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November 15, 2010

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

Re: Case No. 9221

Dear Ms. Romine:

Enclosed please find an original and seventeen (17) copies of the Surrebuttal Testimony of Mr. Steven Hill and Mr. Jonathan Wallach 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,

A handwritten signature in black ink, appearing to read "Anne L. Johnson".

Anne L. Johnson
Assistant People's Counsel

ALJ/eom
Enclosure
cc: All Parties of Record

BEFORE THE
PUBLIC SERVICE COMMISSION
OF MARYLAND

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

SURREBUTTAL TESTIMONY OF STEPHEN G. HILL

ON BEHALF OF THE

MARYLAND OFFICE OF PEOPLE'S COUNSEL

NOVEMBER 15, 2010

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

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I. INTRODUCTION / SUMMARY

Q: PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.

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

Q: ARE YOU THE SAME STEPHEN HILL WHO TESTIFIED PREVIOUSLY IN THIS PROCEEDING ON BEHALF OF THE MARYLAND OFFICE OF PEOPLE'S COUNSEL REGARDING RETURN AND CASH WORKING CAPITAL ISSUES?

A: Yes, I am.

Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?

A: I will respond to issues raised in the Rebuttal Testimony of Baltimore Gas & Electric Company (BGE) witnesses Strunk, Hadlock, Castagnera and Pino, related to the appropriate return and Cash Working Capital (CWC) charges that should be utilized in determining the administrative costs to be included in rates for BGE's Standard Offer Service (SOS). My Surrebuttal focuses primarily on the issues presented in the testimony of Company witness Strunk, but also addresses the testimony of the other BGE witnesses because they share a common logical construct or "story" regarding BGE's provision of SOS service and the return appropriate for that service.

Q: HAS THE COMPANY'S REBUTTAL TESTIMONY CAUSED YOU TO ALTER

1 YOUR ORIGINAL RECOMMENDATION IN ANY WAY?

2 A: No, the Company's Rebuttal Testimony has not caused me to change my
3 recommendation in this proceeding. My Surrebuttal Testimony will show that the
4 Company witnesses' characterization of BGE's SOS service as a risky operation to be
5 considered separate from BGE's distribution operations is not a description of reality, and
6 is constructed merely to attempt to rationalize the Company's attempt to collect an
7 unnecessary profit on SOS service. I am aided in addressing the logical flaws in the
8 Company's position by the Company witnesses' own responses to data requests that
9 show BGE's SOS service to be operationally bundled with BGE's distribution service,
10 more like a traditional utility service. This view of BGE's power procurement and
11 distribution as a bundled service is shared by bond rating agencies as well. The
12 "commercial" risks that the BGE witnesses identify as particular to the provision of SOS
13 service are actually regulatory risks, not risks similar to competitive enterprises. Also,
14 the Company's SOS "story" still has not solved a fundamental logical flaw in its
15 promotion of an unnecessary return, i.e., there is nothing on which to earn a return.
16 There is no asset base in BGE's SOS service. The asset base that the Company witnesses
17 refer to in their testimony is a regulatory construct—Cash Working Capital—a
18 hypothetical asset created by regulation in order to provide utilities a return on their
19 short-term cash outlays incurred as a result of the billing cycle. That hypothetical "asset"
20 already has a return. It does not require another, as the Company would have it.

21 Because SOS service is operationally bundled with BGE's distribution operations,
22 the risks attendant to SOS service are accounted for in the return allowed in BGE's

1 distribution rate case¹, and no additional, explicit return for that SOS service offering is
2 necessary. The only return that is necessary for BGE's SOS service is the return pursuant
3 to Section 7-510 of the Maryland Public Utility Companies Article—the return on Cash
4 Working Capital.

5 While the Company's Rebuttal has not offered any reliable evidence that would
6 cause me to change my recommendations originally offered in this proceeding, certain
7 information has come to light in the Company's response to OPC data requests
8 (individually, a DR, and collectively, the DRs) that requires a conditional consideration.

9
10 Q: WHAT INFORMATION HAS COME TO LIGHT THAT REQUIRES CONDITIONAL
11 CONSIDERATION BY THE COMMISSION?

12 A: As noted by Mr. Pino in his Direct Testimony, the CWC requirement associated with
13 offering SOS service changed this year when PJM Interconnection, L.L.C. (PJM)
14 changed its billing cycle to weekly from monthly. Because of that change in PJM
15 collections, the Company requests that the incremental CWC-related costs created by that
16 change be passed on to customers and recovered as part of the Administrative Charge.
17 That change in PJM billing was the genesis of this entire proceeding.

18 In OPC DR 10-1,² the Company was asked if it voted *in favor* of the change by
19 PJM from monthly to weekly settlements. The Company responded as follows:

¹ As noted in my Direct Testimony, the companies used to estimate the cost of capital in BGE's distribution rate case had substantial purchased power obligations and/or generation assets, which would more than account for BGE's SOS service operational risks. The Company did not respond to that fact in their Rebuttal Testimonies.

² A copy of BGE's response to OPC DR 10 is appended as Attachment SGH-S1.

1 Yes. BGE voted in favor of the change by PJM from
2 monthly to weekly settlements at the Members Committee
3 on January 30, 2009. At that time the financial crisis was
4 near its peak and BGE, along with nearly every other
5 market participant thought it prudent to reduce market
6 participants' exposure to the heightened credit risk faced by
7 PJM members.
8

9 Also, when asked in OPC 10-2 if the Company had assessed the impact of the proposed
10 PJM billing cycle change on BGE's CWC requirements of providing SOS. The answer
11 was "no."³

12 The evidence provided in these two DRs indicates that, without any analysis of
13 the implications or impact on customers, BGE voted to shorten the PJM settlement period
14 and, thereby, increase costs to ratepayers in order to reduce the credit risk exposure of its
15 unregulated affiliates (those that sold power to PJM). This elective risk/cost shifting
16 from BGE's unregulated operations to its regulated ratepayers is the reason we are
17 involved in this proceeding. BGE created its own PJM billing cycle problem and is now
18 asking the Commission to make ratepayers pay for it.

19 Moreover, the Company states that the decision to shorten the PJM billing cycle
20 was made in response to the financial crisis circumstances existing in early 2009. Those
21 circumstances no longer exist and the need (if there ever was one) for shifting risks from
22 suppliers to regulated customers by shortening the settlement period likewise no longer
23 exists.

24 Q: HOW DO THESE REVELATIONS AFFECT YOUR RECOMMENDATION IN THIS
25 PROCEEDING?

³ See Attachment SGH-S1.

