BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND

In the Competitive Selection of Electricity Electricity Supplier/Standard offer or Default Service for Investor-Owned Utility Small Commercial Customers and Allegheny Power, Delmarva Power and Light, and Potomac Electric Power Residential Customers	* * * *	**Case No. 9064**

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BRIEF OF THE OFFICE OF THE PEOPLE'S COUNSEL

The Office of the People's Counsel ("OPC"), by the undersigned, hereby files this Brief regarding the issue presented in Case No. 9064 pertaining to the procurement of electricity by regulated utilities for their provision in June 2007 of Standard Offer Service, and other related issues on the "Staff Issues List" adopted by the Commission in its August 4, 2006 Scheduling Order for this case.

I. OVERVIEW AND SUMMARY

This dispute in this case arises from the belief that there are two competing and antithetical narratives regarding the purpose of Standard Offer Service ("SOS") in the competitive retail regime instituted by the General Assembly when it enacted Maryland's "Electric Customer Choice and Competition Act of 1999 ("the Act")."[1] The first narrative, as fervently urged by the competitive retail suppliers such as RESA[2] and WGES,[3] contends that, despite the Legislature's original intention to have SOS quickly wither away in the face of retail competition, SOS still predominates due to the

[1] Maryland Public Utility Companies Article, Section 7-501, *et seq*. (2003).

[2] The Retail Electric Supply Association

[3] Washington Gas Energy Services

counterproductive and below-market rates which resulted from a simultaneous and ill-considered decision by the Legislature to include price caps on SOS rates in the Act for periods of long duration.[4] Thus, in this proceeding, those retail suppliers ask the Commission to direct SOS providers to purchase their electricity for contracts as short as a month.

The counter narrative, which in fact is not a narrative but rather is the law and to which OPC believes better hews to the facts and which is supported by the changes made to the Act in the recently enacted SB 1,[5] is a story of broken promises. The first promise was made by the electricity industry to the Legislature in 1999 that, if the Act were passed and the utilities were required to "restructure" by selling their generation plants, due to competition future retail electricity bills would *decrease* rather than increase. Based upon that promise, the Legislature included a "phase-out" for "SOS" in 2003 with the "rate caps" as a back-stop and ceiling which would likely never be reached rather than a floor only over which competition could flourish. The industry's promise was broken when virtually no retail competition developed. Since then, the industry made a second promise that competition would develop once the caps had expired. But that second promise, too, was broken. For example, although the rate caps expired for Pepco in 2004, retail competition again has essentially failed to take hold.

Predictably, RESA and similarly-minded parties promise again that competition will flourish but now that promise is conditioned on yet another requirement, *i.e.*, that

[4] As part of the contemplated transition to retail competition, the Act required that residential base rates be reduced between 3 and 7.5% as measured on June 30, 1999 for periods between 4 to 6 years after the right to compete competition for retail customers had begun.
[5] Ch. 5, SB 1 (2006 Md. Laws, 1st Spec. Sess.) ("**SB 1**")

SOS electricity be purchased by the utilities on solely short-term (either monthly or durations no longer than a year) and highly volatile bases which are subject to the whims of the spot market.

If it were not clear before the passage of SB 1, then certainly thereafter the Act's language makes plain that a new paradigm is now required by Maryland law to ensure that residential customers are offered an SOS that provides a low and stable price. In this new paradigm, the utility will buy SOS power in a manner designed to obtain the "best" price and will also be built to ensure that future SOS prices will be less volatile. Rather than "stymie" the development of alternatives to SOS, SOS encourages retail competition, not for its own sake, but one that benefits customers by providing an even better service than that provided by an optimally structured SOS. As summarized by the OPC's policy witness, Ms. Alexander, the changes mandated by SB 1 "will require competitive businesses to offer more volatile prices to those consumers that want this attribute, lower prices than [those] offered through SOS if they are more successful in assembling a portfolio of lower priced electricity, or electricity products with different attributes, such as 'green' electricity or alternative pricing methods that would allow particular customers to lower their monthly bill compared to an SOS price that will be based on the blended price of the entire [managed and laddered SOS procurement] portfolio." OPC Ex. No. 2, p. 11 at l. 21; p. 12 at l. 1-6. In other words, competition will arise not because SOS prices are high and volatile due to purchasing inefficiencies but because retail suppliers will find a way to market electricity in creative ways that will sufficiently persuade residential customers to buy it.

Through its expert witnesses and in this Brief, OPC makes recommendations for the process necessary to begin complying with the new requirements of SB 1, starting with clear direction to the utilities to develop and file a plan with the Commission to incorporate the new requirements into the procurement of the portfolio of power needed to serve SOS load as of June 1, 2007. Other parties have proposed that the Commission order the utilities to implement the basic procurement methodology used under Case No. 8908 with modest changes for power needed to serve SOS load as of June 1, 2007. OPC does not believe that the Case No. 8908 approach can be exclusively utilized for SOS procurement under the requirements of SB 1. However, OPC makes recommendations on those proposed changes, some of which OPC believes would be improvements and some of which OPC believes would be detriments, to that process. The most important of these issues is the length of contracts solicited by the utilities. OPC believes that, to the extent that the Commission decides to rely on the Case No. 8908 procurement methodology, the utilities should include two and three year contracts in the portfolio mix for residential customers.

II. HISTORY

A. The Act and the First Settlements

On September 10, 1998, before the Act was passed, the Commission issued Order No. 74561 in Case No. 8738 which announced the Commission's intention to adopt retail choice for electricity and to docket cases to determine utility stranded costs and consider rate protections for customers. These cases were docketed as Case Nos. 8794 for Baltimore Gas and Electric Company ("**BGE**"), 8795 for Delmarva Power and Light

Company ("**Delmarva**"), 8796 for Potomac Electric Power Company ("**Pepco**"), and 8797 for Potomac Edison Company d/b/a Allegheny Power ("**AP**"). On September 3, 1998, the OPC filed a rate case against BGE asserting that the company's bundled rates, including generation, transmission, and distribution, were allowing the company to earn greater than a lawful reasonable return. Originally docketed as Case No. 8804, the Commission consolidated the rate case with BGE's stranded cost case, Case No. 8794.

In 1999, while the stranded cost and rate protection cases were pending, the Legislature passed the Act which provided that the transition to retail "electric choice" was to be accomplished in stages, starting on July 1, 2000, with full retail competition to be completed by July 1, 2002. The Act relieved the utilities of the obligation to provide SOS after July 1, 2003 as the Legislature had contemplated – based on the industry's representations – that retail competition would make SOS superfluous. The Legislature mandated a rate reduction of between three and seven percent for residential customers and a rate cap for four years.

The Commission adopted settlements in all four of the stranded cost and rate protection cases. The settlements resulted in rate freezes of varying lengths for residential customers. Specifically, rates were frozen for Pepco and Delmarva customers through June 30, 2004; for BGE customers through June 30, 2006; and, for AP customers through December 31, 2008. In other words, "the rate cap period was two years longer [for BGE] than the rate cap period for Pepco and Delmarva, and two years shorter than the

generation rate cap period for AP." *See* PSC No. 9052, Order No. 80638 at 4, Docket Entry No. 24 (April 21, 2006).[6]

On December 18, 2001, the Commission initiated Case No. 8908 to review the issue of the "competitive selection of electricity supplier/standard offer service." In about November 2002, the numerous parties to Case No. 8908 reached a settlement which provided that: AP would continue to provide SOS to residential customers from January 1, 2009, to December 31, 2012; BGE would continue to provide SOS to residential customers from July 1, 2006, to May 31, 2010; Delmarva would continue to provide SOS to residential customers from July 1, 2004, to May 31, 2008; and, Pepco would continue to provide SOS to residential customers from July 1, 2004, to May 31, 2008. In approving the settlement in April 2003, the Commission stated that it "establishes a wholesale competitive procurement methodology to implement utility provided Standard Offer Service to Maryland's retail electric customers after their utility-specific restructuring settlements expire. The Commission is requiring utilities operating in the State to provide these services based on our conclusion that a retail electricity market in Maryland has yet to develop to the point that the Commission can relieve the utilities of this obligation." PSC Case No. 8908, Order No. 78400, Docket Entry No. 184 at 1 (April 29, 2003).

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[6] "APS has two different rate cap periods for residential customers. The APS residential rate cap for rates other than generation expired December 31, 2004. The APS generation rate cap for residential customers ends December 31, 2008. As a result of the Pepco-DP&L merger proceeding, rate caps for distribution service were extended through December 31, 2006 for Pepco and DP&L customers, however the expiration of generation rate caps on June 30, 2004 was unchanged, *see Re Potomac Electric Power Company*, Case No. 8890, 93 Md. PSC 134 (2002)." *See* PSC No. 9052, Order No. 80638 at 4 n. 7, Docket Entry No. 24 (March 6, 2006).

In the Argument, we discuss the current procurement details about the Case No. 8908 settlement agreements, and the impact of SB 1 thereon.

B. <u>Aftermath of expiration of SOS rate freezes for Pepco and Delmarva in 2004</u>

In 2004 after the rate caps expired, annual average residential SOS bills increased 15% for Pepco and 11% for Delmarva (24% and 17%, respectively, for the SOS portion of the bill). *See* PSC No. 9058, Order No. 80747 at 3, Docket Entry No. 24 (April 21, 2006). In 2005 residential bills increased an additional 5% for Pepco and 6% for Delmarva (7% and 9%, respectively, for the SOS portion of the bill). *Id*. In 2006, bills for SOS service increased an additional 39% for Pepco and 35% for Delmarva (59% and 52%, respectively, for the SOS portion of the bill). *Id*.

Thus, for the past three years since the rate caps expired in 2004 for Pepco and Delmarva, there have been total cumulative SOS increases of 59% for Pepco residential customers and 52% for Delmarva residential customers on a total bill basis. *Id.* For the most recent increase, the utilities and other parties, including the OPC, entered into a settlement agreement which provided for a modified "rate mitigation plan" that offered a voluntary, interest free deferral of part of the increase, which this Commission approved in the aforementioned Order No. 80747 issued on April 21, 2006.

C. <u>Aftermath of expiration for price caps for BGE in 2006</u>

For July 1, 2006, the electric generation cost of the average residential consumer's bill went up by about 120%. The total annual bill for the average residential customer increased by about 72% which, according to the Commission, means that it rose from about $86.00 to $148.00 for the average resident. *See, e.g.* "BGE Rate Stabilization Fact

Sheet for Residential Customers,"

http://www.psc.state.md.us/psc/Info/brochures/BGE_MitigationPlanFactSheet.pdf.

As the Commission knows, this increase led to a public outcry and, in response, legislative activity which culminated in the enactment of SB 1. In this particular regard, SB 1 provided for a statutory rate mitigation plan for BGE customers in which all but 15% of the 72% average bill increase was deferred. Section 7-548(b)(1). The deferred amount will be recovered starting January 1, 2006, and be recovered over a period of up to ten years. Section 7-548(b)(3) and (d).

