

STATE OF MARYLAND
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Review of the)
Delmarva Power and Light Company) **Case No. 9226**
Standard Offer Service Administrative Charge)

In the Matter of the Review of the)
Potomac Electric Power Company) **Case No. 9232**
Standard Offer Service Administrative Charge)

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

Resource Insight, Inc.

APRIL 1, 2014

TABLE OF CONTENTS

I. Introduction and Summary..... 1

II. The Administrative Charge 5

III. Incremental Costs 10

IV. Uncollectible Costs 11

V. Return 12

VI. Cash Working Capital 15

VII. Administrative Adjustment 17

Exhibit JFW-1 Professional Qualifications of Jonathan F. Wallach

Attachment JFW-1 Responses to OPC Data Requests

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 past thirty years, I have advised and testified on behalf of clients
12 on a wide range of economic, planning, and policy issues relating to the
13 regulation of electric utilities, including: electric-utility restructuring; wholesale-
14 power market design and operations; transmission pricing and policy; market-
15 price forecasting; market valuation of generating assets and purchase contracts;
16 power-procurement strategies; risk assessment and mitigation; integrated
17 resource planning; mergers and acquisitions; cost allocation and rate design; and
18 energy-efficiency program design and planning.

19 My resume is attached as Exhibit JFW-1.

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

22 A: I have advised and testified on behalf of the Office of People's Counsel
23 ("OPC") in most of the major proceedings relating to Maryland's restructuring
24 process since 1997. During that time, I assisted OPC during settlement

1 negotiations, and testified in support of the settlement agreement that
2 established the Administrative Charge, in Case No. 8908 (“2003 Settlement”).¹ I
3 also testified in Case Nos. 8994 and 8995 regarding derivation of the
4 uncollectible-cost component of the Administrative Charge for Potomac Electric
5 Power Company (“PEPCO”) and Delmarva Power and Light Company
6 (“Delmarva”). In addition, I testified in Case No. 9099 regarding the
7 Commission’s investigation of residential Standard Offer Service (“SOS”) rates,
8 including the Administrative Charge. Finally, in 2010, I testified in the instant
9 proceedings and in Case No. 9221 regarding proposals by PEPCO, Delmarva,
10 and Baltimore Gas and Electric for modifying the Administrative Charge.

11 **Q: Have you testified previously in utility regulatory proceedings?**

12 A: Yes. I have sponsored expert testimony in more than sixty state, provincial, or
13 federal proceedings in the U.S. and Canada. Exhibit JFW-1 includes a detailed
14 list of my previous testimony.

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

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

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

18 A: On August 21, 2013, the Commission issued Order No. 85797 reversing a
19 proposed order by the Hearing Examiner in the instant proceedings and
20 remanding the matter of the Administrative Charge for PEPCO and Delmarva
21 (collectively, “the Companies”) to the Public Utility Law Judge. On February 4,
22 2014, the Companies filed the Joint Motion for Approval and Agreement of
23 Stipulation and Settlement (“2014 Stipulation”) by the Companies, the Staff of

¹ The 2003 Settlement was filed on November 15, 2002, and adopted pursuant to Order No. 78400, issued April 29, 2003, in Case No. 8908.

1 the Public Service Commission, and the Retail Energy Supply Association
2 (collectively, “Settling Parties”). Subsequently, on February 18, 2014, the
3 Companies filed testimony by Susan A. DeVito and the Retail Energy Supply
4 Association (“RESA”) filed testimony by Richard J. Hudson, Jr., both in support
5 of the 2014 Stipulation.

6 This testimony addresses the various provisions of the 2014 Stipulation
7 regarding the Administrative Charge and cash working capital (“CWC”) for
8 residential SOS customers. In addition, this testimony responds to the testimony
9 of Companies witness DeVito and RESA witness Hudson. People’s Counsel is
10 also sponsoring testimony in this proceeding by David Effron regarding the
11 calculation of CWC return and by Steven Hill regarding the return component of
12 the Administrative Charge and the cost to finance SOS-related cash working
13 capital.