1 A: Because the shifting of risks/costs from BGE's unregulated affiliates to the customers of
2 its regulated operations is of its own choosing, an entirely reasonable regulatory response
3 would be to allow the Company no additional CWC return related to PJM's billing cycle
4 change. In that instance, the Commission's response would effectively be, "You created
5 this problem, you fix it." However, OPC takes a more moderate tack and continues to
6 support its original position, i.e., that the change in billing cycle be recognized in the SOS
7 Administrative Charge, but the amount of the additional billing-cycle-related charges be
8 determined by the current prime rate of interest, which is 3.50%, rather than BGE's
9 overall cost of capital. Moreover, because the PJM billing cycle "problem" is one of
10 BGE's own making, it would be not be reasonable for the Commission to utilize the
11 overall cost of capital as a cost rate to apply to the incremental PJM billing cycle-related
12 CWC. Instead, we believe that this new information regarding BGE's participation in the
13 PJM billing cycle change provides additional support for OPC's recommendation of the
14 use of a short-term debt cost for that incremental CWC as the only reasonable alternative.
15

16 **II. THE COMPANY'S VIEW OF BGE SOS SERVICE**

17
18 Q: HOW HAVE THE COMPANY'S WITNESSES DEPICTED BGE'S SOS SERVICE IN
19 THEIR REBUTTAL TESTIMONY?

20 A: In their Rebuttal Testimony BGE's witnesses depict the Company's Standard Offer
21 Service as a high-volume commercial enterprise with a small asset base that has
22 substantial additional risks beyond those of BGE's distribution service. The witnesses
23 testify that those additional risks require an additional return above and beyond that

1 allowed in BGE distribution rate proceedings.⁴ Company witnesses Strunk and Hadlock
2 declare that there is substantial capital “at risk” in BGE’s SOS operation. Also, in order
3 to demonstrate a need for an additional return for SOS service, Company witness Strunk
4 examines the pre-tax profitability of a group of “comparable” competitive retail
5 businesses (e.g., building supply stores, grocery stores), and declares that BGE’s SOS
6 margin should be similar.

7 The Company’s depiction of BGE’s SOS service as a competitive commercial
8 enterprise, operationally separate from BGE’s distribution operations, with significant
9 risks that call for a separate, sales-based return margin simply does not represent reality.
10 In order to rationalize being allowed an additional profit above that already allowed in the
11 distribution rate proceedings, the Company has created a logical construct—BGE SOS—
12 the separate, risky commercial enterprise. However, that logical construct on which BGE
13 bases its conclusions regarding the need for an additional SOS return, exists only in
14 theory and the Company’s conclusions are, therefore, not applicable to the real-world
15 operations of BGE’s SOS service. No additional, volumetric profit is necessary for
16 BGE’s SOS service. The return currently called for in Section 7-510(c) of the Maryland
17 Public Utility Companies Article is the return on Cash Working Capital, and that is all
18 that is necessary for SOS service.

19
20 Q. WHAT ARE THE FLAWS IN THE COMPANY’S DEPICTION OF BGE’S SOS
21 SERVICE?

⁴ Company witness Strunk describes this view of BGE’s SOS service in his testimony and the other BGE Rebuttal witnesses rely on that construct in rationalizing the need for the additional SOS margin they seek in this proceeding.

1 A. There are three primary flaws in the Company's depiction of its SOS service. First, the
2 Company's position assumes that BGE's SOS service has an asset base or a capital
3 investment which is at risk. BGE's SOS service has no capital investment. Second, the
4 Company's position that BGE's SOS service functions as a stand-alone activity and,
5 therefore, can reasonably be compared to actual stand-alone competitive enterprises.
6 BGE's SOS service cannot exist absent BGE's distribution and transmission plant and,
7 therefore, is not a separate business. Third, the "commercial" risks attributed to BGE's
8 SOS service by the Company witnesses are, in actuality, all regulatory risks, i.e., risks
9 faced by a regulated entity, not a competitive entity. Moreover, the "risks" touted by the
10 Company witnesses for BGE's SOS service are theoretical and have not been actually
11 experienced by the Company.

12
13 **A. Asset Base/Capital Investment**
14

15 Q. AT PAGE 3 OF HIS REBUTTAL TESTIMONY, BGE WITNESS STRUNK STATES
16 THAT BGE'S SOS SERVICE HAS AN "ASSET BASE" OF \$150 MILLION. TO
17 WHAT IS HE REFERRING?

18 A. When asked in OPC DR 8-8(a)⁵ to provide a list of all assets that comprise the \$150
19 Million, Mr. Strunk cited Company witness Castagnera's June 25, 2010 testimony in
20 which he sets out the calculation for the cash working capital amounts for Commercial
21 and Industrial (C&I) and Residential customers. The cash working capital amounts, of
22 course, are calculated by multiplying the average daily *dollar expense* incurred by SOS

⁵ A copy of BGE's response to OPC DR 8-8(a) and (b) is appended hereto as Attachment SGH-S2.

1 service by the difference in the revenue lag and expense lag *days*. The result of that
2 multiplication is a dollar-day parameter that is called, for regulatory purposes, a cash
3 working capital “asset.” It is not an asset. It does not appear on the balance sheet. It is a
4 regulatory construct that exists solely to provide the utility a source of cash to
5 compensate for the short-term financing of expenses prior to the receipt of revenues from
6 customers. The manner in which that cash is generated is by multiplying the CWC
7 dollar-day parameter by an appropriate rate of return. In that way, the CWC dollar-day
8 parameter is used for a particular regulatory purpose as an asset, but it is not an asset.

9 When asked in OPC DR 8-8(b)⁶ to list all assets in BGE’s SOS “asset base” of
10 \$150 Million that were tangible, Mr. Strunk responded only by saying that “[c]ash...is
11 tangible.” While that is undoubtedly true, the dollar-day construct that regulators call
12 cash working capital is not cash and is most certainly not a tangible asset. It is merely a
13 means by which regulators are able to provide the Company additional monies to meet
14 their revenue lag financing requirements.

15 There can be no return, in a financial sense, unless there is an investment on
16 which the return can be earned. In BGE’s SOS service, there is no investment base on
17 which any actual return can be earned. It is simply a service. Also, as I noted in my
18 Direct Testimony, as set out in Bluefield, one of the seminal U.S. Supreme Court
19 decisions that have governed the determination of allowed returns for utilities, the
20 “return” to be allowed is proportional to the investment in utility property undertaken. No
21 utility property—no return.

⁶ See Attachment SGH-S2.

1 Q. AT PAGE 4, LINES 3 AND 4 OF HIS REBUTTAL TESTIMONY, MR. STRUNK
2 STATES THAT, FOR BGE'S SOS SERVICE, "THE CAPITAL AT RISK IS FAR
3 GREATER THAN THE REGULATED ASSET BASE." MR. HADLOCK ALSO USES
4 SIMILAR TERMINOLOGY IN HIS REBUTTAL TESTIMONY. ARE THOSE
5 STATEMENTS ACCURATE?

6 A. No. First, as I noted above, the \$150 Million that the BGE witnesses refer to as the SOS
7 service's "asset base" is a dollar-day regulatory construct, not a tangible asset. BGE's
8 SOS service has no asset base. Second, according to OPC DR 8-9(b),⁷ the "capital at
9 risk" referred to by witnesses Strunk and Hadlock, is purchased power costs, not capital.

10 Mr. Strunk compares \$1.8 Billion of BGE's purchased power costs with its \$150
11 Million "asset base" as support for his statement that, for BGE's SOS service, "the capital
12 at risk is far greater than the regulated asset base." Mr. Hadlock's testimony looks at the
13 historical costs of BGE's purchased power as another measure of "capital at risk."