D. Migration of customers from SOS to competitive retail suppliers

Migration of residential customers from SOS to competitive suppliers has been fairly inconsequential. According to the Commission's latest electric switching statistics on its website, as of July 31, 2006, residential switching went up from 1.7% to 1.8% combined for the four Maryland utilities who provide SOS to residential consumers. *See http://www.psc.state.md.us/psc/electric/enrollmentrpt.htm* (August 31, 2006).[7]

E. OPC Initiates The "Investigation Into The Optimal Structure Of The Electric Industry in Maryland"

On March 16, 2006, OPC filed a "Request of the Office of the People's Counsel for an Investigation into the Optimal Structure of the Electric Industry in Maryland"[8] in Case

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[7] "Electric Choice Enrollment Monthly Report All Utilities Where Choice is Available in Maryland Month Ending August 2006"

[8] On April 10, 2006, OPC filed an "Amended Request Of The Office Of The People's Counsel For An Investigation Into The Optimal Structure Of The Electric Industry In Maryland." This filing corrected one sentence in the original pleading.

No. 8908. Filed prior to the passage of SB 1, this investigation squarely brought into focus the need to restructure utility purchasing of electricity in Maryland.

While the matter languished for technical reasons, on June 7, 2006, the OPC filed a "Motion for Immediate Re-Opening of Hearings" in Case Nos. 9063 and 9064. Staff filed a similar request on July 20, 2006. The Commission solicited responses to the motions and held a scheduling conference in both cases on August 2, 2006. Despite OPC's opposition, the Commission issued an order August 4, 2006, that restricted Case No. 9064 to issues related to implementation of a full-requirements contracting approach to acquiring power to serve SOS customers as the utilities have done under the Commission's Orders issued in Case No. 8908. Throughout this proceeding, OPC has been seeking a comprehensive restructuring wherein the purchase of electricity for SOS is radically changed to a balanced portfolio method such as would result in the SOS customer obtaining the lowest possible price while being protected from excessive price increases.

III. ARGUMENT

A. SB 1 Requires changes to the methodology for the procurement of SOS Power

1. SB 1 requires, consistent with OPC's position in seeking this investigation, that, to the greatest extent possible, SOS is to be designed solely to provide customers with the benefits of low and stable prices.

The Commission has interpreted the original Act as allowing an SOS envisioned as a relic waiting for retirement upon the advent of retail electric competition. Presupposing that robust retail competition would indeed quickly materialize and thereby make SOS superfluous, the Legislature included a "sunset" provision in the original Act to terminate by July 1, 2003 the obligation of electric companies to continue to

provide SOS.[9] The termination was subject only to a "back-stop" allowing the Commission to continue to require electric companies to provide SOS if the electricity supply market had not become competitive. PUC § 7-510 (prior to SB 1 amendments effective July 1, 2006).

A fair harmonization of related amendments contained in SB 1 ineluctably lead to the conclusion that the Legislature has now found that SOS will not be only be relevant for years to come but, as well, will now be a vehicle for providing benefits to customers.[10] *See Torboli v. Torboli*, 119 Md. App. 684,688 (1998) ("all the pieces of a statute must be considered together and harmonized in interpreting each provision.")[11] First, while the

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[9] The termination of SOS by an electric company was effective with a 12 month notice.

[10] Until the passage of SB 1, PUC § 7-510 read: "Any obligation of an electric company to provide standard offer service shall cease on July 1, 2003, except that: (i) electric cooperatives and municipal electric utilities may choose to continue providing standard offer service in their respective distribution territories, and may cease offering that service after notifying the Commission at least 12 months in advance; and (ii) 1. if the Commission finds that the electricity supply market is not competitive or that no acceptable competitive proposal has been received to supply electricity to those customers described under paragraph (2) of this subsection, the Commission shall extend the obligation to provide standard offer service to residential and small commercial customers at a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return."

[11] While SB 1 provides discretion to the Commission in making certain determinations, the Commission must first construe the language of SB 1 before applying it to the facts presented here. It is, of course, hornbook law that the "cardinal rule of statutory construction is to determine the intent of the legislature," and that, to discern that intention, the words of the statute must be given their plain and ordinary meaning, and must be read "in the context of the statutory scheme of which they are a part." *See generally*, *Bennett v. S.D.A.T.*, --- Md. App. ---- (2006), 2006 WL 2796226. *Harrison v. John F. Pilli & Sons, Inc.* 321 Md. 336, 342 (1990). As well, all tribunals "must strive to avoid statutory constructions that are illogical, unreasonable, or inconsistent with common sense." *Bennett*, *supra,* citing *Bd. of Physician Quality Assur. v. Mullan*, 381 Md. 157, 168 (2004).

definition of SOS remains the same,[12] SB 1 now indefinitely extends an electric company's obligation to provide SOS. As § 7-510 now reads:

> EXCEPT AS PROVIDED UNDER SUBPARAGRAPH (II) OF THIS PARAGRAPH, ANY obligation of an electric company to provide standard offer service shall cease on July 1, 2003.
>
> (II) 1. ELECTRIC cooperatives and municipal electric utilities may choose to continue providing standard offer service in their respective distribution territories and may cease offering that service after notifying the Commission at least 12 months in advance.
>
> 2. ON AND AFTER JULY 1, 2003, AN ELECTRIC COMPANY CONTINUES TO HAVE the obligation to provide standard offer service to residential and small commercial customers at a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return.

Second, while SB 1 did not eliminate "retail choice" for residential customers, the Legislature now neither believes nor is expecting that real competition (i.e. leading to less expensive electric bills) will occur any time in the near future. Thus, SB 1 newly charges the Commission with establishing (by order or regulation) the definition of "default service" and requires the Commission to report to the Legislature on "the status of the standard offer service, the development of competition, and the transition of standard offer service to a default service." The first of such "status, development and transition" reports is not due until December 31, 2008, however, and they are required to be provided

[12] "Electricity supply purchased from a customer's electric company is known as standard offer service. A customer is considered to have chosen the standard offer service if the customer: (i) is not allowed to choose an electricity supplier under the phase in of customer choice in subsection (a) of this section; (ii) contracts for electricity with an electricity supplier and it is not
11 delivered; (iii) cannot arrange for electricity from an electricity supplier;
(iv) does not choose an electricity supplier; (v) chooses the standard offer service."

"every five (5) years thereafter," with no sunset or other termination provision.[13] Thus, the only reasonable inference gleaned from harmonizing all of these provisions, *see Torboli, supra*, is that the Legislature now believes that it is not in the public interest to rely on retail electric competition arising quickly and, that, as a consequence, SOS will not only be a viable but a required service likely into the next decade and beyond.

2. <u>SB 1 requires SOS electric companies to create a portfolio of procurement contracts with blended long, medium and short term durations with an overall long term horizon to ensure that SOS customers obtain the best prices with low average billing volatility.</u>

While providing the Commission with discretion as to how to implement the details of purchasing SOS, the Legislature also imposed explicit guidelines and directions in the language of SB 1 for the exercise by the Commission of that discretion.[14] Above all,

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[13] The full text at page 7 of SB 1 reads as follows:
1 (III) 1. ON OR BEFORE DECEMBER 31, 2008, AND EVERY 5 YEARS
2 THEREAFTER, THE COMMISSION SHALL REPORT TO THE GOVERNOR AND, IN
3 ACCORDANCE WITH § 2-1246 OF THE STATE GOVERNMENT ARTICLE, TO THE
4 GENERAL ASSEMBLY ON THE STATUS OF THE STANDARD OFFER SERVICE, THE
5 DEVELOPMENT OF COMPETITION, AND THE TRANSITION OF STANDARD OFFER
6 SERVICE TO A DEFAULT SERVICE.

[14] The full text of the pertinent subsection (c)(4) of the amended PUC § 7-510 reads as follows:
(II) 1. UNDER AN EXTENSION OF THE OBLIGATION TO PROVIDE STANDARD OFFER SERVICE IN ACCORDANCE WITH PARAGRAPH (3)(II) OF THIS SUBSECTION, THE COMMISSION, BY REGULATION OR ORDER, AND IN A MANNER THAT IS DESIGNED TO OBTAIN THE BEST PRICE FOR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS IN LIGHT OF MARKET CONDITIONS AT THE TIME OF PROCUREMENT AND THE NEED TO PROTECT THESE CUSTOMERS FROM EXCESSIVE PRICE INCREASES:

A. SHALL REQUIRE EACH INVESTOR-OWNED ELECTRIC COMPANY TO OBTAIN ITS ELECTRICITY SUPPLY FOR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS PARTICIPATING IN STANDARD OFFER SERVICE THROUGH A COMPETITIVE PROCESS IN ACCORDANCE WITH THIS PARAGRAPH; AND

B. MAY REQUIRE OR ALLOW AN INVESTOR-OWNED ELECTRIC COMPANY TO PROCURE ELECTRICITY FOR THESE CUSTOMERS DIRECTLY FROM AN ELECTRICITY SUPPLIER THROUGH ONE OR MORE BILATERAL CONTRACTS OUTSIDE THE COMPETITIVE PROCESS.

the Legislature has directed the Commission to consider **long-term** management of SOS procurement in light of the new and indefinite extension of the obligation of electric companies to continue to provide SOS. *See above,* III.A.1. First and foremost, the Legislature now charges the Commission to consider the reemergence of electric

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2. A. AS THE COMMISSION DIRECTS, THE COMPETITIVE PROCESS SHALL INCLUDE A SERIES OF COMPETITIVE WHOLESALE BIDS IN WHICH THE INVESTOR-OWNED ELECTRIC COMPANY SOLICITS BIDS TO SUPPLY ANTICIPATED STANDARD OFFER SERVICE LOAD FOR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS AS PART OF A PORTFOLIO OF BLENDED WHOLESALE SUPPLY CONTRACTS OF SHORT, MEDIUM, OR LONG TERMS, AND OTHER APPROPRIATE ELECTRICITY PRODUCTS AND STRATEGIES, AS NEEDED TO MEET DEMAND IN A COST-EFFECTIVE MANNER.

B. THE COMPETITIVE PROCESS MAY INCLUDE DIFFERENT BIDDING STRUCTURES AND MECHANISMS FOR BASE LOAD, PEAK LOAD, AND VERY SHORT-TERM PROCUREMENT.

C. BY REGULATION OR ORDER, AS A PART OF THE COMPETITIVE PROCESS, THE COMMISSION SHALL REQUIRE OR ALLOW THE PROCUREMENT OF COST-EFFECTIVE ENERGY EFFICIENCY AND CONSERVATION MEASURES AND SERVICES WITH PROJECTED AND VERIFIABLE ENERGY SAVINGS TO OFFSET ANTICIPATED DEMAND TO BE SERVED BY STANDARD OFFER SERVICE, AND 6 THE IMPOSITION OF OTHER COST-EFFECTIVE DEMAND-SIDE MANAGEMENT PROGRAMS.

3. A. IN ORDER TO PREVENT AN EXCESSIVE AMOUNT OF LOAD BEING EXPOSED TO UPWARD PRICE RISKS AND VOLATILITY, THE COMMISSION MAY STAGGER THE DATES FOR THE COMPETITIVE WHOLESALE AUCTIONS.