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

15 A: The 2014 Stipulation is contrary to the public interest, as it provides for a
16 number of changes to the Administrative Charge that are unreasonable and
17 economically harmful to residential ratepayers. As discussed in detail by OPC
18 witness Hill, the return component of the Administrative Charge, which is
19 maintained under the 2014 Stipulation, is economically inefficient and would
20 provide the opportunity for earnings in excess of the Companies’ authorized
21 rates of return. Mr. Hill also finds that the 2014 Stipulation provides for a return
22 on cash working capital that substantially exceeds the Companies’ cost to
23 finance CWC requirements. Finally, as discussed below, the Administrative
24 Adjustment, as continued under the 2014 Stipulation, bears no relation to actual
25 SOS-related costs and serves no purpose other than to arbitrarily and

1 unreasonably increase the price paid by residential customers for Standard Offer
2 Service.

3 Accordingly, the Commission should reject the Settling Parties' request for
4 approval of the 2014 Stipulation. Instead, I recommend the following changes to
5 the current Administrative Charge for residential SOS:

- 6 • As provided under the 2014 Stipulation, replace the fixed rate for the
7 incremental-cost component with a rate set to recover actual, verifiable,
8 prudently incurred incremental costs. Establish an annual proceeding to:
9 (1) review and assess the prudence of the prior year's spending on
10 incremental costs; (2) reconcile incremental-cost revenues against actual
11 costs; and (3) reset the rate for the upcoming year.
- 12 • Limit the return component to recovery of the return on SOS-related cash
13 working capital. Allow no other costs or other deemed return to be
14 recovered through the return component.
- 15 • Replace the fixed rate for the return component with a rate set to recover
16 the return on SOS-related cash working capital. As part of the annual
17 proceeding for incremental costs, update the return rate as appropriate to
18 reflect changes in wholesale SOS supply costs, revised estimates of net lag
19 days, or approved changes to the assumed finance rate.
- 20 • As provided under the 2014 Stipulation, continue to set the rate for the
21 uncollectible-cost component as part of distribution rate cases.
- 22 • Eliminate the Administrative Adjustment.

23 I further recommend that the rates for each component of the
24 Administrative Charge for residential SOS customers be set initially as shown in
25 Table 1.
26

1

Table 1. Recommended Initial Administrative Charge

	Delmarva	PEPCO
Incremental Cost	0.20 mills/kWh	0.20 mills/kWh
Uncollectible Cost	1.38 mills/kWh	1.59 mills/kWh
CWC Return	0.29 mills/kWh	0.26 mills/kWh
Administrative Charge	1.87 mills/kWh	2.05 mills/kWh

2

The incremental-cost rate shown above is set at the “baseline” rate established in the 2014 Stipulation. The uncollectible-cost rate is the rate derived by the Companies based on the Commission’s determination of SOS-related uncollectible costs in the most recent base distribution rate cases. Finally, the recommended initial rate for CWC return is derived by OPC witness Effron.

3

4

5

6

7

8 **II. The Administrative Charge**

9 **Q: Please describe the 2003 Settlement in Case No. 8908.**

10 A: The 2003 Settlement resolved a number of key concerns at that time associated
 11 with the continued provision of a regulated standard offer service to residential
 12 consumers, by establishing, among other things, the terms and conditions, the
 13 pricing mechanism, and the framework for competitive procurement of
 14 wholesale supply for residential SOS.

15 Specifically, the 2003 Settlement:

- 16 • Established the obligation of each of Maryland’s four investor-owned
 17 utilities to provide residential SOS after the end of each utility’s current
 18 rate-cap or rate-freeze transition period, and defined the period of time
 19 during which the obligation would continue.
- 20 • Established that wholesale supply for residential SOS would be procured
 21 through a competitive procurement process.

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

16 The 2003 Settlement was intensively negotiated over many months by a
17 large and diverse group of parties with competing interests. While each party
18 may not have been satisfied with particular provisions of the 2003 Settlement,
19 and would not have necessarily agreed to such provisions in isolation, the
20 negotiated package as a whole apparently provided tangible benefits and served
21 the interests of settling parties.