14 However, costs are not capital, and the Company's use of the term "capital at
15 risk" is simply incorrect. In its attempt to paint BGE's SOS service as risky the
16 Company has compared the annual cost of purchased power (which it deems "capital") to
17 a regulatory dollar-day construct (which it deems "asset base"). When asked in OPC DR
18 8-9(c) to provide the source of the "capital at risk", Mr. Strunk replied, "The capital at
19 risk is not linked to a given source of capital."⁸ Here we have a situation in which the
20 "capital at risk" is not capital and the "asset base" does not exist, thus, the Company's
21 comparison of those two parameters is meaningless.

⁷ A copy of BGE's response to OPC DR 8-9(b) and (c) is attached hereto as Attachment SGH-S3.

⁸ See Attachment SGH-S3.

B. Stand-Alone Business

Q. YOU NOTED THAT ONE OF THE FLAWS IN THE COMPANY'S DEPICITON OF BGE'S SOS SERVICE IS THAT OF A STAND-ALONE BUSINESS. CAN YOU EXPLAIN WHY THAT VIEW IS INACCURATE?

A. While it is true that, for regulatory purposes, BGE's SOS service—the procurement of power for BGE's SOS customers—can be considered separately from its distribution services, and the prices for SOS service and distribution service can been bifurcated, that does not mean that BGE's SOS service is actually separate and apart from BGE's distribution operations. BGE's SOS service operates seamlessly with BGE's distribution service as it always has, however, following regulatory restructuring, the accountants now separate out the purchased power function for ratesetting purposes.

The Company's responses to OPC DRs 8-12(a) and (b)⁹ show that the SOS operations are not actually separate stand-alone business:

OPC DR 8-12

(a) Please state whether BGE's SOS service is able to reach the customer through any means other than BGE's distribution system....

Response: No electric supply from BGE's SOS of third party suppliers can reach BGE's customers through any means other than BGE's distribution system.

(b) Please state whether BGE's SOS service operates as a stand alone-entity....

⁹ A copy of BGE's response to OPC DR 8-12(a) and (b) is attached hereto as Attachment SGH-S4.

1 Response: Cannot say yes or no....Financially, BGE's SOS
2 activity is not fully independent from BGE's other
3 businesses. BGS [sic] SOS is not a stand-alone corporate
4 entity. The financial consequences of SOS events such as
5 deferrals therefore affect the credit of the entire enterprise.
6 *Furthermore, it is unlikely that a separate corporate entity*
7 *providing SOS service would be viable without being*
8 *supported by the balance sheet and credit of the electric*
9 *and gas distribution businesses and electric transmission*
10 *business.... [emphasis added]*

11
12 These Company responses to OPC data requests shows that, again, their
13 witnesses' depiction of BGE's SOS service as a separate business operation with its own
14 risks is not a representation of reality. BGE's SOS service cannot even exist without
15 BGE's transmission and distribution plant. The service is clearly a regulated service (not
16 a competitive "business") or we would not be involved in the current proceeding as to the
17 rates to charge for that service. Finally, by the Company's own admission, the measure
18 of the riskiness of BGE's SOS operations can only be gauged through the impact on the
19 credit standing of the entire enterprise (BGE distribution and SOS). Moreover, a separate
20 entity providing SOS service would not be "viable" absent the presence of the "balance
21 sheet and credit" of the distribution operation.

22 The bond rating agencies confirm the fact that BGE's SOS operations are
23 considered to be an integral part of BGE and not a "separate business," as portrayed in

1 the Rebuttal Testimony of the Company's witnesses. In recent reports, both Standard &
2 Poor's and Fitch point to the regulatory adjustment clauses related to purchased power
3 (SOS operations) as risk-lowering aspect for BGE's overall utility operations.

4
5 BGE's 'excellent' business risk profile reflects its
6 operational risk and constructive regulatory mechanisms.
7 As a distributor with no generation, BGE has less operating
8 risk than a fully integrated utility. Additionally, we view
9 the regulatory mechanisms in place, such as revenue
10 decoupling and fuel and purchased power adjustment
11 clauses, to be credit supportive. (Standard & Poor's Ratings
12 Direct, Baltimore Gas & electric Co., November 13, 2009,
13 p. 2; BGE Response to OPC DR 8-21, Attach. 4¹⁰)

14
15 Income and cash flow were reduced in 2008 by a customer
16 refund of \$189 million (after-tax \$111 million) that was
17 part of an electric rate settlement with the MPSC, the State
18 of Maryland, and other parties of a controversial tariff
19 adjustment to settle numerous controversies surrounding an
20 earlier 1999 settlement. Since this settlement, BGE has
21 been able to recover its power purchase expense and
22 capacity costs related to SOS....

23 Under MPSC regulations, BGE has various tracking
24 mechanisms that allow pass-through of costs to consumers.
25 In addition to purchased gas adjustment for gas customers
26 and the purchased power adjustments referred to above, the
27 MPSC also ordered and BGE implemented in 2008 electric
28 revenue decoupling for residential and small commercial
29 customers (to eliminate cash flow variance caused by
30 abnormal weather and usage patterns per customer on
31 electric distribution volumes). (Fitch Ratings, Global
32 Power, U.S. Credit Analysis, Baltimore Gas and Electric
33 Company, August 26, 2009, p. 3; BGE Response to OPC
34 DR 8-21, Attach. 6)

35
36 The Company's depiction of BGE's SOS service as a separate business operation
37 is not a reliable representation of those operations. As shown by the bond rating agency

¹⁰ Copies of p. 2 of Attachment 4 and p. 3 of Attachment 6 to BGE's response to OPC DR 8-21 are attached hereto as Attachment SGH-S5.

1 reports, investors consider the SOS operations to be an integral part of BGE's overall
2 utility operations very similar to traditional utility purchased power operations. BGE's
3 SOS operations are different, of course, in the fact that rates are set separately in
4 Maryland for that service. However, that does not mean that they should be considered
5 to be a separate business with different risks because that operation is fundamentally the
6 same as a traditional purchased power operation. Finally, because BGE's SOS operations
7 are fundamentally similar to traditional purchased power obligations and are considered
8 to be part of BGE's utility operations by the investment community, the risks attendant to
9 that service are fully accounted for in the overall cost of capital included in BGE's
10 distribution rates and no additional volumetric return for SOS rates is necessary or
11 warranted.

12
13 Q. IF BGE'S SOS SERVICE IS NOT A SEPARATE BUSINESS, DOES THE
14 COMPANY'S COMPARISON OF THAT SERVICE TO INDIVIDUAL
15 COMPETITIVE ENTERPRISES PROVIDE A RELIABLE INDICATION OF AN
16 APPROPRIATE RETURN?

17 A. No, it does not. First, as I noted above, because BGE's purchased power operations are
18 operating as they have traditionally (except that the cost of the power and administrative
19 costs are separated for regulatory purposes) the return pertinent to those risks is provided
20 in the return allowed in BGE's distribution utility rate proceedings. Therefore, any
21 comparison of a phantom SOS "business" to other competitive businesses is unnecessary.

