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Attachment JFW-2 Responses to OPC Data Requests

1 **I. Introduction**

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

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

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

7 A: Yes.

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

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

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

11 A: This rebuttal testimony responds to reply testimony by Phillip E. VanderHeyden
12 on behalf of the Staff of the Public Service Commission (“Staff”) and by
13 Matthew White on behalf of the Retail Energy Supply Association (“RESA”),
14 both filed on September 15, 2015. Specifically, my rebuttal testimony addresses
15 the following issues:

- 16 • Establishment of a retail choice incentive, as proposed by Mr.
17 VanderHeyden.
- 18 • Functional unbundling of customer-services costs, as discussed by both
19 Mr. VanderHeyden and Mr. White.
- 20 • Continuation of the residential Administrative Adjustment, as proposed by
21 Mr. VanderHeyden.

22 **Q: Do you have any general comments regarding Mr. White’s reply**
23 **testimony?**

1 A: Yes. Mr. White suggests in his reply testimony that the Administrative Charge
2 should be set at a level that reflects not the costs incurred by the Companies, but
3 instead the costs borne by retail suppliers. For example, Mr. White argues with
4 regard to the return component of the Administrative Charge:

5 The inclusion of a reasonable return as a component of SOS assists in
6 leveling the playing field between SOS and the retail products that
7 suppliers offer, and ensures that SOS is a market-priced service as required
8 by statute.¹

9 As I discussed in my third reply testimony, speculation regarding costs
10 incurred or returns achieved by competitive suppliers are irrelevant to the matter
11 of the Administrative Charge. By statute, the Administrative Charge should be
12 set to provide the Companies no more (or less) than their actual, verifiable,
13 prudently incurred costs plus a reasonable return.² Consequently, Mr. White’s
14 proposal to instead set the Administrative Charge at a rate that “levels the
15 playing field” between the Companies and competitive suppliers would be
16 contrary to statute and accordingly should be rejected by the Commission.³

¹ *Reply Testimony of Matthew White on Behalf of the Retail Energy Supply Association*, Case Nos. 9226 and 9232, September 15, 2015, p. 14, ll. 10-12.

² Mr. White justifies charging more than the Companies’ actual costs plus a reasonable return by citing to the “market price” language in the statute. This interpretation of the statute is illogical and without merit. If, as Mr. White implies, the term “market price” in the statute refers to prices charged by competitive retail suppliers to reflect their costs, then the “market price” could in fact be too low to allow the Companies to recover their actual costs plus a reasonable return. In other words, Mr. White’s interpretation of the “market price” language conflicts with the plain language providing for the recovery of the Companies’ actual costs plus a reasonable return. It would be more straightforward to read the “market price” language as referring to the market price of wholesale power supply procured by the Companies through a competitive process to serve SOS load.

³ Moreover, Mr. White fails to offer any evidence to support a specific rate for the residential Administrative Charge.

1 **Q: Are you revising any of the conclusions or recommendations from your**
2 **third reply testimony regarding the Administrative Adjustment in light of**
3 **Mr. VanderHeyden's or Mr. White's reply testimony?**

4 A: No. Nothing in Mr. VanderHeyden's or Mr. White's reply testimony would lead
5 me to alter my conclusion that the Administrative Adjustment bears no relation
6 to actual SOS-related costs and serves no purpose other than to arbitrarily and
7 unreasonably increase the price paid by residential customers for Standard Offer
8 Service. I therefore continue to recommend that the Commission eliminate the
9 Administrative Adjustment from the residential Administrative Charge.

10 **II. Retail Choice Incentive**

11 **Q: What is Mr. VanderHeyden's proposal with regard to an incentive**
12 **mechanism?**

13 A: Although not a detailed proposal, Mr. VanderHeyden recommends that a
14 mechanism be developed that would reward the Companies for taking actions
15 that promote customer migration to competitive retail service. Mr.
16 VanderHedyen further suggests that the incentive mechanism be structured as a
17 fixed fee rather than as a charge pegged to SOS sales, so that the Companies do
18 not have an incentive to take anti-competitive actions in order to retain SOS
19 load.