22 **Q: Please describe the structure of the Administrative Charge established in**
23 **the 2003 Settlement for residential SOS.**

24 A: As noted above, the 2003 Settlement established an Administrative Charge as
25 part of the retail price for residential SOS, and specified a rate of 4 mills/kWh
26 for the Administrative Charge. The 2003 Settlement further specified that there

1 would be four components to the Administrative Charge: (1) incremental cost;
2 (2) return; (3) uncollectible cost; and (4) Administrative Adjustment.

3 The 2003 Settlement set the rate for the incremental-cost component at 0.5
4 mills/kWh, and further specified that this rate would remain fixed over the term
5 of the agreement. Incremental costs were defined in the 2003 Settlement to
6 exclude both the return on SOS-related cash working capital, which were
7 deemed to be collected through the return component, and SOS-related
8 uncollectible costs.

9 The 2003 Settlement set the rate for the return component at 1.5
10 mills/kWh. As with the incremental-cost component, the return rate was fixed
11 for the term of the agreement. As noted above, the return component was
12 defined as the sole means for recovery of the return on SOS-related CWC
13 balances. Consequently, recovery of the SOS-related CWC return was limited to
14 1.5 mills/kWh, regardless of the actual magnitude of that return.

15 For both Delmarva and PEPCO, the rate for SOS-related uncollectible
16 costs was initially set at zero. The 2003 Settlement then provided for changes to
17 that initial rate in subsequent distribution rate cases. By the end of the term of
18 the 2003 Settlement, the rate for uncollectible costs was 0.2 mills/kWh for
19 Delmarva and 0.7 mills/kWh for PEPCO.

20 Finally, the 2003 Settlement established the rate for the Administrative
21 Adjustment as the remainder of the 4 mills/kWh Administrative Charge after
22 subtracting the rates for the incremental-cost, return, and uncollectible-cost
23 components. Thus, at the outset of the 2003 Settlement, the Administrative
24 Adjustment for both Delmarva and PEPCO was set at 2 mills/kWh, which is
25 equal to 4 mills less 0.5 mills for incremental cost, less 1.5 mills for return, and
26 less 0 mills for SOS-related uncollectible costs. By the end of the term of the
27 2003 Settlement, the Administrative Adjustment declined to 1.8 mills/kWh for

1 Delmarva and to 1.3 mills/kWh for PEPCO, reflecting the increase in the rate
2 for the uncollectible-cost component.

3 **Q: Please describe the treatment of revenues associated with the**
4 **Administrative Adjustment.**

5 A: The 2003 Settlement provided that all revenues associated with the
6 Administrative Adjustment would be returned to residential distribution
7 customers, regardless of whether they were SOS customers or were served by a
8 competitive retail supplier.

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

14 **Q: How would the 2014 Stipulation modify the residential Administrative**
15 **Charge?**

16 A: The 2014 Stipulation would make two changes to the current design of the
17 Administrative Charge. First, the 2014 Stipulation would replace the fixed rate
18 for the incremental-cost component with a rate set to recover actual incremental
19 costs. The incremental-cost rate would be initially set at 0.2 mills/kWh, and then
20 updated annually. Second, under the 2014 Stipulation, the return on CWC
21 balances would no longer be deemed to be recovered through the return
22 component, and would instead be recovered separately from the Administrative
23 Charge. The rate for the return component would be reduced from 1.5
24 mills/kWh to 1.3 mills/kWh to reflect the fact that CWC return would no longer
25 be recovered through the return component.