1 Second, Mr. Strunk and the other BGE witnesses elect to consider BGE's SOS
2 operations to be a competitive business. However, when asked in OPC DR 8-14¹¹ why
3 the Commission continues to require BGE to supply SOS service, Mr. Strunk replied,
4 "[i]t is required by statute." The Statute (§ 7-510(c)(3)(ii)(2)) indicates that the
5 obligation of BGE to continue to provide SOS is permanent. Section 7-506(e) declares
6 Standard Offer Service to be a distribution service and § 7-509(a)(1)(i) of the Statute
7 indicates SOS is a regulated service. BGE's depiction of its SOS service as an
8 unregulated competitive business is, again, unrealistic.

9 Third, the only measure that Mr. Strunk uses to select competitive companies that
10 are "comparable" in operational risk to BGE's SOS operations is revenues/capitalization.
11 For BGE's SOS operations Mr. Strunk uses the \$1.8 Billion to \$150 Million ratio as the
12 basis for comparison. As noted in my previous discussion, the \$150 Million figure does
13 not represent capital investment or "capitalization" for BGE's SOS operations. In reality,
14 BGE's SOS operations have no capital investment, and \$1.8 Billion divided by zero is an
15 undefined value, for which any comparator would be difficult to locate.

16 Moreover, the actual competitive firms reviewed by Mr. Strunk have a maximum
17 Revenue/Capitalization ratio of 4.71 (Midwest Banks), which is not similar to the actual
18 Revenue/Capitalization ratio of BGE SOS service (even if we assume it is a separate
19 business). Also, the upper quartile of competitive businesses selected by Mr. Strunk
20 (e.g., banks, grocery stores, steel, educational services, cosmetics)¹² do not appear to be
21 similar in investment risk, and he has provided to evidence to show that they are.

¹¹ A copy of BGE's response to OPC DR 8-14 is attached hereto as Attachment SGH-S6.

¹² Strunk Exhibit 3, p. 2.

C. Risks Relevant to SOS Service

Q. AT PAGE 9 OF HIS REBUTTAL TESTIMONY, MR. STRUNK STATES THAT BGE'S PROVISION OF SOS SERVICE FACES A "WIDE VARIETY OF COMMERCIAL RISKS, REGULATORY RISKS AND LEGISLATIVE RISKS." WHAT ARE YOUR COMMENTS?

A. Mr. Strunk provides, at pages 9 through 14 of his Rebuttal Testimony, a recapitulation of the events following deregulation in Maryland, including the implications of the 72% rate increase sought by BGE following the rate moratorium and describes the impact of regulatory and legislative responses to that rate increase. However, what Mr. Strunk is describing is regulatory risk, i.e., whether regulators in their task of balancing the interests of the Company and its ratepayers will allow all costs incurred by the Company to be passed on to ratepayers. That is a risk that is faced by all regulated utility operations and is not unique to BGE or its SOS operations. Most importantly, Mr. Strunk's historical review does not support BGE's position here that SOS service is uniquely affected by regulatory risks. Those very same risks are borne by BGE distribution and are accounted for in the return allowed in utility base rate proceedings. Those risks—and the return appropriate for those risks—cannot again be claimed for the "separate" SOS service, as the Company attempts to do in this proceeding. BGE is already being compensated for those risks and does not need additional compensation.

At pages 14 and 15 of his Rebuttal Testimony, Mr. Strunk discusses what he characterizes as "commercial" risks, again, under his incorrect depiction of BGE SOS

1 service as a “commercial business.” However, those risks he describes as “commercial”
2 are actually regulatory risks, and serve to underscore the actual fact that BGE SOS
3 service is an integral part of the utility operations of BGE.

4 Mr. Strunk cites supplier default, a volume adjustment, and a price anomaly
5 threshold trigger as potential “commercial risks.” While it is true that these potential
6 changes in SOS costs to BGE could be triggered by the actions of commercial power
7 vendors or other factors, the key to any such attendant risk to BGE is regulatory risk—
8 whether or not this Commission will allow any additional costs incurred to be passed on
9 to consumers. Therefore, no matter what happens in the commercial power market the
10 risks to BGE SOS service is a regulatory risk, not a commercial risk. Again, the risks
11 attendant to BGE’s SOS service, contrary to the testimony of BGE witness Strunk, are
12 entirely regulatory risk and are accounted for fully in the return allowed BGE in its
13 distribution utility proceedings, and no additional return is necessary to compensate BGE
14 for providing SOS service to its customers.

15 Finally on this point, when asked in OPC DR 8-24¹³ to provide a detailed
16 description of an example of BGE ever incurring the type of “commercial risks”
17 described by Mr. Strunk, he responded that the Company has never incurred financial
18 losses as a result of the commercial risks cited by Mr. Strunk.

19
20 Q. DO YOU HAVE ANY CONCLUDING REMARKS REGARDING THE COMPANY’S
21 DEPICITON OF ITS SOS SERVICE IN THIS PROCEEDING?

¹³ A copy of BGE’s response to OPC DR 8-24 is attached hereto as Attachment SGH-S7.

1 A. According to an old, mildly-funny economist joke, if you ask an economist who won the
2 Orioles game last night, his response will begin with “Imagine a baseball diamond...”.
3 With that premise (an imaginary playing field), of course, any result can be produced,
4 and the joke is a play on an economist’s ability to rationalize any outcome with selective
5 assumptions. While an imaginary playing field could be helpful in describing the Orioles
6 most recent season, that approach is not helpful in understanding the operations of BGE’s
7 SOS service and the need for a separate additional return to be passed on to ratepayers.
8 Yet, that is the approach followed in this proceeding by the Company.

9 The Company’s depiction of BGE SOS service as a separate commercial business
10 with its own, substantial risks apart from those of BGE’s distribution operations is
11 grounded on several assumptions that are not accurate depictions of reality. As a result,
12 the Company’s conclusion that BGE’s SOS service should be allowed an additional profit
13 above that allowed in its utility rate cases and above that appropriate for Cash Working
14 Capital is not a reliable one. This Commission should not allow the Company to recover
15 a return in the SOS Administrative Charge other than for Cash Working Capital.

17 **III. OTHER ISSUES**

18
19 Q. AT PAGE 5 OF HIS TESTIMONY IN THIS PROCEEDING, MR. HADLOCK
20 STATES THAT IF THE INTERVENORS’ PROPOSALS ARE ADOPTED BGE WILL
21 LOSE MONEY FOR EVERY SINGLE MWH OF POWER IT PROCURES FOR SOS
22 SERVICE. DOES THAT MEAN THAT BGE WILL NOT BE ABLE TO RECOVER
23 ITS PRUDENTLY INCURRED POWER COSTS?

1 A. No. When asked in OPC DR 8-29¹⁴ if his statement on page 5 of his Rebuttal Testimony
2 meant that, if the intervenors' recommendations were adopted, BGE would recover a per
3 MWh cost from customers that is *below* the cost paid to power suppliers, his response
4 was "no." Mr. Hadlock's statement is based on his belief that the "losses" BGE will
5 incur are related to the SOS-related Administrative charges. For example, Mr. Hadlock
6 and the Company believe that an additional profit should be included in the SOS
7 Administrative charges. I have described previously in my testimony why the
8 Company's support for that additional profit is flawed and that sort of charge is
9 unnecessary. While Mr. Hadlock may choose to call that a "loss" it does not represent a
10 receipt of revenue below the Company's actual costs. Rather, it amounts to a receipt of
11 less revenue for SOS-related Administrative Costs than BGE believes it is entitled to.