20 **Q: Why does Mr. VanderHeyden want to provide an incentive to enhance**
21 **switching from standard offer to competitive retail service?**

1 A: The only rationale offered by Mr. VanderHeyden for such an incentive is that
2 “the development of retail choice markets are [sic] required by the statute.”⁴

3 **Q: Is this reasonable grounds for providing the Companies an incentive to**
4 **enhance retail choice?**

5 A: No. By Mr. VanderHeyden’s logic, the Companies should also be rewarded for
6 promoting standard offer service and increasing SOS load, since the provision of
7 standard offer service is also “required by the statute.”⁵

8 Rewarding the Companies for favoring either competitive retail or standard
9 offer service would appear to be contrary to one of the fundamental goals of the
10 restructuring statute: providing customers the opportunity to choose freely
11 between competitive retail and standard offer service.⁶ For there to be retail
12 choice, utilities must be neutral facilitators of the choice process. The
13 restructuring statute promotes neutrality by ensuring that utilities recover no
14 more or less than their actual, verifiable, and prudently incurred SOS-related
15 expenses and a reasonable return on SOS-related assets. In contrast, Mr.
16 VanderHeyden’s proposal would reward the Companies – with the opportunity
17 to recover more than actual costs and a reasonable return – for taking sides in
18 the choice process.

19 **Q: To what extent have the Companies profited from the provision of**
20 **residential SOS over the last decade?**

21 A: As indicated in Table 1, I estimate that from June of 2005 through May of 2015
22 residential SOS revenues (excluding Administrative Adjustment revenues)

⁴ Reply Testimony of Phillip E. VanderHeyden on Behalf of the Staff of the Public Service Commission, Case Nos. 9226 and 9232, September 15, 2015, p. 3, line 4.

⁵ See, generally, Public Utilities Article §7-510(c).

⁶ Public Utilities Article §7-504.

1 exceeded actual incremental, uncollectible, and CWC costs for the Companies
 2 by about \$65.4 million, or by about 0.9 mills per kilowatt-hour of residential
 3 SOS sales.⁷ For the purposes of this estimate, actual CWC “costs” includes not
 4 only the cost to finance CWC balances at short-term debt but also the return on
 5 such balances at the difference between overall cost of capital and short-term
 6 debt. Consequently, my estimate of \$65.4 million represents profits to the
 7 Companies over and above their return on cash working capital.

8 **Table 1: PHI Profit from Residential SOS**

	Revenue Net of Administrative Adjustment	Actual Incremental, Uncollectible, and CWC Cost	Profit
6/05-5/06	18,619,363	7,942,895	10,676,468
6/06-5/07	18,739,415	11,005,591	7,733,824
6/07-5/08	18,536,008	15,104,481	3,431,527
6/08-5/09	19,752,622	14,922,994	4,829,628
6/09-5/10	19,816,778	23,106,118	(3,289,340)
6/10-5/11	25,513,745	20,210,595	5,303,150
6/11-5/12	22,439,291	13,306,170	9,133,121
6/12-5/13	21,926,217	11,252,928	10,673,289
6/13-5/14	21,678,745	13,808,262	7,870,482
6/14-5/15	22,208,900	13,185,519	9,023,381
10-Year Total	209,231,084	143,845,553	65,385,531

9

⁷ The Companies do not have actual cost data for the first SOS year from June, 2004 to May, 2005.

1 My estimate of annual profits in the first four years (starting June, 2005)
2 may be overstated because the Companies calculated CWC revenue
3 requirements for those years based on June, 2004 to May, 2005 power supply
4 prices.⁸ If actual profits were instead zero in the first four years, the Companies'
5 profit would have been \$38.7 million over the last ten years.

6 **Q: What do you recommend with regard to Mr. VanderHeyden's proposal for**
7 **an incentive mechanism?**

8 A: The Commission should reject Mr. VanderHeyden's proposal to reward the
9 Companies for promoting customer migration to competitive retail service, since
10 such an incentive would be contrary to the fundamental goals and specific cost-
11 recovery provisions of the restructuring statute.