1 Furthermore, the 2014 Stipulation would reduce the total rate for the
 2 Administrative Charge from 4 mills/kWh to 3.5 mills/kWh. As noted above, the
 3 charge for CWC return would be in addition to the 3.5 mills/kWh
 4 Administrative Charge. According to Company witness DeVito, the total charge
 5 to residential SOS customers for the Administrative Charge and CWC return
 6 would be 4.46 mills/kWh for Delmarva's ratepayers and 4.38 mills/kWh for
 7 PEPCO's ratepayers. The initial rates for the individual components of the
 8 Administrative Charge and for the separate CWC return charge would be as
 9 shown in Table 2.²

10 **Table 2. 2014 Stipulation Initial Administrative Charge and CWC**

	Delmarva	PEPCO
Incremental Cost	0.20 mills/kWh	0.20 mills/kWh
Uncollectible Cost	1.38 mills/kWh	1.59 mills/kWh
Return	1.30 mills/kWh	1.30 mills/kWh
Administrative Adjustment	0.62 mills/kWh	0.41 mills/kWh
Administrative Charge	3.50 mills/kWh	3.50 mills/kWh
CWC Return	0.96 mills/kWh	0.88 mills/kWh
Total Charge	4.46 mills/kWh	4.38 mills/kWh

11
 12 I discuss below the provisions of the 2014 Stipulation regarding each of the
 13 components of the Administrative Charge and the additional charge for cash
 14 working capital.
 15

² *Testimony of Susan A. DeVito in Support of the Joint Motion of Stipulation and Settlement*, Case Nos. 9226 and 9232, February 18, 2014, Table 1.

1 **III. Incremental Costs**

2 **Q: Please summarize the provisions of the 2014 Stipulation regarding the**
3 **incremental-cost component of the Administrative Charge.**

4 A: As noted above, the 2014 Stipulation would replace the fixed rate for the
5 incremental-cost component with a rate set to recover actual incremental costs,
6 where “actual incremental costs” are defined as “additional reasonable costs
7 prudently incurred by the Companies as a direct result of providing SOS that are
8 not included in distribution service rates.”³

9 The incremental-cost rate would be initially set at 0.2 mills/kWh, and then
10 updated annually based on a report filed by the Companies each year regarding
11 actual incremental expenditures during the previous year. These annual
12 proceedings would provide the Commission the opportunity to:

- 13 • Audit and assess the prudence of the prior year’s incremental costs.
- 14 • Determine the reasonableness of the Companies’ proposed allocation of
15 incremental costs to SOS service types.
- 16 • Reconcile incremental-cost revenues against actual costs.
- 17 • Reset the rate for the upcoming year in order to recover expected spending
18 in the next year and outstanding balances from prior years’ reconciliations.

19 **Q: Does the 2014 Stipulation provide a reasonable mechanism for recovering**
20 **actual incremental costs?**

21 A: Yes. The 2014 Stipulation provides a reasonable mechanism for ensuring that
22 the Companies recover actual, verifiable, and prudently incurred incremental
23 costs.

³ 2014 Stipulation, ¶4.

1 **IV. Uncollectible Costs**

2 **Q: Please describe the treatment of uncollectible costs for residential SOS**
3 **under the terms of the 2014 Stipulation.**

4 A: The 2014 Stipulation would continue the process established under the 2003
5 Settlement, whereby the rate for SOS-related uncollectible costs is set as part of
6 a distribution rate case.

7 **Q: Is this treatment reasonable?**

8 A: Yes. It makes sense to continue setting the rate for SOS-related uncollectible
9 costs in distribution rate cases. This process allows for full evidentiary review of
10 the Company's methods for unbundling total uncollectible costs into distribution
11 and SOS-related portions, and provides a record for the Commission to rely on
12 to ensure that uncollectible costs are unbundled in a consistent manner and that
13 the distribution and SOS-related portions are appropriately reflected in base
14 rates and the Administrative Charge, respectively.

15 **Q: What do the Companies propose for the initial rates for the uncollectible-**
16 **cost component of the Administrative Charge for residential SOS?**

17 A: According to Companies witness DeVito, the Companies propose initial rates of
18 1.38 mills/kWh for Delmarva and 1.59 mills/kWh for PEPCO.⁴

19 **Q: Do these initial rates appear reasonable?**

20 A: I am unable to determine the reasonableness of the proposed initial rates at this
21 time, because the Companies have not yet responded to OPC discovery
22 regarding this matter. In particular, I am concerned that these rates do not reflect
23 test-year revenues from SOS-related late payment charges. Such revenues

⁴ DeVito Testimony, Table 1.