B. BY REGULATION OR ORDER, THE COMMISSION MAY ALLOW A DATE ON WHICH A COMPETITIVE WHOLESALE AUCTION TAKES PLACE TO BE ALTERED BASED ON CURRENT MARKET CONDITIONS.

4. BY REGULATION OR ORDER, THE COMMISSION MAY ALLOW AN INVESTOR-OWNED ELECTRIC COMPANY TO REFUSE TO ACCEPT SOME OR ALL OF THE BIDS MADE IN A COMPETITIVE WHOLESALE AUCTION IN ACCORDANCE WITH STANDARDS ADOPTED BY THE COMMISSION.

5. THE INVESTOR-OWNED ELECTRIC COMPANY SHALL PUBLICLY DISCLOSE THE NAMES OF ALL BIDDERS AND THE NAMES AND LOAD ALLOCATION OF ALL SUCCESSFUL BIDDERS 90 DAYS AFTER ALL CONTRACTS FOR SUPPLY ARE EXECUTED.

(5) An electric company may procure the electricity needed to meet its standard offer service electricity supply obligation from any electricity supplier, including an affiliate of the electric company.

(6) IN ORDER TO MEET LONG-TERM, ANTICIPATED DEMAND IN THE STATE FOR STANDARD OFFER SERVICE AND OTHER ELECTRICITY SUPPLY, THE COMMISSION MAY REQUIRE OR ALLOW AN INVESTOR-OWNED ELECTRIC COMPANY TO CONSTRUCT OR, ACQUIRE, OR LEASE, AND OPERATE, ITS OWN GENERATING FACILITIES, AND TRANSMISSION FACILITIES NECESSARY TO INTERCONNECT THE GENERATING FACILITIES WITH THE ELECTRIC GRID, SUBJECT TO APPROPRIATE COST RECOVERY.

companies as power providers themselves to meet **"<u>long-term</u>, anticipated demand** in the State for **Standard Offer Service**." PUC § 7-510(c)(6) (emphasis added). In that regard, the Commission may now not only allow but also "require" an investor-owned electric company "to construct or, acquire, or lease, and operate, its own generating facilities, and transmission facilities necessary to interconnect the generating facilities with the electric grid, subject to appropriate cost recovery." Without overstatement, this change, and the statement in new SB 1's new Section 7 that the Commission should consider "reregulation," *see infra*, is a radical departure from the "power-less" electric companies contemplated in the original Act who were required to sell off all of their power generation plants, and clearly manifests (at the least) the Legislature's intention that SOS be designed to achieve the highest level of consumer benefits possible and, as such, set a highly competitive bar which non-regulated electric suppliers must surmount.

Second, and certainly as important for this long term approach, the Commission is charged with directing the implementation by the electric companies of a "managed portfolio" of electric supply contracts. The changes that the Commission must consider and then effect to "provide residents [with] the benefit of a reliable electric system at the best possible price," are to have electric companies: (1) develop a "portfolio" of electricity supply; (2) that provides electricity; (3) at the "*lowest cost*"; (4) with the "*least volatility*." *See*

Section 7(a).[15]

The kind of "portfolio" the Legislature intended is brought into focus by another amendment contained in SB 1, which provides that electric companies shall elicit SOS bids for anticipated SOS service "as part of a *portfolio* of blended wholesale supply contracts of *short, medium, or long terms*, and other appropriate electricity products and strategies, as needed to meet demand in a cost-effective manner." PUC § 7-510.[16] (Emphasis added).

Further, the demands of this "portfolio" must be "*designed*" with essentially two purposes, to obtain a "best price" in consideration of the addition of the inclusion of a price premium to minimize volatility. As now stated in subsection (c)(4) of PUC § 7-510, the first purpose is to obtain the "*best price* for residential and small commercial customers in light of market conditions at the time of procurement." The second purpose is that the

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[15] SECTION 7. AND BE IT FURTHER ENACTED, That:
8 (a) The Public Service Commission appointed in accordance with Section 12 of
9 this Act shall initiate an evidentiary proceeding to study and evaluate the status of
10 electric restructuring in the State as it pertains to the availability of competitive
11 generation to residential and small commercial customers and the structure,
12 procurement, and terms and conditions of standard offer service for residential and
13 small commercial customers. In its evaluation, the Commission shall consider
14 changes that are necessary to provide residents the benefit of a reliable electric
15 system at the best possible price and options for reregulation, if advisable, and to
16 allow electric companies to develop a portfolio of electricity supply that provides
17 electricity at the lowest cost with the least volatility.
(Underline in original).

[16] " 2. A. AS THE COMMISSION DIRECTS, THE COMPETITIVE PROCESS SHALL INCLUDE A SERIES OF COMPETITIVE WHOLESALE BIDS IN WHICH THE INVESTOR-OWNED ELECTRIC COMPANY SOLICITS BIDS TO SUPPLY ANTICIPATED STANDARD OFFER SERVICE LOAD FOR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS AS PART OF A PORTFOLIO OF BLENDED WHOLESALE SUPPLY CONTRACTS OF SHORT, MEDIUM, OR LONG TERMS, AND OTHER APPROPRIATE ELECTRICITY PRODUCTS AND STRATEGIES, AS NEEDED TO MEET DEMAND IN A COST-EFFECTIVE MANNER."

"portfolio" must be "designed" with the "need to protect these customers from excessive price increases." *Id*.

Because the words of the statute should be given their plain and ordinary meaning, we first turn to the various definitions of "portfolio." A "portfolio" in this context means: "A group of investments. **The more diversified** the investments in a portfolio, the **more likely** the investor is to **earn the same return as the market**." *See* portfolio. Dictionary.com. *Wall Street Words*, Houghton Mifflin Company. http://dictionary.reference.com/browse/portfolio (accessed: October 04, 2006, emphasis added). We then move to the term "best" as it used in "best price," for which the most apt definition is "most advantageous, suitable, or desirable." *See* best. Dictionary.com. *Dictionary.com Unabridged (v 1.0.1)*, Based on the Random House Unabridged Dictionary, © Random House, Inc. 2006. http://dictionary.reference.com/browse/best (accessed: October 04, 2006).

In short, the Legislature has directed the Commission to ensure that electric companies now manage an SOS "portfolio" comprising contracts of diversified (i.e. short, medium or long term) lengths so as to minimize volatility and obtain the "best" -- *i.e.* to SOS customers, the most advantageous, suitable or desirable – price "in light of market conditions at the time of procurement," with great flexibility to change the durations and types of contracts so as to achieve those goals.

These conclusions are strongly supported by the testimony of Barbara A. Alexander, an experienced Consumer Affairs Consultant, who stated that "these statutory changes should have a different impact on the Commission's near term and long term

implementation of Standard Offer policies than might otherwise have been the case when the Commission initiated these two proceedings [i.e. Case Nos. 9063 and 9064] last May [2006] . . . While the Commission may undertake particular short term actions or transitional mechanisms to implement these policies in light of the forthcoming end of certain Standard Offer contracts and the exposure of residential customers to that fact in June 2007, the overall policy and intent that should govern the Commission's short term actions should be designed to implement a new 'vision' for Standard Offer Service as reflected in Senate Bill 1." OPC Ex. No. 1, p.3 at l. 16-18; p.4 at l. 8-13.

As Ms. Alexander further testified, the new "vision" of SOS as directed by SB 1 cannot be realized "without a longer term analysis done in the context of a procurement plan for SOS." OPC Ex. No. 1, p.8 at l. l-2. According to Ms. Alexander, it is the **job of each electric company** to develop "immediately initiate a procurement planning process" to design the "portfolio" mandated by SB 1. OPC Ex. No. 1, p. 14 at l. 11-13. Further, the Commission must ensure that each electric company take these steps immediately:

> "It is no longer appropriate to assume that Maryland's generation supply portion of the electricity bill should be acquired in a wholesale market in which the entire portfolio of potential generation resources are priced on the marginal cost of the most expensive unit in the system, i.e. natural gas fired electric generation. The overall basic approach to the acquisition of SOS should be done pursuant to a procurement plan submitted by the utility which reflects an exploration of a variety of contract terms, contract types, and energy management as well as traditional general supply services."

OPC Ex. No. 1, p.8 at l. 2-9, p. 14 .[17] Indeed, without a "longer planning horizon" of between 10 to 15 years, it is not possible any of the electric companies "to implement any of the options authorized by Senate Bill 1, particularly with respect to bilateral contracts with suppliers, the utility 'self build' option, or the energy efficiency investment and contracts . . ." OPC Ex. No. 1, p. 15 at l. 10-17.

No party other than the OPC presented a witness such as Ms. Alexander to provide testimony solely concerning an analysis of the language of SB 1 and the policies that should be adopted in light of that language. Indeed, and in contrast to Ms. Alexander's careful analysis of the language of SB 1 in her Direct Testimony and that undertaken in the above-stated argument in this Brief, most of the other witnesses in their Direct Testimony "completely ignored the enactment of SB 1." OPC Ex. No. 2, at p. 3. For example, on behalf of RESA, Mr. Steffes urged the Commission to adopt a regimen of monthly SOS procurement auctions not because any language in SB 1 led him to this conclusion but rather because of his admission that, "Unless the default product becomes

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[17] After the enactment of SB 1, the OPC filed with the Commission a request for Case Nos. 9063 and 9064 to be consolidated, which the Commission denied. As Ms. Alexander recommended, "the Commission [should] reconsider its initiation of Cases 9064 and 9063 in light of the new statutory directive and authority reflected in Senate Bill 1. The predicate for these cases when they were initiated in May 2006 reflects pre-existing law [that is now superseded] and the Commission's proceedings under these cases should be reformed to reflect the new obligations imposed on the Commission and the utilities to assure the best price' for SOS for residential and small commercial customers. The Commission's orders to date in these dockets and the newly issued Procedural Orders fail to recognize the significant changes imposed by and reflected in Senate Bill 1 and the amended Section 7-510(c)." OPC Ex. 1, p. 14 at l. 7-14. As Ms. Alexander further stated, "It is not clear why the Commission's August 4th Procedural Order in Case No. 9064 appears to contemplate no change in the method of acquisition of SOS for power flows beginning June 2007 and shunts off the 'broader' SOS procurement issues to Case No. 9063. **There is no statutory basis for this distinction**." OPC Ex. 1 p. 15 at l. 8-16, (emphasis added). **The OPC reaffirms its objection** to the bifurcation of these proceedings but moves forward in deference to the Commission's ruling on OPC's request.

more responsive to current market conditions, competitors will find it difficult to build a sustainable market presence and will not invest capital to enter and offer consumers competitive products." *See* RESA Ex. 1, p. 7 at l. 13-16; OPC Ex. No. 2, p. 9.