12 **III. Functional Unbundling of Customer-Service Costs**

13 **Q: Please summarize your third reply testimony with regard to the**
14 **Companies' functional unbundling of customer-service costs.**

15 A: In my third reply testimony, I noted that the Companies complied with the
16 Commission's directive by functionally unbundling embedded customer-service
17 costs, but in doing so asserted that the costs functionally unbundled as
18 commodity-related were not actually avoidable. In other words, the Companies
19 claimed that such "SOS-related" embedded customer-service costs would
20 neither decrease as customers switch to competitive supply nor increase if
21 customers returned to SOS. Thus, according to the Companies, these unbundled

⁸ See Attachment B of Delmarva's response to OPC Data Request No. 4-11 in Case No. 9226 and Attachment B of PEPCO's response to OPC Data Request No. 2-11 in Case No. 9232. Copies of all responses to OPC data requests cited herein are provided as Attachment JFW-2.

1 costs are not *incremental* SOS-related costs since the incremental cost of
2 customer services for SOS customers is zero. Based on the Companies' findings
3 that these "SOS-related" costs are fixed, I concluded in my third reply testimony
4 that it would be economically inefficient and contrary to principles of cost
5 causation to recover such costs through the Administrative Charge.

6 **Q: What are Mr. VanderHeyden's and Mr. White's positions with regard to**
7 **the unbundling of customer-service costs?**

8 A: Mr. VanderHeyden contends that the Companies recover through base
9 distribution rates certain customer-service costs that were incurred to provide
10 standard offer service.⁹ In addition, he disputes the Companies' finding that
11 such allegedly SOS-related costs are fixed, claiming instead that it would be
12 "likely that many of these functions would be provided by the supplier" if the
13 Companies no longer provided standard offer service.¹⁰ Mr. VanderHeyden
14 therefore recommends that customer-service costs be functionally unbundled
15 into distribution-related and SOS-related portions, and that SOS-related
16 customer-service costs be recovered through the Administrative Charge.¹¹

17 Mr. White similarly contends that SOS-related costs are currently being
18 recovered through distribution rates and that such SOS-related customer-service
19 costs would "likely be much less if SOS were eliminated."¹² Mr. White further
20 claims that the recovery of allegedly SOS-related costs through distribution rates

⁹ VanderHeyden Reply, p. 28, ll. 13-19.

¹⁰ *Id.*, p. 29, ll. 7-9.

¹¹ As discussed in Section IV below, Mr. VanderHeyden further recommends continuation of the Administrative Adjustment until customer-service costs can be unbundled and the SOS-related portion of those costs can be directly recovered through the Administrative Charge.

¹² White Reply, p. 10, ll. 11-12.

1 results in a “scenario where distribution rates subsidize SOS rates.”¹³
2 Consequently, Mr. White recommends that customer-service costs be
3 functionally unbundled based on customer count and that unbundled SOS-
4 related costs be directly recovered through the Administrative Charge.¹⁴

5 **Q: What is the basis for Mr. VanderHeyden’s and Mr. White’s assertions that**
6 **SOS-related costs are currently being recovered through distribution rates?**

7 A: Neither Mr. VanderHeyden nor Mr. White has offered any evidence that a
8 portion of customer-service costs are due to the provision of standard offer
9 service or that the portion of the costs they believe to be SOS-related are not
10 already recovered through the incremental-cost component of the
11 Administrative Charge.

12 **Q: What is the basis for Mr. VanderHeyden’s and Mr. White’s claims that**
13 **allegedly SOS-related customer-service costs are avoidable?**

14 A: Neither Mr. VanderHeyden nor Mr. White has offered any evidence in support
15 of their argument that such costs would be avoidable if the Companies ceased
16 providing standard offer service.¹⁵

17 **Q: Do you agree with Mr. White’s assertion that recovery of all embedded**
18 **customer-service costs through distribution rates provides a subsidy to SOS**
19 **customers?**

¹³ *Id.*, p. 11, ll. 20-21.

¹⁴ However, in the event that the Commission rejects direct recovery, Mr. White recommends continuation of the Administrative Adjustment as a proxy for explicit unbundling.

¹⁵ Regardless, the premise of their argument is strictly hypothetical, since the Companies’ statutory obligation to provide standard offer service is permanent. See Public Utilities Article §7-510(c)(3)(ii)(2).