1 should be accounted for in the calculation of the rate for the uncollectible-cost
2 component of the residential Administrative Charge.⁵

3 **V. Return**

4 **Q: Please describe the terms of the 2014 Stipulation relating to the return**
5 **component of the Administrative Charge for residential SOS.**

6 A: The 2014 Stipulation would continue charging ratepayers through the return
7 component established under the 2003 Settlement. As noted above, the 2014
8 Stipulation would reduce the residential return rate from its current value of 1.5
9 mills/kWh to 1.3 mills/kWh.

10 **Q: What is the basis for this reduction in the return rate?**

11 A: According to Companies witness DeVito, the 2014 Stipulation would reduce the
12 current rate by 0.2 mills/kWh to reflect the fact that CWC return would no
13 longer be recovered through the return component:

14 Previously, the Utility Return was set at 1.5 mills for the Companies by the
15 2003 Settlement, but this amount also included a CWC component which
16 will be separately stated in the [2014 Stipulation]. Therefore, the return
17 component in the [2014 Stipulation] is essentially the same as the prior
18 return component established in the 2003 Settlement, which previously was
19 1.5 mills and included approximately .29 mills of assumed CWC....⁶

20 In response to OPC Data Request No. 7-1(c), the Companies indicate that
21 the stated rate of 0.29 mills/kWh for “assumed CWC” was the rate for PEPCO

⁵ Likewise, such revenues should no longer be counted as distribution revenues for the purposes of determining distribution revenue adequacy and setting distribution rates.

⁶ DeVito Testimony, p. 4, ll. 17-22.

1 CWC return in 2004 as previously estimated by PEPCO witness A. Glenn
2 Simpson in Case No. 9232.⁷

3 **Q: Is this a reasonable basis for setting the return rate at 1.3 mills/kWh?**

4 A: No. To the contrary, the rationale for setting the return rate at 1.3 mills/kWh
5 appears arbitrary and inconsistent with the provisions of the 2003 Settlement. If
6 Settling Parties believe that a reasonable return should be “essentially the same”
7 as the current 1.5 mills/kWh return less “assumed CWC”, then the return for
8 PEPCO should have been set at 1.21 mills/kWh (i.e. 1.5 mills less 0.29 mills).
9 For that matter, the return for Delmarva should have been set at 0.98 mills/kWh,
10 since Delmarva witness Simpson in Case No. 9226 estimated an “assumed
11 CWC” for Delmarva of 0.52 mills/kWh.⁸ In either case, Companies witness
12 DeVito does not explain why Settling Parties adopted a return rate that exceeds
13 the rate that would result by taking the difference between the current return rate
14 and “assumed CWC”.

15 Regardless of the result, it was not reasonable for Settling Parties to set the
16 return rate at the difference between the current return rate and “assumed
17 CWC”, because parties to the 2003 Settlement did not “assume” any specific
18 amount for CWC return to be included in the return component of the
19 Administrative Charge for residential SOS.⁹ In fact, the only agreement among
20 parties reflected in the 2003 Settlement with respect to residential CWC return
21 was that such return would be recovered through, and only through, the return

⁷ Copies of all responses to OPC data requests cited herein are provided as Attachment JFW-1.

⁸ See *Direct Testimony and Exhibits of Company Witness A.G. Simpson*, Case No. 9226, June 14, 2010, Exhibit DPL (AGS)-4.

⁹ The Companies do not dispute this description of the 2003 Settlement as it relates to the treatment of CWC return. See their response to OPC Data Request No. 7-1(a).