To the extent that some witnesses did briefly acknowledge the directives contained in SB 1, they quickly proceeded to ignore or distort them. For example, while Staff's witness, Mr. VanderHayden, paid lip service by accurately stating that the "new language [in SB 1] also requires evaluation of contract lengths, blended portfolios or other strategies with the intended result of securing efficiently priced SOS," Staff Ex. No. 1, p. 9 at l. 25-27, he nonetheless omitted in his testimony any discussion of how the language of SB 1 actually determined or applied to his recommendations, and he failed to explain why one of SB 1's two goals, i.e. minimizing long-term volatility for the cost of SOS, was excluded from his proposed result of securing simply "efficiently priced SOS." As another example, to support his rejection of the Legislature's direction to electric companies to design and manage a laddered portfolio of contracts of varying duration for SOS procurement, Mr. Vanderhayden improperly (and myopically) focused on the single prepositional phase in SB 1 -- "at the time of procurement" -- to the exclusion of *all* mentions of portfolio management and the "long-term" imperatives contained in SB 1:

> Staff reads SB 1 to require that SOS be provided in a manner that is intended to obtain the lowest prices at the time of procurement. **This language implies a single point in time, or a limited timeframe for procurement. A multi-year procurement is not the first thing that comes to mind from the language 'at the time of procurement.'** Otherwise it might have said "during the years of the procurement cycle." Clearly the legislature has left it to the Commission to determine the proper procurement method and timeframe.

Staff Exhibit No. 2, p. 15 at 3-9. In short, such an approach constitutes sophistry rather than a thorough analysis to ascertain the Legislature's intentions.[18] Mr. VanderHayden's interpretation ignores the fact that there are many different wholesale electricity products that can be purchased in the wholesale market, and also ignores the fact that the Legislature's dictate that SOS be designed to obtain the "best price…in light of market conditions at the time of procurement" applies to the purchases of various products, particularly products of various lengths, such as the contracts of "short, medium, and long term" as mandated in the same subsection of the law. PUC § 7-510(c)(4)(ii).

Simply, testimony from any witness is not relevant to these proceedings unless it is logically based on a careful and thorough analysis of SB 1, the law which now governs these proceedings.

3. <u>The Commission has already approved a managed portfolio approach to power procurement that is similar to that called for by SB 1.</u>

In Order No. 79503, the Commission approved the proposal of Southern Maryland Electric Cooperative ("SMECO") to serve its SOS load using a managed portfolio consisting of a variety of wholesale electricity products. Case No. 8985, Order No. 79503, Docket Entry No. 55 (September 29, 2004). In that order, the Commission prohibited SMECO from making any purchases for electricity to be delivered after May 31, 2008.

On March 24, 2006, SMECO made a compliance filing in Case No. 8985 expressly requesting the Commission to approve the indefinite continuation of its "managed portfolio process" for acquiring its wholesale SOS power supply and eliminate the

[18] For instance, Mr. VanderHayden's ultimate conclusion, "Clearly the legislature has left it to the Commission to determine the proper procurement method and timeframe," is inarguable but does not logically follow from either his syllogistic major or minor premises.

restriction against long term purchasing in order to "immediately begin taking advantage of attractively priced blocks of power . . ." The Commission granted SMECO's request for it to continue purchasing power to serve SOS customers through a managed portfolio of electricity contracts and revised the restriction on purchasing long term power to prevent purchases beyond May 31, 2010. Case No. 8985, Order No. 80839 (July 14, 2006).

4. <u>The new paradigm of SOS procurement as called for in SB 1 is in accord with the direction to which other States with similar laws are moving.</u>

While not identical to SB 1, recent changes to laws in other states regarding SOS procurement are similar enough to warrant their consideration by the Commission in making its determination in this case as well as in Case No. 9064. OPC Ex. No. 1, p.8 at l. 10-18. The "clear trend" from most jurisdictions is to "move away from shorter term SOS procurement strategies to longer term SOS procurement planning and the exploration of longer term contracts and investment in energy efficiency resources as part of the SOS portfolio." OPC Ex. No. 2, p.14 at l. 21, p. 15 at l. 1-3.

As Ms. Alexander described in detail in both her Direct and Rebuttal Testimony, Delaware has "rejected short term SOS procurement models and required Delmarva to prepare and submit a long term integrated procurement plan for SOS that includes most of the alternative strategies and approached reflected in SB 1." OPC Ex. No. 2, p.14, l. 1-5; OPC Ex. No. 1, p. 8 at 19-23, *and generally*, pp. 8-10. Maine's Public Utilities Commission("PUC") in 2004 "adopted a 'laddering' approach for residential SOS and acquires 1/3 of the load for a three-year fixed price contract annually," OPC Ex. No. 1, p.10 at l. 15-18, and additionally Maine's PUC "may negotiate long term capacity contacts

(with a priority given for renewable resources) and order the distribution utilities to sign and recover the costs of such contracts through distribution rates." OPC Ex. No. 1, p.11 at l. 15-17. In 2006, Rhode Island's General Assembly enacted a comprehensive bill to reform SOS policies and procurement, which extended the obligation of the electric utilities to arrange for Standard Offer Service "from 2009 through 2020," with the obligation to plan and acquire the necessary resources now governed by "least cost procurement." OPC Ex. No. 1, p.12 at l. 19-21. "New Jersey and the District of Columbia have adopted the rolling three-year fixed price contract approach to date, but the District of Columbia has announced that it will initiate a new proceeding to reconsider that approach and consider the longer term procurement planning model recommend by the District's public advocate and consumer representatives." OPC Ex. No. 2, p. 13 at l. 19-22, p. 14 at l. 1. Illinois has adopted the New Jersey-style auction with a blend of 1, 2 and 3-year contracts that was implemented beginning September 2006. OPC Ex. No. 2, p. 14 at l. 12-14.

In contrast, Massachusetts "has relied on 12-month contracts, half of which is obtained every six months, with the result that prices there have risen faster and higher than in neighboring states with a longer term SOS portfolio." OPC Ex. No. 2, p.14 at l4-17. However, Massachusetts "is starting to move away from the short term contracts because the Massachusetts regulators approved a stipulation in December 2005 which authorizes NSTAR (the largest electric utility) to use a portfolio of one, two, and three-year contracts for this service for residential and small commercial customers. OPC Ex. 2, p. 14. at l. 17-21. As pointed out by Ms. Alexander, the Virginia Corporation Commission concluded in

a recent study that, "In states where the transition period has ended and the generation portion of the customers' bills have been determined by the market, prices have increased faster than the national average and in states that did not restructure." OPC Ex. No. 2, p. 15 at 3-7.[19]

B. The Commission must now recognize that SB 1 has changed the original Act and, in conformance therewith, timely order the electric companies to begin designing their respective laddered and far-horizoned portfolios required by SB 1. If the Commission intends to continue the procurement processes arising out of the settlements of Case Nos. 8908, the Commission should nonetheless direct each electric company: (a) to immediately begin to design such portfolios; and, (b) to generally follow the bid schedule outlined by Staff but to consider for the second and third tranches the alternatives to full requirements contracts as required by SB 1 and to immediately purchase a mix of one-, two- and three-year contracts for the first round of bidding.

Since March 2006 and, thus, even before the Legislature enacted SB 1, OPC has unsuccessfully urged the Commission to change the basis of the SOS procurement to a longer term, portfolio approach designed to obtain averaged best prices tempered by low volatility. As discussed in Section A above, through SB 1 the Legislature has now approved and codified this approach. Nonetheless, for the past three months since SB 1 became effective on July 1, the Commission has not ordered the electric companies to begin designing their respective laddered and far-horizoned portfolios for SOS procurement. The Commission has separated the procurement approaches into two separate, short and long-term, dockets and, as well, has given every indication that the Commission will – but for some tinkering – go forward with the procurement process as provided in the settlement agreements for Case Nos. 8908 even though many of their

[19] K. Rose and K Meeusen, *2006 Performance Review of Electric Power Markets: Review Conducted for the Virginia State Corporation Commission*, August 27, 2006 at 4.

essential premises have now been superseded by the new directions mandated by SB 1.[20] OPC has provided evidence in this case, through its expert, Jonathan Wallach, on the proposals made by other parties to make adjustments to the basic Case No. 8908 procurement methodology.

1. To the extent that the Commission decides to utilize the Case No. 8908 procurement methodology for SOS power needed beginning June 1, 2007, it should include the changes recommended in the "Procurement Improvement Process" Report.

Staff witness Mr. VanderHayden attached to his direct testimony in this proceeding a copy of the "Report on the 2006 Procurement Improvement Process" that was filed with the Commission under Case No. 8908. Staff Exhibit No. 1, PEV-Ex. 2 ("PIP Report"). OPC concurs that, to the extent that the Commission decides to use a full requirements contracts approach to purchasing power for SOS similar to what was done

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[20] In his Direct Testimony, William Pino, Director of Electric Supply, BGE Pricing and Regulatory Services Department, discusses the compromise of various interests that is in the 8908 settlements with the result being a "well-balanced model that took into account fairness for all stakeholders," which included "customer advocates, utilities, wholesale suppliers, retail suppliers, government entities and regulators," and balancing "the customers' desire for a reasonably-priced utility-sponsored backstop service that offers some level of price stability" against four (4) other factors, including the retail suppliers' desire for the inclusion in the retail price of a proxy for additional costs incurred at the retail level, periodic recalibration of the price to prevailing market conditions, and no impediments to customers moving to and from the competitive retail market." BGE Ex. 1, p. 5 at 19-30, p. 6 at 1 through 8. Based thereupon, Mr. Pino recommended that changes to the "8908 model" should be made "very carefully, after due consideration, and only to the extent necessary." BGE Ex. 1, p. 5 at 20-22.

While Mr. Pino's characterization of the "8908 model procurement process" is reasonably accurate, Mr. Pino fails to discuss the impact of the many changes to SOS procurement mandated by SB 1, as discussed *supra*, and fails to take into account that the Legislature has now directed **by law** the goals of SOS and the ways and means of SOS procurement by electric companies. Accordingly, stakeholder "compromises" in developing an SOS policy are simply no longer lawful or appropriate under Maryland law. In other words, while a compromise of various interests such as BGE attributes to the 8908 settlements may be appropriate for other aspects of implementing SB 1, the language of the statute itself prohibits such a compromise in making SOS procurement policy.

under the Case No. 8908 orders, the changes to that procurement process discussed in the PIP Report would be improvements.

The bid schedule included in the PIP Report calls for three rounds of bidding, with the first round commencing in December of this year and the third round completed by mid-February of 2007.[21] As summarized by the OPC's expert, Jonathan Wallach, Vice-President of Resource Insight, Inc., the schedule is designed to:

- Spread procurement over time in order to limit the impact of extraordinary market events;
- Minimize overlaps with solicitations in surrounding States;
- Avoid scheduling solicitations during major holiday weeks; and,
- Complete procurement prior to the ARR [Auction Revenue Rights] auction in March of 2007

OPC Ex. No. 3, p. 6 at l. 11-20.

