)

18       should be the overall authorized rate of return, and that the return on the incremental CWC

19       requirement resulting from the acceleration by PJM to a weekly payment schedule (the

20       “incremental CWC”) should be a short-term debt rate of 3.25%. I begin by separating the

21       total CWC requirement into the base CWC and the incremental CWC. I then apply the

1 recommended rates of return to each of the components of the CWC to calculate the total  
2 SOS CWC revenue requirement for residential customers.

3

4 Q. How do you separate the total CWC requirement into the base CWC and the incremental  
5 CWC?

6 A. I begin by calculating the total SOS CWC requirement based on the factors shown on page  
7 8 of the testimony of Robert G. Castagnera. The total SOS CWC for residential customers  
8 is \$123,944,000. I then calculate the incremental CWC requirement resulting from the  
9 acceleration of the power supply payment from monthly in arrears (35.89 days) to weekly  
10 in arrears (12.50 days). This amount is \$90,426,000. The residual amount of \$33,518,000,  
11 or the base CWC, is what the CWC requirement would be if the payment lag for the power  
12 supply had remained at 35.89 days.

13

14 Q. What is the revenue requirement of this SOS CWC requirement?

15 A. Applying a pre-tax authorized rate of return of 12.65% to the base CWC and a short term  
16 debt rate of 3.25% to the incremental CWC, the total residential revenue requirement for  
17 the return on the SOS CWC is \$7,179,000 (Schedule DJE-1).

18

19 Q. What is the resulting rate per residential kWh?

20 A. Based on the 12,301,000 mWh on page 8 of Mr. Castagnera's testimony, the residential  
21 rate is \$0.00058 per kWh (or \$0.58 per mWh).

22



1 Q. Does this conclude your direct testimony?

2 A. Yes.

## APPENDIX 1

### RESUME OF DAVID J. EFFRON

#### UTILITY REGULATION EXPERIENCE

Assistance to offices representing customer interests in Rhode Island, Maryland, Massachusetts, Illinois, and Texas regarding electric utility restructuring matters.

Presentation of testimony on various utility regulation matters involving electric, gas, telephone, and water utilities in the following jurisdictions: Alabama, Arizona, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, Washington, and FERC.

Assistance to attorneys in preparing discovery, cross-examination, post-hearing briefs, and analysis of orders; provision of technical assistance during settlement negotiations.

#### OTHER BUSINESS EXPERIENCE

Supervision of capital project analysis, capital budgets, spending reports, leasing program, and special studies; feasibility studies, accounting systems, statistical surveys; audits of publicly held companies in various industries.

#### EMPLOYMENT HISTORY

<u>Dates</u>	<u>Company</u>
March 1982 - Present	Berkshire Consulting Services (Self employed)
January 1977 - February 1982	Georgetown Consulting Group
April 1975 - January 1977	Gulf & Western Industries
February 1973 - March 1975	Touche Ross & Company

#### EDUCATION

Columbia University, MBA, 1973  
Dartmouth College, BA Economics, 1968

#### HONORS AND AWARDS

Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 Certified Public Accounting Examination in New York State.  
Graduated from Dartmouth College with distinction in the field of Economics.

**ATTACHMENT DJE-1**  
**SCHEDULE DJE-1**  
**SOS CWC REVENUE REQUIREMENT**

BALTIMORE GAS AND ELECTRIC COMPANY  
CASH WORKING CAPITAL - POWER SUPPLY  
(\$000 Except per KWH)

		<u>RES</u>
1	Net Power Supply Expense	RGC, p. 8
2	Expense per Day	1/365
3	Net Lag Days	RGC, p. 8
4	Total Cash Working Capital	2*3
		<u>\$ 123,944</u>
5	Power Supply (Including Transmission)	RGC, p. 8
6	Expense per Day	1/365
7	Lag Days - Present	RGC, p. 8
8	Lag Days - Prior	RGC, p. 8
9	Decrease in Lag Days	8-7
10	Incremental Cash Working Capital	9*6
		<u>\$ 90,426</u>
11	Base Cash Working Capital	4-10
		<u>\$ 33,518</u>
12	Pre-tax Rate of Return	RGC, p. 8
13	Short-Term Debt Rate	Mr. Hill
14	Revenue Requirement - Base	12*11
15	Revenue Requirement - Incremental	13*10
16	Total Revenue Requirement	14+15
17	Other Costs	RGC, p. 8
18	Total CWC Costs to Recover	16+17
		<u>\$ 7,188</u>
19	MWH Sales	RGC, p. 8
20	Rate per KWH	18/19
		<u>\$ 0.00058</u>