12
13 Q. MR. HADLOCK STATES THAT SOS REPRESENTS BGE'S SINGLE LARGEST
14 EXPENSE? IS THAT UNUSUAL FOR DISTRIBUTION UTILITIES?

15 A. When asked in OPC DR 8-30¹⁵ whether it was unusual for purchased power expenses to
16 be the "vast majority" of costs for an electric distribution utility operation, Mr. Hadlock
17 (BGE's Chief Financial Officer) was unable to say yes or no. In my experience, power
18 costs are the primary cost for distribution utilities and also can represent a significant
19 portion of the costs for utilities that also generate their own power. Therefore, if Mr.
20 Hadlock was attempting to imply that BGE's SOS operation was, somehow, unusually
21 risky, in furtherance of the Company's request for an additional return, he has not made

¹⁴ A copy of BGE's response to OPC DR 8-29(a) is attached hereto as Attachment SGH-S8.

¹⁵ A copy of BGE's response to OPC DR 8-30 is attached hereto as Attachment SGH-S9.

1 that case by citing the proportion of BGE's operating costs comprised by purchased
2 power costs.

3

4 Q. AT PAGE 2 OF HIS REBUTTAL TESTIMONY COMPANY WITNESS

5 CASTAGNERA STATES THAT OPC PROPOSES THAT BGE NO LONGER BE

6 ALLOWED TO EARN ANY LEVEL OF SOS RETURN. IS THAT CORRECT?

7 A. No. OPC recommends that the Company be allowed to earn a return on Cash Working

8 Capital. Further, the amount of Cash Working Capital attributable to the traditional

9 monthly PJM billing should receive a return equivalent to the overall return awarded in

10 BGE's most recent rate case proceeding. Also the incremental CWC attributable to the

11 change to weekly PJM billings should receive a return equal to the current prime rate of

12 interest.¹⁶

13

14 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY, MR. HILL?

15 A. Yes, it does.

16

¹⁶ As I noted at the outset of my testimony, BGE voted for the change in PJM billing and one reasonable response to that action would be for the Commission to calculate CWC allowance based only on a monthly billing cycle.

Attachment SGH-S1

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to Office of People's Counsel Data Request 10

Item No.: OPCDR10-1

Please state if BGE voted in favor of the change by PJM from monthly to weekly settlements at the Members Committee Meeting held on January 30, 2010.

- a) Please begin your answer with "yes," "no" or "cannot state yes or no."
- b) Please provide the name of BGE's representative(s) present at the referenced Members Committee Meeting.

RESPONSE:

Yes. BGE voted in favor of the change by PJM from monthly to weekly settlements at the Members Committee on January 30, 2009. At that time the financial crisis was near its peak and BGE, along with nearly every other market participant thought it prudent to reduce market participants' exposure to the heightened credit risk faced by PJM members.

Case No. 9221
Baltimore Gas and Electric Company
Response to Office of People's Counsel Data Request 10

Item No.: OPCDR10-2

Please state whether BGE performed any analysis regarding the affect or impact of the proposed change by PJM from monthly to weekly settlements on BGE's CWC requirements of providing SOS.

- a) Please begin your answer with "yes," "no" or "cannot state yes or no."
- b) If your answer is wholly or partially in the affirmative, please provide all copies of all documents and workpapers of such analysis (leaving intact all formulas and cells in any Excel spreadsheets).
- c) If your answer is "cannot state yes or no," please provide a detailed explanation of your answer.

RESPONSE:

No. At that time BGE did not conduct an analysis of the impact on its CWC requirements related to SOS.

Attachment SGH-S2

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-8

Referencing page 3, lines 29 and 30 of the Strunk Rebuttal, with regard to BGE's \$150 million in SOS "assets" and \$1.8 billion in revenues, please respond to the following:

- a. Please provide a detailed list those assets that comprise the \$150 million.
- b. Please provide a detailed list all of those assets that are tangible.
- c. Please provide copies of all workpapers, internal memoranda, reports, or other documentation relied on to derive the \$150 million amount.
- d. Please provide a detailed description of how those assets were financed.
- e. Please provide a copy of BGE's most recent balance sheet and identify those assets thereon.
- f. Please provide copies of all workpapers, internal memoranda, reports or other documentation relied on to derive the \$1.8 billion in revenues.
- g. For the annual revenue of \$1.8 billion, please state the annual after-tax profit currently allowed in the administrative charge. Please provide copies of all workpapers, internal memoranda, reports or other documentation relied on in providing your response to this Data Request 8.g.

RESPONSE:

- a. See direct testimony of Company Witness Castagnera, filed June 25, 2010, pages 8 for C&I (\$27 million) and page 9 for residential (\$124 million) for a grand total of approximately \$150 million).
- b. Cash needed to fund the payment lag between revenue collection and expense payment is tangible.

Attachment SGH-S3

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-9

Referencing page 4, lines 3 and 4 of the Strunk Rebuttal,

- a. Please provide copies of all workpapers, internal memoranda, reports, or other documentation relied on to show that “[f]or SOS, the capital at risk is far greater than the regulated asset base.”
- b. Please provide a detailed explanation of the “capital” to which Mr. Strunk is referring.
- c. Please identify the amount of capital at risk for SOS service, as well as the source of that capital.
- d. Please provide a detailed explanation of what is meant by the term “regulated asset base” for SOS service.
 - i. If “regulated asset base” refers to other than the designated amount of cash working capital, please specifically identify those assets.

RESPONSE:

- a. See Attachment 1, OPC Data Request No. 8, Item No. 8 which supports \$1.8 billion in 2009 purchased power costs- the SOS capital at risk. \$1.8 billion tax-affected is \$1,073,475,000, as shown on page 9 of Company Witness Hadlock’s rebuttal testimony.

The SOS regulated asset base is a reference to the \$150 million CWC asset associated with SOS. For support, see OPC Data Request 8, Item No. 8, sub-part a above.

\$1.8 billion is significantly larger than \$150 million.

- b. The term “capital at risk” as used in the testimony of Company Witnesses Strunk and Hadlock is a reference to the potential losses that BGE faces in the provision of SOS, for which cost recovery is dependent on the decision of the Commission. The maximum potential loss is the cost of purchased power.
- c. On page 9 of Company Witness Hadlock’s rebuttal testimony, Mr. Hadlock presents an estimate of the maximum SOS capital at risk based on the historic cost of purchased power for SOS. On a forward-looking basis, the capital at risk will depend on the cost of serving the SOS load in the PJM market, and could be higher or lower than the historic level. Higher costs to serve imply more capital at risk, while lower costs to serve result in lower levels of capital at risk. The capital at risk is not linked to a given source of capital.