Concurring with Ms. Alexander, Mr. Wallach testified that the proposed schedule unlawfully "does not take account of the procedural schedule in Case No. 9063 or the statutory requirement of SB 1." OPC Ex. 3, p. 7 at l. 1-5. Because it is unlikely that the Commission will resolve the policy issues identified for Case No. 9063 or complete its Report to the Legislature mandated by Section 7 of SB 1[22] by mid-December 2006 (i.e. when the first bidding tranche will occur), Mr. Wallach concluded that, with the exception of Delmarva (which intends to procure all supply for residential SOS in the second round

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[21] A fourth round of bidding is permitted in the event that the awards made in the previous three rounds did not fully cover the load obligation.

[22] (c) On or before December 31, 2006, the Commission shall report to the Governor and, in accordance with § 2-1246 of the State Government Article, to the General Assembly on its findings and recommendations. (d) (1) The Commission may not implement any of the actions under subsection (b)(1) through (4) of this section that are otherwise authorized by this Act unless the Commission finds that the action is in the public interest.

of bidding in January 0f 2007), "the proposed schedule fails to allow for the possibility of a Commission finding that calls for procurement of resources other than full requirements contracts that would have already been procured in the first round of bidding under the proposed schedule." OPC Ex. 3, p. 7 at l. 11-14.

Because the bid schedule provided in the PIP Report "may allow for implementation of alternative resource strategies in the second or third tranches in 2007," and due to the large magnitude of the procurements therein which "may create opportunities to introduce alternatives to full requirements contracts for a portion of the total amounts to be solicited in these latter two rounds of bidding," and due to the impracticality of delaying the first round of bidding, Mr. Wallach ultimately concluded that the bid schedule outlined in the PIP Report is a reasonable one in the context of a Case No. 8908 procurement approach. OPC Ex. 3, p. 7-8, *generally.* As Mr. Wallach stated, the "bid schedule provided in the Staff report represents a reasonable timeline for procuring in a timely fashion all the resources necessary to serve SOS load, while **providing the opportunity to phase-in a portfolio of resource options**." OPC Ex. 3, p. 8 at l. 9-13.

2. Contract terms should include three year contracts in order to avoid unreasonably large exposure to market conditions in the future.

As Mr. Wallach testified, to comport with the requisites of SB 1, electric companies "should seek to maximize price stability and minimize portfolio risk by layering contracts of varying terms, selecting from the full range of commercially available and reasonably priced contracts." OPC Ex. 3, p. 13 at l. 10-16. On one hand, to the extent that full-

requirements contracts continue to be included in the SOS portfolio, it is not reasonable to arbitrarily limit the terms of such full-requirement contracts. *Id*. On the other hand, it is for a model designed by each electric company to comply with SB 1's directives and based on competent analysis, rather than for the opinion of any one expert, to determine the precise make-up of each "*portfolio* of blended wholesale supply contracts of *short, medium, or long terms*, and other appropriate electricity products and strategies, as needed to meet demand in a cost-effective manner." PUC § 7-510.

In accord with his testimony discussed in this Brief's preceding section as well as with an eye toward practicality, Mr. Wallach further opined that, if the Commission decides to use the "8908" approach for procuring SOS electricity needed starting June 1, 2007, the Commission should adopt – **for the first tranche only** -- the proposal put forward by PHI to solicit a mix of one-, two- and three year contracts in the upcoming December 2006 procurement. OPC Ex. 3, p. 14 at l. 1-7. Mr. Wallach supports this proposal because "procurement of mixed-duration contracts in the first round reasonably promotes price stability without unduly limiting the Commission's options for the latter two rounds or procurements in future years." *Id*.

Mr. Wallach's support for PHI's proposal, however, **does not extend to the second and third tranches** because such actions would ignore and, thus, violate the directives of SB 1. Rather, Mr. Wallach urged the Commission "to direct BGE and PHI to evaluate the feasibility of bid plans for the second and third tranches that [pursuant to SB 1] would allow for the procurement of alternatives to full-requirements contracts for a portion of

the total amounts to be solicited in these latter two rounds of bidding." OPC Ex. 3, p. 14 at l. 8-13.

In and of itself, PUC § 7-510 does not mandate the precise relative proportions in each electric company's respective portfolio of "short, medium or long term" procurement contracts, and thus it is possible (if unlikely) that one or two of these durational-type contracts could constitute a much larger portion of an electric company's SOS procurement than the remaining type. Nonetheless, without **introduction into evidence in this proceeding** of such a portfolio that has **included competent analysis** "of blended wholesale supply contracts of *short, medium, or long terms*, and other appropriate electricity products and strategies, as needed to meet demand in a cost-effective manner," PUC § 7-510, it is impossible for the Commission to lawfully conclude that any SOS procurement scheme will "provide electricity at the lowest cost with the least volatility." *See* Section 7(a).

In a nutshell, **no party has introduced any evidence** in this proceeding (or, as yet, in Case No. 9063) that it has even attempted to provide the analysis needed to create such a portfolio, much less a portfolio which accurately and lawfully considers the pertinent factors specified and required by SB 1. Consequently, testimony by witnesses which calls for **any** limitation on the duration of SOS procurement contracts is either incompetent, irrelevant or both. Indeed, this is precisely the reason why both Ms. Alexander and Mr. Wallach have demurred from doing so. Accordingly, other than for reasons of pressing practical needs, the Commission should pend its decision on the make-up of the utilities'

portfolios until the Commission has before it competent and relevant evidence upon which a decision may be properly based.

That being said, there is nonetheless evidence that including one-, two- and three-year contracts in the first tranche makes sense in terms of SB 1 and also economically. **First**, Peter Schaub, General Manager of Energy Supply for PHI, one of the few witnesses who referenced as authority for his recommendations the amendments contained in SB 1, *see* Hearing Transcript Vol. III, p. 253 at l. 12-23 (hereinafter, "**Tr. Vol. ___ at l. ___**"); p. 254 at l. 1-3, testified that SB 1 provides "specific guidance as we go forward beyond 8908 in putting together the procurement practices that we will use in the future. And in this case it is describing to us a requirement to get the best price that we can when we bid but also to control the changes in those prices year to year." Tr. Vol. III, p. 254 at l. 4-22. As well, Mr. Schaub believes that "competition exists under our current regime and will exist with the rolling three-year contract" that he recommended. Tr. Vol. III, p. 261 at l. 2-5.

Second, the preponderance of the testimony reflects that there will be far more robust supplier interest in and, thus, a much more competitive auction for, longer term rather than shorter term SOS procurement contracts. According to Matthew Kahal, who testified on behalf of the Maryland Energy Administration, "Most suppliers would not consider one year to be long or even two years to be long." Tr. Vol. IV, p. 384 at l. 9-20.

Robert P. Reeping, Allegheny Power's General Manager of Electric Supply whose job is to procure generation services to provide SOS load, Tr. Vol. III, p. 203 at l. 2-15, testified that, based on his overall experience as well as recent auctions for five-month contract durations, when soliciting SOS procurement contracts, as the term (i.e. duration)

of a procurement contract decreases, the number of bidders participating in the auction is less robust (i.e. there are fewer bidders). Tr. Vol. III, p. 209 at l. 2-23, p. 210 at l. 1-9; Tr. Vol. III, p. 214 at l. 18-23; p. 215 at l. 1-6. According to Mr. Reeping, the preference by wholesale suppliers for contracts of longer durations is because, at least for high congestion areas, "bidders take into account the fact that they can request the ARRs [Auction Revenue Rights] to help credit against the overall cost, as well as, if they choose, to transform those into FTRs [Financial Transmission Rights]." Tr. Vol. III, p. 211 at l. 1-9. Mr. Reeping therefore recommends a minimum term of one year and maximum term of three years, which is within the framework of PHI's recommendation for the first tranche.

The testimony of the witnesses for the two wholesale suppliers participating in this proceeding were unanimous in concurring with Mr. Reeping's assessment that solicitations for SOS procurement contracts of longer duration result in more robust auctions and overall better prices. For example, Martin Proctor, testifying on behalf of the Constellation Energy Commodities Group, stated that suppliers "in general have less interest in contracts of shorter duration than of longer duration," Tr. Vol. III, p. 223 at l. 11-22, because contracts of longer duration are generally more profitable. Tr. Vol. III, p. 226 at l. 2-23; p. 227 at l. 1-14. As another example, David M. Connelly, testifying on behalf of Connectiv Energy Supply, Inc. ("CESI"), stated that wholesale suppliers would reduce their interest in bidding if monthly SOS supply bid were ordered, Tr. Vol. IV, p. 345 at l. 8-12, and that he would find it "unusual" that other suppliers that had generation that they were trying to hedge over time periods of time would want to participate in 30-day auctions. Tr. Vol. IV, p. 350 at l. 15-23; p. 351 at l. 1-6. In contrast, Harry Warren,

testifying on behalf of retail supplier Washington Gas Energy Services ("WGES") conceded that he did not know whether fewer suppliers would be interested in participating in offering their power for purchase 12 times a year. Tr. Vol. III, p. 199 at l. 7-20.

Further testimony by Mr. Kahal also strongly supported these conclusions. As Mr. Kahal stated, "A monthly product may not attract as many wholesale bidders as the current structure. In all of the stakeholder processes, settlement meetings, all of the discussions I've had and so forth, I have seen no enthusiasm or strong interest on the part of wholesale suppliers in structuring stand offer service as a monthly product." Tr. Vol. IV, p. 381 at l. 21-23; p. 382 at l. 1-17. Moreover, "even for selling power to utilities in a nonretail access setting, whole[sale] suppliers have clearly indicated that they are interested in something longer than really short-term transactions." Tr. Vol. IV, p. 383 at l. 16-23.

Third, fewer auctions per year result in lower costs for electric companies which should result in lower prices for SOS consumers. Conversely, a great number of auctions per year result in higher costs that are ultimately passed on to residential SOS customers. As Mr. Reeping of AP testified, the administrative cost of an a SOS electric company to conduct bids for a single SOS procurement is between $50,000 to $75,000. Tr. Vol. III, p. 208 at l. 9-23, p. 209 at l. 1. According to Mr. Reeping, those costs are relatively fixed on a per procurement basis and increased frequency would not (by dint of familiarity or repetition) decrease the individual costs associated with each procurement. Tr. Vol. III, p. 209 at l. 2-23, p. 210 at l. 1-9. For those same reasons, Mr. Schaub of PHI concluded that

the "more frequent the auctions, the more it will drive up costs." Tr. Vol. III, p. 274 at l. 13-23; p. 275 at l. 1-3. This testimony was unrebutted and uncontradicted.

Fourth, it would seem irrefutable that, simply by using basic mathematics, contracts of a longer duration result in the lower volatility that is called for by SB 1. In a word, contracts whose prices change less frequently produce less variation in price. A rational portfolio can make use of a number of long-term contracts that have varying starting and ending points. That way, the long-term contracts can provide price stability during their term and not subject customers to large changes in price when a contract is replaced because, even though there may be a large price differential between the old contract and its replacement, the price impact on the overall portfolio is minimal because that particular contract makes up only a small percentage of the portfolio. While Mr. VanderHayden, on behalf of Staff, believes that there are other important factors in determining volatility in addition to the percentage of the load that a particular contract represents, he admitted that he "has not thought about" what those other factors may be. Tr. Vol. IV, p. 428 at l. 3-13.