1 component. In other words, the 2003 Settlement was silent as to the amount of
2 CWC return to be recovered through the return component at the outset or at any
3 time during the term of the agreement. Instead, the 2003 Settlement explicitly
4 provided that the return element was the sole source of recovery for CWC
5 return, and that the recovery of such return was capped at 1.5 mills regardless of
6 the magnitude of actual CWC return. As parties to the 2003 Settlement, the
7 Companies therefore agreed to assume all risk of an unexpected increase in
8 actual CWC return, and agreed that the remaining amount of the 1.5 mill return
9 rate over and above actual CWC return was reasonable compensation for
10 assuming CWC risk or any other risk associated with the provisions of the 2003
11 Settlement.

12 **Q: However determined, should the Companies be allowed to recover a return**
13 **other than return on CWC balances?**

14 A: No. According to OPC witness Hill, it is unnecessary and economically
15 inefficient to provide the Companies any additional “return” beyond the return
16 on SOS-related cash working capital. Accordingly, Mr. Hill recommends that
17 the return component of the residential Administrative charge be limited strictly
18 to the return on SOS-related cash working capital.

19 Based on Mr. Hill’s recommendations, I recommend that the return rate be
20 set so that the return component recovers only that amount required to provide
21 the Company with a reasonable return on SOS-related cash working capital.¹⁰
22 The Company should not be allowed to recover any other costs or other deemed
23 return through the return component of the Administrative Charge for residential
24 SOS.

¹⁰ I provide my recommendations regarding the return on cash working capital in Section VI, below.

1 **VI. Cash Working Capital**

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

3 A: The Company pays the bills from wholesale SOS suppliers prior to receiving the
4 revenues from SOS customers to cover those payments. Cash working capital is
5 the short-term capital the Company needs to fund payments during the period
6 that revenue recovery lags bill payments.¹¹ Cash working capital return
7 represents the cost to finance that capital during the lag period.

8 **Q: Please summarize the terms of the 2014 Stipulation regarding return on**
9 **cash working capital for residential SOS.**

10 A: Under the terms of the 2014 Stipulation, return would be calculated on
11 residential SOS-related CWC balances based on the Companies' currently
12 authorized rates of return, and recovered separately from the Administrative
13 Charge.

14 According to Companies witness DeVito, the initial rates for the CWC
15 return charge would be 0.963 mills/kWh for Delmarva and 0.879 for PEPCO.¹²

16 **Q: Is this a reasonable approach for setting the residential rate for CWC**
17 **return?**

18 A: According to OPC witness Hill, it would be more appropriate to use a short-term
19 debt rate rather than the overall cost of capital to calculate the cost to finance
20 SOS-related cash working capital. Based on Mr. Hill's recommendations to use
21 a short-term debt rate of 3.25%, OPC witness Effron calculates a rate for

¹¹ The Companies' calculation of SOS-related cash working capital also accounts for lags in the recovery of incremental costs and income taxes.

¹² DeVito Testimony, Table 1.

1 residential CWC return of 0.29 mills/kWh for Delmarva and 0.26 mills/kWh for
2 PEPCO.

3 **Q: Why does the 2014 Stipulation recover CWC return separately from the**
4 **residential Administrative Charge?**

5 A: The Settling Parties have not offered any rationale for separate recovery, other
6 than vague and unsupportable arguments offered by the Companies in response
7 to OPC Data Request No. 7-8 that a separate charge for CWC return “keeps
8 intact the Administrative Charge and its components” and “provides
9 transparency concerning the Companies’ Cash Working Capital requirements.”
10 Given the lack of a reasonable explanation by the Settling Parties, one can only
11 presume that the purpose of separate recovery is to ensure that ratepayers would
12 be charged more for the combination of the revised residential Administrative
13 Charge, at 3.5 mills/kWh, and the separate CWC return charge than under the
14 current rate of 4 mills/kWh for the residential Administrative Charge.

15 **Q: What do you recommend with respect to the recovery of CWC return?**

16 A: I recommend that the current fixed rate for the return component be replaced
17 with a rate that is set to recover the return on residential SOS-related CWC
18 balances. Based on calculations by OPC witness Effron, I also recommend that
19 the CWC return rate be set initially at 0.29 mills/kWh for Delmarva and 0.26
20 mills/kWh for PEPCO.