1 A: No. These embedded costs are joint and common costs incurred for the purposes
2 of providing customer services to both customers taking only distribution
3 service and those customers who take both distribution and standard offer
4 service. A subsidy would arise only in the event that distribution-only customers
5 are paying more for these embedded costs than would be the case if the
6 Companies only provided distribution service or in the event that SOS
7 customers were paying less than the incremental cost incurred by the Companies
8 to provide standard offer service in addition to distribution service.

9 Neither of these situations would appear to apply with respect to the
10 customer-service costs currently recovered through the Companies' distribution
11 rates. According to the Companies, it is unlikely that embedded costs would
12 have been materially lower if the Companies provided just distribution service.¹⁶
13 Nor is it the case that SOS customers are paying less than the incremental costs
14 of providing standard offer service.¹⁷ Consequently, contrary to Mr. White's
15 assertion, recovery of embedded customer-service costs through distribution
16 rates does not appear to provide a subsidy to SOS customers.

17 **Q: How do you respond to Mr. White's recommendation to unbundle**
18 **customer-service costs based on customer count?**

19 A: It is not clear to me why Mr. White recommends this particular approach since,
20 contrary to Mr. White's intent, it would increase the amount of allegedly SOS-

¹⁶ Nor, as noted above, has Mr. White offered any evidence that distribution-only embedded costs would have been less than embedded costs to provide both distribution and standard offer service.

¹⁷ In fact, as I discussed in my third reply testimony, residential SOS customers are paying more than incremental cost because Administrative Adjustment revenues collected from those customers are being credited back to all distribution customers. Thus, contrary to Mr. White's contention, SOS rates are actually subsidizing distribution rates.

1 related costs recovered through distribution rates as customers migrate to
2 competitive retail supply. For example, if 25% of residential customers are
3 currently served by competitive retail suppliers, then under Mr. White's
4 approach about 43% of fixed customer-service costs would be deemed to be
5 SOS-related, removed from distribution rates, and instead recovered through the
6 Administrative Charge. However, if an additional 25% of residential customers
7 migrate over time, then only 33% of the same amount of customer-service costs
8 would be deemed to be SOS-related. Thus, in this example under Mr. White's
9 approach, 10% of fixed customer-service costs that had initially been deemed be
10 SOS-related, removed from distribution rates, and instead recovered through the
11 Administrative Charge would be re-branded as distribution-related and put back
12 into distribution rates as a result of customer migration. Mr. White's approach
13 would therefore lead to recovery of costs through distribution rates that Mr.
14 White believes to be SOS-related.

15 **Q: Are you opposed to further separation of customer-service costs into**
16 **distribution and SOS functions?**

17 A: No. However, as I discussed in my third reply testimony, the charge for SOS-
18 related customer-service costs should be determined in a distribution rate case
19 through a full evidentiary review of the Companies' proposed functional
20 unbundling of customer-service costs into distribution-related and SOS-related
21 cost categories. This process would provide a record for the Commission to rely
22 on to ensure that:

- 23 • The only customer-service costs classified as SOS-related and recovered
24 through the Administrative Charge are those incremental costs incurred as
25 a result of providing standard offer service.

- 1 • Customer-service costs are unbundled in a reasonable and consistent
2 manner and that the distribution and SOS-related portions are appropriately
3 reflected in base distribution rates and the Administrative Charge,
4 respectively.
- 5 • Supplier fees are set at appropriate amounts to reflect supply-related
6 customer-service costs attributable to the provision of customer services to
7 retail suppliers.

8 **IV. Administrative Adjustment**

9 **Q: What does Mr. VanderHeyden propose with regard to the Administrative**
10 **Adjustment?**

11 A: According to his response to OPC Data Request No. 2-6(a), Mr. VanderHeyden
12 recommends continued collection of the Administrative Adjustment in the
13 manner proposed by the Companies, until such time that customer-service costs
14 can be functionally unbundled and recovered through the Administrative
15 Charge. Mr. VanderHeyden contends that the Administrative Adjustment
16 reasonably approximates the portion of the Companies' customer-service costs
17 that would be classified as SOS-related if such costs were functionally
18 unbundled in a base rate proceeding:

19 The use of the Administrative Adjustment does not precisely allocate
20 customer service costs, but it provides a reasonable facsimile of costs that
21 would have been allocated, had it been possible to set base rates and SOS
22 rates simultaneously and continue to adjust costs over time.¹⁸

23 **Q: Has Mr. VanderHeyden offered any evidence to support his claim that the**
24 **amounts recovered through the Administrative Adjustment reasonably**

¹⁸ VanderHeyden Reply, p. 33, line 18 – p. 34, line 2.