In contrast, there is strong evidence that SOS procurement through shorter contracts results in great volatility. For example, James Steffes, testifying on behalf of the Retail Energy Supply Association ("RESA"), conceded that monthly auctions would not offer any sort of way to dampen monthly change in prices ranging from 35% increases one month to 15% reductions the following month. Indeed, "fourteen percent of the time in this time frame prices would have gone down as much as 42% and sixteen percent of

the time you would have gone up as much as 47 percent, with thirty percent of the months being greater than 20%." Tr. Vol. III, pgs. 143-44, *generally*.

The Commission's questions at the hearings were centered on a fear that, if an electric company did purchase SOS contracts of long durations, the company could be locked into a deal which in hindsight turns out to be a costly error and, thus, drives SOS bills up as well as causing excessive migration of SOS customers from the electric company. That fear, simply, is unfounded. As Ms. Alexander testified, "In no case should any utility enter into a long-term contract with fixed prices for 100% or even close to 100% of its obligation to provide SOS service." Tr. Vol. IV, p. 396 at l. 3-21. Because SB 1 calls for a "portfolio" of procurement contracts with mixed durations, "the kinds of portfolio management techniques that are being talked about here is to look at the diversity of options, one of which would be a long-term contract, maybe only for 10 percent, 15 percent of the load obligation over the time period in questions." *Id*. For these reasons, Ms. Alexander also believed that the fears about excessive migration were overblown. As she testified, "I think the risk of migration of 85% of the utility's customers, or more, in the time period that we're talking about here, is extraordinarily low and would not be a serious part of any concern or should not be a concern by the utility." *Id*.

To further ease this unwarranted fear, and as Mr. Wallach stated in his Rebuttal Testimony, "the Commission can set the mix of one-, two-, and three-year contracts to limit the amount of committed load in both years two and three. For example, the Commission could require procurement of a 75%/ 15%/ 10% mix of one-, two-, and three-

year contracts. In this case, only 15% of the load would be committed in year two and only 10% would be committed in year three. The Commission could vary these percentages in innumerable ways in order to achieve whatever level of load commitment it deems reasonable for years two and three." OPC Ex. 3, p. 13 at l. 17-24.

Consequently, based on the directives of SB 1 and the comments of Mr. Wallach and Ms. Alexander, the proposition put forth by RESA, Staff, and WGES that inclusion of long-term contracts in a portfolio would increase the volatility, or price variability, of SOS bills for residential customers, is simply off the mark and inapplicable here. In short, their argument is premised on a situation where BGE had essentially procured a long-term contract for **100% of the load** that **expired all at one time,** and that one-time price volatility resulted from BGE customers being 100% exposed to the market.
Similarly, Pepco and Delmarva customers suffered a large price increase from being 75% exposed to the market. **It is the level of market exposure at one time, not the length of contracts, that is the key factor** and such a situation cannot ever realistically arise again if

the Commission follows the law as provided in SB 1.[23]

The fear of being locked in to high-priced contracts is also misplaced because the problems that follow from such a situation are not symmetric. While prices for electric power can certainly decrease, they can only decrease *so much* because their fuels will always cost *something* and the power companies will need to make a profit to stay in business. In a nutshell, practically speaking, prices for SOS power can never drop, or come close, to "zero." In contrast, other than natural energy (e.g. wind and solar) sourced plants, these primary power plant fuels constitute nonrenewable resources whose supply is declining and whose costs must therefore inevitably rise. Consequently, in designing a far-horizoned portfolio of SOS power contracts as mandated by SB 1, the risk is far greater to be short than long, so long as the portfolio is constructed (as the OPC urges) with a mixture of short, medium and long term contracts and, as well, with a mixture of fixed and unfixed prices, full requirements and other alternative types of procurement contracts which, together, aim to provide the best SOS price with the lowest volatility.

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[23] During the hearing, there were a number of questions and responsive testimony on the issue of whether longer-term contracts result in higher "risk premiums" in bids. The witnesses on behalf of wholesale suppliers testified that longer-term contracts actually provide a valuable hedge for generation owners and, thus, reduces their risk. Tr. Vol. IV, p. 345at l. 20 – p. 346 at l. 15 and p. 364 at l. 7-15 (Mr. Gabbard on behalf of Conectiv Energy Supply, Inc.); Tr. Vol. III, p. 223 at l. 19-22, p. 230 at l. 14-23, and p. 235 at l. 11-20 (Mr. Proctor on behalf of Constellation Energy Commodities Group, Inc.). Mr. Gabbard also explained how the risk premium associated with keeping bids open while they are being evaluated for acceptance by the utility and by the Commission is lower for a long-term contract as opposed to a series of short-term contracts. CESI Ex. No. 1, p. 4 at l. 8 – p. 5 at l. 6. To the extent that longer contracts provide price risk to wholesale suppliers, using shorter term contracts does not eliminate that risk, but only transfers that risk to customers. There was also discussion of the migration risk, that is, the risk that customers will leave or return to SOS during the course of a contract. While there is reason to think that a longer term contract might put more migration risk on the wholesale supplier, it is important to note that this concern is only relevant to a full-requirements contract. If the long-term contract is for fixed quantity of electricity over a certain time period, migration risk is not an issue for that contract.

Because the recommendations of other witnesses are either contrary to SB 1 or are simply bad policy, they can be quickly dispatched. As they have argued in numerous other proceedings, RESA and WGES propose contract terms of one month to one year.[24] In addition to the irrefutable fact that exceedingly high volatility results from monthly contracts, such short term contracts will also draw into the auctions companies which are essentially "speculators." Tr. Vol. IV, p. 410 at l. 11-22. As Mr. Gabbard testified, companies which have a business model which focus on short term contract procurements "have been more financially constrained historically. They have [financial] issues to where they have not been able to participate and so they adopt this format." Tr. Vol. IV, p. 366 at l. 2-10. Again according to Mr. Gabbard, resorting to the use of short-term contracts would greatly reduce the interest in participation of companies such as his

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[24] RESA and WGES both represented that use of a volatile SOS, even to the extreme of SOS power that is purchased on a monthly basis, would give rise to a competitive retail market for residential customers. Mr. Steffes, on behalf of RESA, supported his testimony with references to the electric power markets in Texas and New York. While Texas and New York have areas of the state with higher shopping rates than the rest of the country, although all below 40% for residential customers, Ms. Alexander fully explains in her rebuttal testimony that these higher switching rates are associated with policies that are not beneficial to customers and not acceptable in Maryland. OPC Ex. No. 2, p. 15 at l. 12 - p. 21 at l. 2. As Ms. Alexander explains, the higher switching rates in Texas seem to be linked with a policy for the SOS-type service, called the Price-to-Beat, that allow the price to go up as prices in the wholesale natural gas market rise but does not require the retail electricity price to come down as wholesale natural gas market prices come down. OPC Ex. No. 2, p. 19 at l. 5 – 21 at l. 2. This, among other aspects of state policy, have resulted in significant difference between the rates paid by municipal electric customers, whose utilities are part of the same whole market as the investor-owned utilities, and the Price-to-Beat. OPC Ex. No. 2, BA Reply-6 (rates for municipal electric customers are below 9 cents per kwh while the Price-to-Beat rates are 15 cents per kwh and above). The higher switching rates in New York, which are only found in certain service territories in the state, are associated with policies that provide "incentives" for switching that are subsidies funded, in part, by all customers. OPC Ex. No. 2, p. 15 at l. 17 – p. 16 at l. 6. Further, in the Consolidated Edison service territory, where the utility supply service for residential customers has varied on a monthly basis, albeit for a customer base that, on average, has much lower usage than Maryland utilities, the latest report shows that switching is only 7.7% and a mechanism to dampen the volatility of the prices has been adopted by the commission. OPC Ex. No. 2, p. 18 at l. 3-16.

that own generation and seek to sell its output on a stable, long-term, lower risk, lower profit basis. *See generally*, Tr. Vol. IV, p. 383, l. 18 through p. 368 at l. 16. As Mr. Pino of BGE stated in his Rebuttal Testimony, "At a time when the Legislature has directed the Commission to find ways to provide SOS customers with more price stability, WGES would have the Commission put all load up for re-bid at least annually, and perhaps much more frequently." BGE Ex. 2, p. 6 at l. 22-25. Additionally, Mr. Pino characterized RESA's proposal for SOS procurement to be made on a monthly basis as "extremely unacceptable" and "not to be taken seriously":

> It would seem that this extreme proposal, to have mass market customers' prices swinging wildly up and down with each twitch of the energy markets, is not intended to be taken seriously. Rather, I suspect that RESA may be making this extremely unacceptable proposal so that other only slightly less desirable outcomes, like quarterly or annual re-bids of the entire residential service load, will be seen by the Commission as a "middle ground." Frankly, this tactic of deliberately yanking the frame of the debate to one side with extreme proposals seems to have worked increasingly well for RESA and WGES in Case Nos. 9037 and 9056. In this instance, however, I am hopeful that the Commission will disregard RESA's ploy.

BGE Ex. 2, p. 7 at l. 24-30 and p.8 at l. 1-6.

Moreover, WGES's proposal of using only one-year contracts would be a double hit to SOS customers. The first "hit" is that SOS customers would be deprived of the protection from excessive price increases required by SB 1.[25] The recent experience of PEPCO and Delmarva residential customers demonstrates the type of excessive price increases that can occur when using all one-year contracts. Both of those companies were

[25] SOS procurement using only one year contracts could have been accomplished under the original restructuring Act provided the Commission made the required findings regarding the state of competition under Section 7-510(c)(3). By SB 1, the Legislature has rewritten that section, providing a clear indication that it did not intend for SOS purchasing to be done on a yearly basis.

soliciting approximately 75% of their residential SOS needs in the last RFP process. For Pepco, the last increase in Maryland for customers on a retail basis was 39% for the total bill and for Delmarva it was 35%, having purchased 75% to the total load in the previous winter. Tr. Vol. III, p. 250 at l. 12-23; p. 251 at l. 1-5. The other 25% had already been procured in previous years using longer-term contracts. If Pepco and Delmarva had been using only one-year contracts, thus leaving its customers 100% exposed to the market every year, the increase would have been even higher for those customers.[26] In the District of Columbia, Pepco uses a rolling one-third, 3-year contract for procurement. Tr. Vol. III, p. 252 at l. 5-9. For Pepco's DC residential customers, and in stark contrast to the recent experience of Maryland SOS customers, the last procurement was for one-third of the total load which resulted in only a 12 percent increase for the total bill. Tr. Vol. III, p. 251 at l. 9-23; p. 252 at l. 1-4. This demonstrates that using only one year contracts exposes customers to excessive price volatility, which can be mitigated by using longer-term contracts. If the contract duration is limited to one year for the next procurement cycle, Pepco and Delmarva customers will be completely exposed and BGE customers 75% exposed to the market as of June 1, 2008. This would be the same exposure that residential customers faced in for the procurement of power to start June 1, 2006, except it was BGE customers that were 100% exposed and Pepco and Delmarva customers that

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[26] One can deduce that that the legacy contracts in the portfolio for the PHI companies had a dampening effect on the price increase those customers experienced from the fact that the resulting retail prices for Pepco and Delmarva customers are lower than the retail prices for BGE customers.

were 75% exposed.[27]

The second "hit" to SOS customers from using only one-year contracts for SOS power procurement is that they would have little hope of vigorous retail competition developing. According to the witness for RESA, an organization of all but one national retail supplier (Tr. Vol. III, p. 122 at l. 13-20), it would be wrong to think that customers would benefit from vigorous competition at the retail level with an SOS based on one-year contacts.[28] Tr. Vol. III, p. 140 at l. 4-17.[29] Thus, not only would the customers be subject to an unreasonable risk of excessive price increases, but there would be no justification for expecting that there would be vigorous competition at the retail level to possibly provide customers at least some of the benefits that were being denied to them because of the SOS policy.