Attachment SGH-S4

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-12

Referencing page 5, line 5 of the Strunk Rebuttal,

- a. Please state whether BGE's SOS service is able to reach the customer through any means other than BGE's distribution system. Please begin your answer with "yes," "no" or "cannot state yes or no." If your answer is wholly or partially in the affirmative, please provide a detailed explanation for your answer.
- b. Please state whether BGE's SOS service is regulated by the Maryland Public Service Commission. Please begin your answer with "yes," "no" or "cannot state yes or no." If your answer is wholly or partially in the negative, please provide a detailed explanation for your answer.
- c. Please state whether BGE's SOS service operates as a separate stand-alone entity. Please begin your answer with "yes," "no" or "cannot state yes or no." If your answer is wholly or partially in the affirmative, please provide a detailed explanation for your answer.

RESPONSE:

- a. No electric supply from BGE's SOS or third party suppliers can reach BGE's customers through any means other than BGE's distribution system.
- b. Yes. BGE's SOS service is regulated by the Maryland Public Service Commission, although the Commission does not price-regulate the SOS supply product as they would distribution service. The prices resulting from the SOS auctions are market-based, whereas the price of distribution service is based on the traditional regulated cost of service model. The supply procurement process, including the RFP, FSA and resulting market-based contract prices are subject to PSC approval.

Attachment SGH-S5

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Baltimore Gas & Electric Co.

Major Rating Factors

Strengths:

- Cumulative enhancements that insulate Baltimore Gas and Electric Co. (BGE) from its parent's unregulated businesses;
- Lower-risk regulated transmission and distribution company; and
- Credit supportive regulatory mechanisms.

Weaknesses:

- Less credit supportive regulatory environment; and
- Weaker parental credit quality.

Corporate Credit Rating

BBB+/Stable/A-2

Rationale

The ratings on Baltimore Gas & Electric (BGE) reflect its stand-alone credit quality, separated from Constellation Energy Group Inc.'s credit profile. The rating also reflects BGE's excellent business risk profile and aggressive financial risk profile. As of Sept. 30, 2009, the Baltimore-based BGE had about \$2.6 billion of total debt outstanding.

The rating on BGE is two notches higher than the rating on parent Constellation. The structural protections including the establishment of a special purpose entity between Constellation and BGE, independent directors, dividend limitations, non-consolidation opinions, and the legal separation of the entities, insulate BGE's credit quality from its weaker parent, and provide us with sufficient basis to differentiate BGE's corporate credit rating from its parent. In most normal circumstances, Standard & Poor's will not rate a wholly-owned subsidiary higher than the parent. The structural protections will allow BGE's corporate credit rating to be no more than three notches higher than Constellation's.

BGE's 'excellent' business risk profile reflects its operational risk and constructive regulatory mechanisms. As a distributor with no generation, BGE has less operating risk than a fully integrated utility. Additionally, we view the regulatory mechanisms in place, such as revenue decoupling and fuel and purchase power adjustment clauses, to be credit supportive. These strengths are partially offset by the regulatory environment in Maryland, which Standard & Poor's assess as in the least credit supportive category (see Standard & Poor's Assessments Of Regulatory Climates For U.S Investor-Owned Utilities, published Nov. 25, 2008, on RatingsDirect). The recent Maryland Public Service Commission's (MPSC) approval of the Constellation-Electricité de France International and Constellation Energy nuclear joint venture subject to BGE's \$110.5 million refund to customers and the 2008 comprehensive settlement agreement that refunded \$187 million to customers are indicative of the political environment that BGE continues to operate under. As the structural protections are implemented, we assume that BGE will be viewed by its regulators as a separate entity from its parent, operating under a more constructive regulatory framework.

The 'aggressive' financial risk profile reflects BGE's stand-alone financial measures. For the 12 months ended September 2009, adjusted debt to total capital was 56.6% compared to the 57.6% at year-end 2008. Cash flow measures recently improved primarily due to increased deferred income taxes. For the 12 months ended Sept. 30,

in the public interest, but no new capacity has been ordered or built since the passage of the law.

Income and cash flow were reduced in 2008 by a customer refund of \$189 million (after-tax \$111 million) that was a part of an electric rate settlement with the MPSC, the State of Maryland, and other parties of a controversial tariff adjustment to settle numerous controversies surrounding an earlier 1999 settlement. Since this settlement, BGE has been able to recover its power purchase expense and capacity costs related to SOS. In 2009, income and cash flow are showing a rebound relative to the 2008 periods affected by the refund.

Under MPSC regulations, BGE has various tracking mechanisms that allow pass-through of costs to consumers. In addition to purchased gas adjustment for gas customers and the purchased power and capacity adjustments referred to above, the MPSC also ordered and BGE implemented in 2008 electric revenue decoupling for residential and small commercial customers (to eliminate cash flow variance caused by abnormal weather and usage patterns per customer on electric distribution volumes.) Therefore, these revenues are affected primarily by customer growth. The MPSC approved revenue decoupling for the majority of the remaining commercial and industrial customers beginning Feb. 1, 2009. Gas revenues were already subject to weather normalization.

Some of BGE's capital expenditures are subject to recovery via a tracking mechanism. Investments in energy efficiency, smart grid, and automated meter initiatives are subject to a tracker with recovery amortized over 12 months for 2009 investments, and after 2009, are recovered over a five-year amortization period. For other types of capital investments, BGE must go through traditional base rate proceedings in order to recover the investment in rates.

As a result of the electric settlement that BGE entered into in March 2008, the utility is bound by the following agreements:

- Any electric distribution base rate case filed by BGE will not result in increased distribution rates prior to October 2009, and any increase in electric distribution revenue awarded will be capped at 5% with certain exceptions.
- Any subsequent electric distribution base rate case may not be filed prior to Aug.1, 2010.
- The agreement does not govern or affect the utility's ability to recover costs associated with gas rates, federally approved transmission rates and charges, electric riders, tax increases, or increases associated with SOS power supply auctions.

While BGE could under the terms of the settlement have filed for a rate increase to be effective in October 2009, BGE has not done so and is likely to delay filing its next rate increase application until after the resolution of the pending review by the MPSC of the CEG/EDF nuclear transaction.

One difficulty in predicting the outcome of future rate cases for BGE is that there is not much precedent for normal rate cases in recent years for BGE. Electric base rates have been affected by lengthy rate freezes and settlements; the most recently approved ROE in an electric distribution rate case was 11.74% in a case decided in 1993. BGE's most recently approved ROE on gas rate base was 11% in 2005. By way of comparison, the ROE finding in Potomac Electric Power's July 2007 Maryland rate case was 10%.

Capital Spending

Capex was roughly \$300 million-\$400 million per annum over the period 2006-2009, with approximately \$450 million planned for 2009. BGE management has increased its

Attachment SGH-S6

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
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Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-14

Referencing page 6, lines 18 through 29 of the Strunk Rebuttal, please state whether the electricity supply market in Maryland is competitive.

- a. Please begin your answer with “yes,” “no” or “cannot state yes or no.”
- b. If your answer is “yes” or “cannot state yes or no,” please provide a detailed explanation for why the Commission continues to require BGE to provide SOS service.