1 **approximate the amount of SOS-related costs allegedly being recovered**
2 **through distribution rates?**

3 A: No. Mr. VanderHeyden has not offered any evidence that the amounts recovered
4 through the initial rate for the Administrative Adjustment would reasonably
5 reflect the SOS-related costs allegedly being recovered through distribution
6 rates. Nor, for that matter, does he offer any evidence that changes to the rate in
7 the future (due to changes in incremental, cash working capital, or uncollectible
8 costs) would be consistent with changes in the SOS-related costs allegedly being
9 recovered through distribution rates.

10 In fact, in his response to OPC Data Request No. 2-6(d), Mr.
11 VanderHeyden acknowledges that he was “not assuming a specific rate for the
12 Administrative Adjustment” when he made the claim in his reply testimony that
13 the Administrative Adjustment “provides a reasonable facsimile of costs that
14 would have been allocated.” Thus, Mr. VanderHeyden is simply stating his
15 opinion without any basis in fact when he asserts that the Administrative
16 Adjustment “provides a reasonable facsimile” of the costs incurred to provide
17 standard offer service.

18 **Q: The lack of evidence notwithstanding, could one reasonably expect that the**
19 **Administrative Adjustment mechanism would yield a rate that**
20 **approximates unbundled SOS-related costs?**

21 A: No. As I discussed in my third reply testimony, there is no reason to expect that
22 the rate for the Administrative Adjustment would approximate the Companies’
23 actual unbundled SOS-related costs since the rate is derived based on costs other
24 than unbundled costs. Specifically, under the Companies’ proposal, the rate for
25 the Administrative Adjustment is derived as the difference between a fixed rate
26 for the residential Administrative Charge and the sum of the rates for

1 incremental costs, uncollectible costs, and return as those rates vary over time.
2 If, for example, uncollectible costs were to increase, the rate for the
3 Administrative Adjustment would decrease, all else equal. However, the effect
4 on the Administrative Adjustment in this instance notwithstanding, there is no
5 reason to believe that an increase in uncollectible costs would actually lead to a
6 reduction in unbundled costs. Thus, the Administrative Adjustment under the
7 Companies' proposal would not serve as a reasonable proxy for unbundled
8 SOS-related costs.

9 **Q: What do you recommend with regard to Mr. VanderHeyden's proposal to**
10 **continue collection of the Administrative Adjustment through the**
11 **residential Administrative Charge?**

12 A: The Commission should reject Mr. VanderHeyden's proposal. Mr.
13 VanderHeyden has failed to provide any evidence that the amounts collected
14 through the Administrative Adjustment represent actual, verifiable, and
15 prudently incurred costs to provide standard offer service. Furthermore, there is
16 no reason to expect that the Administrative Adjustment mechanism would yield
17 a rate that reasonably approximates actual costs. Consequently, continued
18 collection of the Administrative Adjustment through the residential
19 Administrative Charge would be contrary to statute.

20 Moreover, as I discussed in my third reply testimony, the Administrative
21 Adjustment no longer serves a useful purpose in terms of promoting retail
22 choice. The retail market has developed and matured over more than a decade of
23 competition in the supply of electricity to consumers. Consequently, it is neither
24 necessary nor reasonable to charge SOS customers more than the actual
25 incremental cost of residential SOS – and to require that SOS customers
26 subsidize customers served by retail suppliers in the process of crediting

1 Administrative Adjustment revenues – in order to provide an artificial
2 competitive edge to retail suppliers. Accordingly, I recommend elimination of
3 the Administrative Adjustment from the Administrative Charge for residential
4 SOS.

5 **Q: Does this conclude your third rebuttal testimony?**

6 A: Yes.