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[27] The attempts of retail suppliers to draw a parallel between their proposal for a volatile electric SOS and the Maryland retail gas market are off the mark. Primarily, there is no equivalent to SB 1 on the gas side. Therefore, the usefulness of looking to the retail natural gas market in designing SOS procurement under SB 1 is very limited. Additionally, as was made clear during the hearing, BGE does not buy all of its winter gas on a month-to-month basis. BGE's witness, Mr. Pino, explained that BGE purchases approximately 50% of the gas it needs for the winter ahead of time, approximately 30% through storage and 20% with financial instruments. Tr. Vol. III, p. 297 at l.14-22. Mr. Pino also made the rather obvious points during the hearing that by hedging in this way, BGE reduces the month-to-month variability in prices to a level that is less than what would be experienced under the monthly SOS proposal. Tr. Vol. III, p. 313 at l. 9-14.

[28] While the testimony of witnesses on behalf of retail suppliers is inherently self-interested as it is their goal on behalf of their companies is create markets in which they can maximize their profits (Tr. Vol. III, p. 128, l. 17 – p. 130, l. 23), this admission by RESA's witness is particularly telling.

[29] Q. . . . So if someone thought that a year-to-year SOS was going to benefit consumers by attracting vigorous competition, that wouldn't be the case, would it? If somebody thought that a year-to-year SOS was going to attract -- for residential customers, is going to attract vigorous competition, they would be wrong, wouldn't you say?

A. [Mr. Steffes:] I would think that a one-year contract, as we say, is still not responsive enough to the underlying wholesale market.

Q. It's not going to attract vigorous competition?

A. Yes.

Tr. Vol. III, p. 140 at l. 4-17.

Staff witness VanderHayden recommends one- or two-year term contracts at a maximum. Preliminarily, Mr. VanderHayden's recommendation has absolutely no foundation in SB 1; indeed, Mr. VanderHayden believes that the main purpose of the Electric Restructuring Act is still the provision of a smooth transition from SOS to a fully competitive market, and the language of SB 1 "has had no impact" on Mr. VanderHayden's opinion "on what Maryland SOS policy should be." Tr. Vol. IV, p. 437 at l. 11-23. As well, under cross examination, Mr. VanderHayden acknowledged that his proposal would put all SOS customers in the position of being 100% exposed to the market again in 2009. Tr. Vol. IV, p. 454 at l. 23 – p. 455 at l. 16.

That being said, we will address Mr. VanderHayden's main concern that the Commission "not be constrained in its consideration of alternative SOS procurement methods in Case 9063 by committing a significant portion of the Maryland SOS load for more than two years." Staff Ex. 1, p. 5 at l. 20-30. As Mr. Wallach stated in his Rebuttal Testimony, "although Mr. VanderHayden's goal of not limiting the Commission's options is reasonable, there are a number of reasons why his proposal is not." OPC Ex. 3, p. 13 at l. 1-4. As Mr. Wallach stated, "short-term (i.e., less than five-year) full-requirements contracts are likely to be a part of any diversified resource portfolio that is ultimately submitted and approved by the Commission. Thus, committing some portion of the SOS load to three-year contracts in the upcoming solicitation will probably not limit the Commission's options in future procurements." OPC Ex. 3, p. 13 at l. 5-9. As Mr. Wallach further noted, "to the extent that full-requirements contracts continue to be included in the SOS portfolio, it is not reasonable to arbitrarily limit the terms of such full-

requirement contracts. Instead, utilities should seek to maximize price stability and minimize portfolio risk by layering contracts of varying terms, selecting from the full range of commercially available and reasonably priced contracts. As Mr. Schaub notes, the wholesale market currently supports full-requirements contracts of up to three-year duration." OPC Ex. 3, p. 13 at l. 10-16.

Mr. VanderHayden's suggestion that "dollar cost averaging" is sufficient to protect SOS customers is not supported by the facts. On cross-examination, Mr. VanderHayden stated that the "dollar cost averaging" he is suggesting is simply the spreading of purchasing into three tranches over three months that was done last year under the Case No. 8908 procedure. Tr. Vol. IV, p. 438, l. 22 - . 439, l. 3. Obviously, considering the excessive price increases experienced by PHI residential customers last year, that "dollar cost averaging" approach is insufficient to protect customers.

In short, Staff's fear of SOS contracts being longer than a two-year duration which would unduly restrict the Commission's flexibility is not a valid concern. Procuring one, two, and three year contracts in the next procurement cycle would virtually not restrict at all the Commission's ability to adopt a different procurement methodology in the future. The mix proposed by PHI for the first tranche, and supported by OPC, would include one-third of load in 3 -year contracts, with two-thirds of the load in one and two year contracts for the year starting June 1, 2009. From any viewpoint, the known risk of electric companies being fully exposed in 2009 – the consequences of accepting Staff's proposed two-year contract duration limits – far exceed the de minimis risks (if they are

such at all) of the Commission adopting the portfolio proposed by PHI for the first tranche of an RFP process set forth in the PIP report.

3. The Commission should reject the proposal by CECG to amend the language in the full requirements service agreement regarding migration of load due to municipal aggregation.

Martin V. Proctor, on behalf of Constellation Energy Commodities Group, Inc. ("CECG"), recommends that a new provision be added to the Full Requirements Service Agreement approved in Case No. 8908 "to deal with the situation in which suppliers face significant loss due to the implementation of a municipal aggregation program." CECG Ex. 1, p. 9 at l. 5-8. "Municipal aggregation is a way to create a customer group for the purpose of buying energy based on the municipality in which those customers reside." Staff Ex. 2, p. 17 at l. 3-4. Mr. Proctor's recommendation arises from CECG's concern that "the potential for municipal aggregation poses a significant risk of migration to suppliers, and that such risk will either discourage participation or result in substantial risk premiums on offer prices." OPC Ex. 3, p. 8 at l. 20-22 through p. 9. at l. 1.

To mitigate its concern, CECG's proposed new provision would add to the FSA language that, in the event that a municipality is allowed to aggregate retail electricity customers through an "opt-out" program, and subject to Commission consideration and approval, wholesale suppliers would have the right "**to charge the costs it incurs** as a result of the implementation of such [an] opt-out aggregations, **including . . . costs incurred to unwind hedges associated with the aggregated load formerly supplied by the Seller** [i.e. the wholesale supplier] under a Transaction [i.e. a procurement contract]."

CECG Ex. 1, p. 9 at l. 10-22, emphasis added.[30]

The Commission should reject CECG's proposal because it would "unreasonably shift aggregation risk from suppliers to consumers" as well as "inefficiently and inequitably expose consumers to additional risk." OPC Ex. 3, p. 9 at l. 9-20. CECG's proposed shift of risk is unreasonable because it would remove risk "from the party that can most efficiently manage that risk [i.e. the wholesale seller] and plac[e] it on the party that is incapable of hedging against such risk [i.e. individual SOS consumers]." OPC Ex. 3, p. 10-13. In other words, because migration risk is **already factored in** by a wholesale

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[30] CECG's proposed provision reads, in full: "4.12. Municipal Aggregation Rights. In the event that a municipality is allowed to aggregate retail electricity customers, where an electricity customer located within the municipality is automatically included in such aggregation unless the customer specifically requests not to be included in such aggregation (opt-out aggregation) for the purpose of supplying such retail customers their electricity, and a municipality implements such aggregation anytime during a Transaction's Delivery Period, Seller shall the right to charge the costs it incurs as a result of the implementation of such opt-out aggregation, including, but not limited to, costs incurred to unwind hedges associated with the aggregated load formerly supplied by Seller under a Transaction. Such costs shall be recovered by Seller as follows: Seller shall provide the Buyer, subject to the confidentiality provisions of this Agreement, sufficient information to demonstrate that costs for which the Seller seeks recovery from Buyer are due solely to the implementation of a municipal opt-out aggregation program and such costs are commercially reasonable. Buyer will file with the Maryland PSC, and provide notice to all Parties (as that term is used in the PSC Settlement), a request for a proceeding to be opened to consider recovery of such additional costs. Seller is required to intervene in any such proceeding before the Maryland PSC. Such additional costs can only be recovered by Seller from Buyer to the extent that the Maryland PSC agrees that the costs were commercially reasonable and due solely to the implementation of a municipal opt-out aggregation program, and therefore approves Buyer's recovery of those costs from SOS customers. Approved additional costs that are incurred by Seller prior to the date of Maryland PSC approval shall include interest at the Interest Rate, applied on a monthly basis from the date the costs are incurred. Seller agrees to be bound by the decision of the Maryland PSC (subject to the normal rules for appeal of the decision of the Maryland PSC) and waives all claims concerning this issue before FERC. Notwithstanding the foregoing, nothing in this Agreement shall preclude Seller from taking any position before any governmental body regarding creation of or changes to the municipal opt-out aggregation programs." CECG Ex. 1, pp. 9-11.

supplier **into its pricing**, *see* Tr. IV at p. 354, l. 4-23 through p. 355 at l. 1-6[31], CECG is simply trying to make an additional (or double) profit on the heart of its own business, that is, the business of hedging its portfolio of electric power contracts. Following there from, and as Mr. Wallach also pointed out, CECG's proposal "also exposes consumers to substantial regulatory risk, since it will be extremely difficult, if not impossible, to determine whether a supplier [such as CECG] seeking recovery of aggregation-related costs is overstating the incremental impact of aggregation on supply-portfolio costs or whether the expected value of such additional costs are already included in the supplier's offer price (e.g., in the form of a risk premium.)" OPC Ex. 3, p. 9 at l. 13-19. Staff concurs with OPC's position on this issue. Staff Ex. 2, p. 18. at l. 1-2.

4. The Commission should not adopt the proposals to change the bid week schedule for a full-requirements contracts RFP process.