RESPONSE:

- a. Cannot state yes or no. Mr. Strunk has not performed an analysis of whether the electricity supply market in Maryland is competitive. The terms “electricity supply market” and “competitive” are open to many interpretations. Mr. Strunk is aware that all customers have the right to elect to be served by a competitive supplier.
- b. It is required by statute.

Attachment SGH-S7

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-24

Referencing pages 14 and 15 of the Strunk Rebuttal, for each “commercial risk” listed,

- a. Please provide a detailed description of an example of BGE actually incurring such a risk.
- b. Please quantify the actual historical financial impact of such risks.

RESPONSE:

To date, BGE has been fortunate and has not incurred financial losses as a result of the commercial risks cited by Mr. Strunk, which include the risk of supplier default and the risk of having to serve load directly in the PJM market. Other buyers of power in PJM, however, have experienced supplier default and resulting financial losses. For example, PJM itself experienced financial losses from the default of Lehman Brothers in December 2008. Consequently, supplier default should not be perceived as a risk from which BGE is immune. If BGE were to experience additional costs due to supplier default and/or having to serve load directly in the PJM market, the recovery of such costs would then become a regulatory/legislative risk.

Attachment SGH-S8

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-29

Referencing page 5, lines 5 and 6 of the Rebuttal Testimony of Kevin Hadlock ("Hadlock Rebuttal"),

- a. Please state whether it is Mr. Hadlock's testimony that BGE will recover a per KWh cost from customers that is below the per MWh cost paid to suppliers.
 - i. Please begin your answer with "yes," "no" or "cannot state yes or no."
 - ii. If your answer is "yes," please provide copies of all supporting data, documents, reports, and/or workpapers relied on you in support of your answer.
 - iii. If your answer is "no" or "cannot state yes or no," please provide a detailed explanation of your answer.
- b. Please state whether it is Mr. Hadlock's testimony that if OPC's recommendations are adopted BGE will be recovering less per MWh than it now recovers.
 - i. Please begin your answer with "yes," "no" or "cannot state yes or no."
 - ii. Please provide a detailed explanation of your answer.
- c. Please provide all documents, workpapers, reports, and/or data and calculations to show how BGE is "losing money" for every MWh of power it purchases.

RESPONSE:

- a.
 - i. No.
 - ii. Not applicable.
 - iii. The losses at issue in this proceeding are associated with SOS-related costs other than those associated with the actual purchase of electric commodity. Administrative charge revenues are not sufficient to cover related costs.

Attachment SGH-S9

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
For Recovery of Standard Offer Service
Related Cash Working Capital Revenue Requirement

Case No. 9221
Baltimore Gas and Electric Company
Response to OPC Data Request 8

Item No.: OPC DR8-30

Referencing page 6, lines 12 through 18 of the Hadlock Rebuttal, please state whether, in Mr. Hadlock's experience it is unusual for the purchased power expenses of an electric distribution utility to comprise the vast majority of its operating expenses.

- a. Please begin your answer with "yes," "no" or "cannot state yes or no."
- b. Please provide a detailed explanation of your answer.

RESPONSE:

- a. Cannot say yes or no.
- b. BGE has not done an industry-wide analysis on this topic.

STATE OF MARYLAND
BEFORE THE PUBLIC SERVICE COMMISSION

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

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

Resource Insight, Inc.

NOVEMBER 15, 2010

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

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

4 **Q: Are you the same Jonathan F. Wallach that filed reply and rebuttal**
5 **testimony in this proceeding?**

6 A: Yes.

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

8 A: I am testifying on behalf of the Office of People’s Counsel (“OPC”; “People’s
9 Counsel”).

10 **Q: What is the purpose of your surrebuttal testimony?**

11 A: On September 17, 2010, Baltimore Gas and Electric Company (“BGE”; “the
12 Company”) filed rebuttal testimony by Company witnesses Kevin W. Hadlock,
13 William B. Pino, Robert G. Castagnera, and Kurt G. Strunk. This surrebuttal
14 testimony responds to a number of the assertions and proposals by these
15 witnesses. In particular, this surrebuttal testimony disputes the Company’s claim
16 that People’s Counsel’s proposals with regard to the residential Administrative
17 Charge would result in an economic loss to the Company.

18 **Q: Please summarize your conclusions regarding the Company’s claim that**
19 **the OPC proposal for the residential Administrative Charge would result in**
20 **an economic loss to the Company.**

21 A: The Company incorrectly attributes any such losses to People’s Counsel’s
22 proposal. The Company claims that the OPC proposal would deny BGE
23 recovery of revenues associated with the return component of the residential
24 Administrative Charge, including the return on cash working capital (“CWC”).
25 This claim is unfounded. People’s Counsel’s proposal would have no impact on

1 the Company's recovery of return or CWC revenues, since recovery of such
2 revenues is already effectively foreclosed under the terms of a 2008 settlement
3 agreement between the Company, the State of Maryland, and the Commission
4 ("2008 Settlement Agreement").¹ In other words, any economic loss that BGE
5 might suffer would be due not to People's Counsel's proposal for the residential
6 Administrative Charge, but to the Company's decision to enter into the 2008
7 Settlement Agreement.

8 Consequently, I recommend, as I did in my reply testimony, that the
9 Commission reject the Company's proposal to recover CWC costs through a
10 new, separate component of the residential Administrative Charge. Instead, the
11 allowed return on cash working capital should continue to be recovered through
12 the return component and refunded to consumers pursuant to the provisions of
13 Senate Bill 1, as modified by the 2008 Settlement Agreement. Furthermore, as
14 recommended by OPC witness Stephen Hill, the rate for the return component
15 should be set so that the return component recovers only that amount required to
16 provide the Company with a reasonable return on SOS-related cash working
17 capital.

18 **Q: What is the Company's estimate for the economic loss associated with the**
19 **People's Counsel's proposal for the residential Administrative Charge?**

20 A: The amount of the economic loss appears to be a matter of disagreement among
21 the Company's witnesses. According to Mr. Hadlock, the OPC proposal would
22 result in an annual loss to BGE of \$50 million per year. According to Mr. Pino,
23 the annual economic loss would be only \$23 million per year, or less than half
24 of Mr. Hadlock's estimate.

¹ A copy of the 2008 Settlement Agreement was attached to my reply testimony as Attachment JFW-1.

1 There appear to be two sources for the \$27 million difference between Mr.
2 Hadlock's and Mr. Pino's estimates of the economic loss attributable to People's
3 Counsel's proposal for the residential Administrative Charge. First, Mr. Hadlock
4 claims that the OPC proposal would result in a loss of return revenues from non-
5 residential SOS customers of \$8 million.² This claim is without merit, since
6 OPC has not proposed any changes to the Administrative Charge for non-
7 residential SOS customers.

8 Second, unlike Mr. Pino, Mr. Hadlock asserts that the OPC proposal would
9 lead to a \$19 million loss of return revenues from residential SOS customers.³
10 There is also no merit to this claim. As Mr. Pino recognizes, BGE is already
11 foregoing these return revenues pursuant to the terms of the 2008 Settlement
12 Agreement. Contrary to Mr. Hadlock's claim, the \$19 million "loss" of
13 residential return revenues is attributable not to the OPC proposal, but to the
14 Company's decision to enter into the 2008 Settlement Agreement.