21 I also recommend that CWC return revenues be reconciled as part of the
22 annual proceeding for incremental costs. Specifically, such revenues should be
23 reconciled against a revenue amount based on actual wholesale supply costs and
24 any changes in estimated net lag days during the preceding year.

25 Finally, I recommend that, as part of the annual proceeding for incremental
26 costs, the rate for the CWC return component be updated as appropriate to

1 reflect changes in wholesale SOS supply costs, changes in estimated net lag
2 days, or approved changes to the assumed finance rate.

3 **VII. Administrative Adjustment**

4 **Q: Please describe the provisions of the 2014 Stipulation regarding the**
5 **Administrative Adjustment.**

6 A: The 2014 Stipulation would continue collection of the Administrative
7 Adjustment as part of the 3.5 mills/kWh Administrative Charge for residential
8 SOS. As under the 2003 Settlement, the rate for the Administrative Adjustment
9 would be calculated as the total rate of 3.5 mills/kWh for the residential
10 Administrative Charge less the sum of the rates for the other components of the
11 Administrative Charge.¹³ The 2014 Stipulation would also continue crediting
12 the amounts collected through the Administrative Adjustment to all residential
13 distribution customers.

14 According to Companies witness DeVito, the initial rate for the
15 Administrative Adjustment would be 0.62 mills/kWh for Delmarva and 0.41
16 mills/kWh for PEPCO.¹⁴

17 **Q: What was the purpose of the Administrative Adjustment in the 2003**
18 **Settlement?**

19 A: In comments and testimony in Case No. 8908, certain parties expressed the
20 belief that, at least at the outset of competition, competitive retail suppliers

¹³ However, unlike the 2003 Settlement, the rate for CWC return (which, under the 2003 Settlement, was deemed to be included in the return component) would not be netted from the total rate for the purposes of calculating the Administrative Adjustment under the 2014 Stipulation.

¹⁴ DeVito Testimony, Table 1.

1 would be at a competitive disadvantage to residential SOS in terms of the costs
2 associated with supplying retail service. Specifically, some parties argued that
3 utility incremental cost was not fully compensatory of the retailers' cost to
4 provide retail service, and thus would impede retailer entry during the early
5 stages of market development. In contrast, other parties argued that consumers
6 should pay no more than incremental cost for providing a regulated service, and
7 that charging more than incremental cost as part of the SOS price would distort
8 price signals and be economically inefficient. The Administrative Adjustment
9 was designed to balance these competing concerns by: (1) increasing the
10 apparent price of providing the retail service against which competitive retailers
11 would compete, and (2) providing for the refund to residential ratepayers of all
12 revenues associated with the Administrative Adjustment.

13 **Q: Why do Settling Parties support a continuation of the Administrative**
14 **Adjustment?**

15 A: Both Companies witness DeVito and RESA witness Hudson claim that the
16 Companies' distribution rates recover generation-related customer service costs
17 which are more appropriately recovered through SOS rates. Ms. DeVito further
18 claims that recovery of these allegedly generation-related costs through
19 distribution rates provides a potential subsidy to SOS customers.

20 Both Ms. DeVito and Mr. Hudson support the Administrative Adjustment
21 as a proxy for the generation-related costs that they allege are currently being
22 recovered through distribution rates. According to Ms. DeVito, the
23 Administrative Adjustment would "avoid or minimize" the potential subsidy to
24 SOS customers and would "create a more level competitive playing field
25 between SOS and competitive suppliers."¹⁵ Mr. Hudson also claims that the

¹⁵ DeVito Testimony, p. 8, ll. 16-18.