Witnesses for both BGE and PHI made suggestions as to changing the schedule of events during bidding under the Case No. 8908 process. Pepco/Delmarva Ex. No. 1, p. 3 at l. 14 and BGE Ex. No. 1, p. 9 at l. 23. While both witnesses state that their respective proposals are designed to reduce "bid hold premiums," however, each witness proposed different changes to the schedule to accomplish that goal. Neither proposal is part of the consensus changes in the PIP Report. OPC does not support either of the proposals.

While the goal each of these proposals is designed to achieve is appropriate and in SOS customers' interests, OPC's witness Wallach stated that neither proposal is sufficiently developed for the Commission to conclude that it will achieve the intended

[31] Testimony of Mr. Gabbard on behalf of CESI, a wholesale energy supplier.

goal without causing unintended harm. OPC Ex. No. 3, p. 10 at l. 11 – p. 11 at l. 13. Mr. Wallach points out that, while Mr. Schaub's proposal on behalf of PEPCO and Delmarva to move bid submittal to 10:00 a.m. and award contracts by 5:00 p.m. of the same day avoids the problem of holding bids overnight, it seems to create an equivalent problem by requiring bids to be held for most of a trading day. OPC Ex. No. 3, p. 10 at l. 21 through p. 11 at l. 2. In contrast, Mr. Pino's proposal on behalf of BGE to move the bid submittal to 4:30 p.m. and award contracts by 8:00 p.m. of the same day avoids the problem of bidder risk during a trading day, but nonetheless raises the possibility of substantial negative consequences by unduly limiting the utilities to only 210 minutes between bid submittal and contract award. OPC Ex. No. 3 at p. 11 at l. 3-13.[32] In summary, while the goals of each proposal are well intended, both raise substantial known risks and, because they are both theoretical and untested, additionally raise the risk of unintentional and foreseen consequences which are too great without additional and more specific evidence to warrant the Commission's support.

5. OPC supports BGE proposal for TOU bidding with the cautions provided by Mr. Wallach.

Historically, BGE has offered its customers whose homes contain a particular type of usage meter, time differentiated (or "time of use" ["TOU"]) SOS retail price tariffs.

[32] As Mr. Wallach specifically testified, "Mr. Pino's proposal of a bid deadline of 4:30 [PM] avoids the problem of intra-day risk posed by PHI's proposal. However, his proposal to award contracts by 8 PM of the bid day raises a concern that there will not be enough time to process and confirm all offers, evaluate such offers for conformance with the Price Anomaly Threshold, and resolve any outstanding issues regarding compliance with bid or contract-award procedures. In other words, the 210-minute window between offer deadline and contract award proposed by BGE may not allow for any margin for error or unanticipated problems. It is not clear from Mr. Pino's proposal what actions would be taken if such errors or problems could not be resolved by the 8 PM contract-award deadline." OPC Ex. No. 3, p. 11 at l. 3-13.

BGE Ex. 1, p. 6 at l. 15-16, 26. Those tariffs provide for three-tiered pricings, the three tiers being as follows: (a) on, (b) intermediate, and, (c) off-peak. BGE Ex. 1, p. 6 at l. 18-20. In previous years' procurements, bidders were required to offer prices for the particular time periods specified in TOU rates. OPC Ex. 1, p. 5 at l. 1-3.

In contrast to BGE's three-tiered pricing, PJM-traded products are limited to two tiers: (a) on-peak, and, (b) off-peak. BGE Ex. 1, p. 6 at l. 16-18, 27-29. BGE is now concerned that the inconsistency between the time periods for PJM-traded wholesale products and for the Company's TOU retail rates may raise barriers to participation and increase risks to participants. OPC Ex. 1, p. 5 at l. 10-16; BGE Ex. 1, p. 6 at l. 26-30 through p. 7, l. 1-7.

Consequently, for the upcoming procurement, BGE proposes to require bidders to offer prices for on- and off-peak periods that are consistent with the standard time periods for PJM wholesale-market products. Under this proposal, BGE would generate retail TOU prices by translating the on- and off-peak prices from winning bids into on-, intermediate-, and off-peak prices consistent with the time periods specified in TOU rates. BGE Ex. 1, p. 6 at l. 16-24; OPC Ex. 1, p. 5 at l. 6-9. BGE believes that its proposal may improve pricing by increasing competition and reducing risk premiums. BGE Ex. 1, p. 7 at l. 3-4.

While OPC's expert witness, Mr. Wallach, is generally "supportive" of the proposal because it appears to be a "reasonable approach" for **investigating** whether the inconsistency between PJM two-tiered priced contracts and BGE's three-tiered time differentiated rate structure "has a material impact on bidder participation and offer

pricing." OPC Ex. 3, p. 6, l. 3-10. As Mr. Wallach notes, it is as yet only "a matter of speculation whether the general levels and time-differentiation of TOU prices offered in previous years' solicitations are due to the inconsistency between wholesale and retail rating periods." OPC Ex. 3, p. 5, l. 18-20. Thus, Mr. Wallach expressed "concern that the resulting mismatch between prices paid to winning bidders and prices charged to retail TOU customers may lead to excessive under- or over-recovery of wholesale power costs." OPC Ex. 3, p. 6, l. 3-6.

For those reasons, while the OPC does not oppose the implementation of BGE's TOU plan for **this year's** SOS solicitation, the OPC urges the Commission to adopt the recommendations of Mr. Wallach that BGE be directed: (1) to evaluate and report on the impact of the proposal on price offers for TOU load; and, (2) to "closely monitor true-up accounts to determine whether more-frequent billing true-ups are warranted." OPC Ex. 3, pp. 5-6.

6. OPC supports the proposal for an evidentiary hearing for each bid week.

OPC supports BGE's proposal to have an evidentiary hearing prior to approval of any contracts selected as part of a Case No. 8908 bidding process. BGE's witness, Mr. Pino, describes the proposal as including weekly evidentiary hearings which will include reports from the independent Bid Monitor and testimony, if requested, by any other parties. The hearing would result in an order issued by the Commission making findings on the propriety of the bidding process and the contracts resulting there from. As Mr. Pino stated:

> BGE proposes that the Commission hold an evidentiary hearing, on the Thursday or Friday of every bid week, to explicitly approve the contract awards from that week's tranche. At the hearing, the Independent Consultant who has been monitoring the bidding for the Commission will report on whether the bidding has been conducted in accordance with the approved procedures, and would be subject to cross-examination under oath. Other parties would be free to offer testimony. The Commission would then issue an order making express findings as to whether the bidding was properly conducted and the contracts are approved.

BGE Ex. No. 1, p. 11 at l. 22-29.[33]

The public would benefit from a process that is as open and transparent as possible for the acceptance of bids under a Case No. 8908 procurement process. An evidentiary hearing would allow to be made public the observations, or at least the conclusions, of the Commission's independent consultant as to the competitiveness of the process, and would also provide a ready forum for the OPC or any other party to submit evidence on the process. Having such a hearing will not only allow parties a ready forum to air objections to or concerns with the process but it can also encourage greater public confidence in the process with respect to the objections and concerns that are not raised during the hearing.

Concerns raised about such hearings pertaining to confidentiality should not preclude adoption of the proposal. Appropriate confidentiality arrangements can be made for the various parties to the extent that inquiry into detailed information about the bidding process is needed. While a fully transparent hearing would be the most

[33] Mr. Schaub, on behalf of Pepco and Delmarva, said that those companies "do not object to the additional protection and transparency for the process." PEPCO/Delmarva Ex. No. 2, p. 5 at l. 5-10.

advantageous to the public, a semi-transparent proceeding is nonetheless better than a process that is entirely hidden from public view.

C. SOS Rates Should Reflect Only Actual Wholesale Supply Costs, Administrative Costs, And Reasonable Profit For The Utility

Pursuant to SB 1, the Commission should now prohibit artificial charges added into SOS rates or mechanisms that create a subsidy from SOS customers to customers who have switched.

Currently, an "Administrative Charge" of 0.4 cents per kwh is imposed upon residential SOS customers as part of the Settlement for setting rates that resolved Case No. 8908.[34] *See* Testimony of William Pino, Tr. III, p. 298 at l. 19-23 through p. 299 at l. 1; BGE Exhibit 1, p. 4 at l. 28-29. The so-called "Administrative Charge" is an "additional cost" added to wholesale price attained from the RFP through which the SOS power was purchased. BGE Exhibit 1, p. 4 at l. 28-29, p. 5 at l. 1-2. The "Administrative Charge" is a rate mechanism that serves as a "proxy" for costs believed to be incurred by retail marketers but not by electric companies in providing SOS. Tr. III, p. 298 at l. 19-23 through p. 299 at l. 6-12.

The Commission approved this "Administrative Charge" as part of the settlement of Case No. 8908 because it was part of a "well-balanced model that took into account fairness for all stakeholders," who by necessity included retail suppliers. BGE Exhibit 1, p. 4 at l. 24-25. Particularly, the "Administrative Charge was included as part of that

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[34] There are also administrative charges of 0.55 cents per kwh for Type I and 0.65 cents per kwh for Type II SOS customers imposed as a result of the Case No. 8908 settlement. Tr. III, p. 298 at l. 19-23 through p. 299 at l. 1.

balance because it represented "the retail suppliers' desire for the inclusion in the retail price of a proxy for additional costs incurred at the retail level." BGE Ex. 1, p. 5 at 1-3.

With the enactment of SB 1, there is no longer any legal basis or justification for the imposition of any type of "administrative charge," be it a proxy or if any precise amount is ever calculated. The inclusion of "proxy" costs is for the benefit of the retail suppliers and creates a subsidy from residential customers on SOS to residential customers that have switched to another supplier. Before SB 1 was enacted, the Commission could justify an "administrative charge" under the original Act to artificially stimulate competition at the expense of SOS and where an electric company's obligation to provide SOS was supposed to terminate in 2003. SB 1, however, mandates that SOS be the "best price." There is simply no room any longer under the language or requirements of SB 1 for a rate mechanism that increases SOS rates above the utility's actual cost (including administrative costs and any utility return required by the Act) to procure electricity for SOS. Consequently, the Commission is now required to order that such a rate mechanism is no longer going to be part of SOS pricing.

IV. CONCLUSION

For the foregoing reasons, OPC respectfully requests that the Commission direct the utilities to file a plan with the Commission that implements the requirements of SB 1 to design the SOS portfolio to achieve the best price with protection from excess volatility including the purchasing for SOS power needed by June 1, 2007. To the extent that the Commission orders the utilities to implement a Case No. 8908-type full requirements contracts approach to purchase SOS power for 2007, the Commission should direct the

utilities to include two and three year contracts in the portfolio mix, implement the changes set forth in the PIP Report, accept BGE's proposal to alter the bidding for TOU customers, and conduct an evidentiary hearing for each tranche of bidding. The Commission should not accept the proposal to include language addressing municipal aggregation nor the proposals to change the timing of bid submittal and contract awarding. Further, the Commission should order that under SB 1 SOS rates will not reflect any additional costs or subsidies to artificially motivate retail switching.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this _____ day of October, 2006, the foregoing "Brief of the Office of the People's Counsel" was either hand-delivered, e-mailed or mailed first-class, postage prepaid to all parties of record to this proceeding.

____

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