15 **Q: What is the basis for Mr. Pino's claim that the OPC proposal will result in**
16 **a \$23 million annual loss to BGE?**

17 A: Mr. Pino estimates that OPC's proposal with regard to the uncollectible-cost
18 component of the residential Administrative Charge would result in an annual
19 loss to BGE of about \$7 million. In addition, Mr. Pino asserts that BGE would
20 suffer an annual loss of about \$16 million as a result of People's Counsel's
21 proposal to continue recovering CWC costs through the return component of the
22 residential Administrative Charge.

² *Rebuttal Testimony of Kevin W. Hadlock on Behalf of Baltimore Gas and Electric Company*, Case No. 9221, September 17, 2010, p. 12.

³ *Id.*

1 **Q: Is Mr. Pino’s estimate of a \$7 million annual loss under the OPC proposal**
2 **for uncollectible costs valid?**

3 A: No. Mr. Pino’s estimate appears to be based on a misunderstanding of People’s
4 Counsel’s recommendation for the uncollectible-cost component. In fact, there
5 would not be any economic loss to BGE from People’s Counsel’s proposal,
6 since OPC recommends that the Commission adopt the Company’s proposed
7 rate for the uncollectible-cost component.

8 In my reply testimony, I recommended that the rate for SOS-related
9 uncollectible costs continue to be set in distribution rate cases. However, I also
10 stated that it would be unfair to deny the Company full recovery of uncollectible
11 costs in this proceeding simply because BGE had not proposed an increase to
12 the rate for SOS-related uncollectible costs in the current distribution rate case. I
13 therefore recommended that the Commission adopt the Company’s proposed
14 rate of 1.59 mills/kWh, and that any future changes be made through
15 distribution rate cases.

16 Given that I recommended adoption of the Company’s proposed rate, there
17 should not be any economic loss attributable to People’s Counsel’s proposal for
18 the uncollectible-cost component. However, when Mr. Pino estimated the
19 economic loss associated with the OPC proposal for uncollectible costs, he
20 mistakenly assumed that OPC was recommending a rate of 1.03 mills/kWh, not
21 the 1.59 mills/kWh rate actually recommended by People’s Counsel. This
22 incorrect assumption appears to be based on a misunderstanding of People’s
23 Counsel’s proposal, as indicated by the Company’s response to OPC DR 9-3:

1 It is BGE's understanding that OPC's position is that the residential
2 uncollectible rate will be determined as part of distribution rate cases, and
3 the \$1.59/MWh estimated by BGE in Mr. Pino's Rebuttal Testimony
4 **would be changed to whatever the test year level of residential SOS**
5 **uncollectibles was in the current distribution rate case (CN 9230).** At
6 the time of submitting Mr. Pino's Rebuttal testimony, the level of
7 residential SOS uncollectibles in CN 9230 translates into \$1.03/MWh using
8 sales volumes from the 12 months ended May 2010.⁴

9 The Company apparently believes that People's Counsel is recommending
10 a rate based on results from the current distribution rate case, when in fact the
11 OPC proposal is to adopt the 1.59 mills/kWh rate proposed by BGE and to make
12 changes as warranted in future distribution rate cases.

13 **Q: Would the OPC proposal to continue recovering CWC costs through the**
14 **return component result in an economic loss to the Company?**

15 A: To the contrary, the Company's proposal to recover CWC costs through a new,
16 separate component of the residential Administrative Charge would provide
17 BGE with a windfall gain of \$16 million per year.

18 As I explained in my reply testimony, the provisions of Senate Bill 1, as
19 modified by the 2008 Settlement Agreement, require the Company to refund to
20 consumers all revenues collected through the return component, including
21 revenues associated with the return on cash working capital, until December 31,
22 2016. Contrary to those provisions, the Company proposes in this proceeding to
23 retain all CWC revenues collected through its proposed new component of the
24 residential Administrative Charge. Consequently, the Company's proposal to
25 establish a separate charge for the return on cash working capital, and to not
26 refund the revenues from this separate charge pursuant to the provisions of

⁴ Emphasis added. A copy of this response is attached hereto as Attachment JFW-S1.

1 Senate Bill 1 and the 2008 Settlement Agreement, would provide a windfall
2 gain to BGE of about \$16 million per year.

3 The Company should not be allowed to circumvent the terms of the 2008
4 Settlement Agreement by creating a separate component for the recovery of
5 CWC costs. Instead, the allowed return on cash working capital should continue
6 to be recovered through the return component and refunded to consumers
7 pursuant to the provisions of Senate Bill 1, as modified by the 2008 Settlement
8 Agreement.

9 **Q: Do you have any other comments regarding the Company's rebuttal filing?**

10 A: Yes. According to Mr. Pino, the Company supports "moving in the direction of
11 the allocated cost approach" recommended by Staff witness Matthew Schultz,
12 because:

13 It may be that the Administrative Charges are insufficient representations
14 of retailers' costs for certain customer segments, such as the residential
15 segment, and correcting for such deficiencies would allow for more robust
16 competition.⁵

17 Adequate representation of retailers' costs is not a valid basis for adopting
18 Staff's proposal for the Allocated Cost component of the residential
19 Administrative Charge. By statute, the Administrative Charge should be set to
20 recover solely the utility's "verifiable, prudently incurred costs to procure or
21 produce the electricity plus a reasonable return." Therefore, the reasonableness
22 of Staff's proposal should be judged solely on the basis as to whether the
23 resulting Administrative Charge collects no more than the utility's actual,
24 verifiable, and prudently incurred costs. In contrast, artificially increasing the
25 rate for the Administrative Charge beyond that required to recover actual,

⁵ *Rebuttal Testimony of William B. Pino on Behalf of Baltimore Gas and Electric Company*, Case No. 9221, September 17, 2010, p. 19.

1 verifiable, and prudently incurred costs in order to more closely reflect retailers'
2 costs would be contrary to statute.

3 **Q: Does this conclude your surrebuttal testimony?**

4 A: Yes.

Attachment JFW-S1

PSC 9221- In the Matter of a Request by
Baltimore Gas and Electric Company
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Case No. 9221
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Response to Office of People's Counsel Data Request 9

Item No.: OPCDR9-3

Referencing the table on page 6 of the Rebuttal Testimony of Mr. Pino ("Pino Rebuttal") which indicates that OPC proposes a rate of 1.03 mills/kWh for the uncollectible component of the residential Administrative Charge, please provide a detailed explanation reconciling this rate with Mr. Wallach's recommendation of a rate of 1.59 mills/kWh for the uncollectible-cost component, as indicated on page 5, lines 5 through 7 of Mr. Wallach's Reply Testimony.

RESPONSE:

It is BGE's understanding that OPC's position is that the residential uncollectible rate will be determined as part of distribution rate cases, and the \$1.59/MWh estimated by BGE in Mr. Pino's Rebuttal Testimony would be changed to whatever the test year level of residential SOS uncollectibles was in the current distribution rate case (CN 9230). At the time of submitting Mr. Pino's Rebuttal testimony, the level of residential SOS uncollectibles in CN 9230 translates into \$1.03/MWh using sales volumes from the 12 months ended May 2010.