1 Administrative Adjustment would “simulate the types of costs that retail
2 suppliers incur and must recover from their customers through the prices they
3 offer.”¹⁶

4 **Q: What are the bases for Ms. DeVito’s and Mr. Hudson’s claims that SOS-
5 related costs are currently being recovered through distribution rates?**

6 A: Neither Ms. DeVito nor Mr. Hudson offer any evidence that would support their
7 claims that a portion of the customer service embedded costs currently
8 recovered in distribution rates are due to the provision of standard offer
9 service.¹⁷ In particular, neither Ms. DeVito nor Mr. Hudson offer any evidence
10 that embedded costs currently recovered in distribution rates are greater than
11 they would have been if the Companies provided only distribution service,
12 rather than both distribution and standard offer service.

13 **Q: Do you agree with Ms. DeVito’s assertion that recovery of all customer
14 service embedded costs through distribution rates provides a subsidy to
15 SOS customers?**

16 A: No. These embedded costs are joint and common costs incurred for the purposes
17 of providing customer services to both customers taking only distribution
18 services and those customers who take both distribution and standard offer
19 service. As such, a subsidy would arise only in the event that distribution-only
20 customers are paying more for these embedded costs than would be the case if
21 the Companies only provided distribution service or in the event that SOS

¹⁶ *Direct Testimony of Richard J. Hudson on Behalf of Retail Energy Supply Association*, Case Nos. 9226 and 9232, February 18, 2014, p. 8, ll. 3-4.

¹⁷ See the Companies’ response to OPC Data Request No. 7-5 and RESA’s response to OPC Data Request No. 1-1(a).

1 customers were paying less than the incremental cost incurred by the Companies
2 to provide standard offer service in addition to distribution service.

3 Neither of these situations would appear to apply with respect to the
4 customer service costs currently recovered through the Companies' distribution
5 rates. It is unlikely that embedded costs would have been materially lower if the
6 Companies provided just distribution service.¹⁸ Nor is it the case that SOS
7 customers are paying less than the incremental costs of providing standard offer
8 service. Consequently, contrary to Ms. DeVito's assertion, recovery of customer
9 service embedded costs through distribution rates does not appear to provide a
10 subsidy to SOS customers.

11 **Q: Have either Ms. DeVito or Mr. Hudson offered any evidence to support**
12 **their claims that the rate for the Administrative Adjustment provides a**
13 **reasonable proxy for the SOS-related costs allegedly being recovered**
14 **through distribution rates?**

15 A: No. Neither witness has offered any evidence that the initial rate for the
16 Administrative Adjustment reasonably reflects the SOS-related costs allegedly
17 being recovered through distribution rates. Nor, for that matter, does either
18 witness offer any evidence that changes to the rate in the future (due to changes
19 in incremental or uncollectible costs) would be consistent with changes in the
20 SOS-related costs allegedly being recovered through distribution rates.

21

¹⁸ Nor, as noted above, have the Settling Parties offered any evidence that distribution-only embedded costs would have been less than embedded costs to provide both distribution and standard offer service.

1 **Q: Would it be appropriate to use the Administrative Adjustment to “create a**
2 **more level competitive playing field”, as suggested by Ms. DeVito, or to**
3 **“simulate the types of costs that retail suppliers incur”, as proposed by Mr.**
4 **Hudson?**

5 A: No. By statute, Public Utilities Article §7-510(c)(3)(ii)(2), the Administrative
6 Charge should be set to recover no more than a utility’s “verifiable, prudently
7 incurred costs to procure or produce the electricity plus a reasonable return.”
8 Artificially increasing the rate for the Administrative Charge beyond that
9 required to recover actual, verifiable, and prudently incurred costs in an attempt
10 to level the playing field or more closely reflect retailers’ costs would be
11 contrary to statute.

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

13 A: No. The retail market has developed and matured over more than a decade of
14 competition in the supply of electricity to consumers. Consequently, it is neither
15 necessary nor reasonable to charge SOS customers more than the actual
16 incremental cost of residential SOS – and to require that SOS customers
17 subsidize customers served by retail suppliers in the process of crediting
18 Administrative Adjustment revenues – in order to provide an artificial
19 competitive edge to retail suppliers.

20 Accordingly, I recommend elimination of the Administrative Adjustment
21 from the Administrative Charge for residential SOS.

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

23 A: Yes.