

Brian R. Greene
GreeneHurlocker, PLC
707 E. Main Street, Suite 1025
Richmond, VA 23219-2812
804-672-4542 (Direct)
BGreene@GreeneHurlocker.com

April 18, 2014

By Electronic Filing

David J Collins, Executive Secretary
Maryland Public Service Commission
William Donald Schaefer Tower
6 Saint Paul Street, 16th Floor
Baltimore, MD 21202-6806

Re: Case Nos. 9226 and 9232

Dear Mr. Collins:

On behalf of the Retail Energy Supply Association, enclosed please find an original and 17 copies of the Direct Rebuttal Testimony Richard J. Hudson, Jr.

Please feel free to contact me should you have any questions.

Sincerely,



Brian R Greene

Cc. Richard J Hudson, Jr.
Service List

**BEFORE THE
PUBLIC SERVICE COMMISSION
OF MARYLAND**

In the Matter of the Review of the
Delmarva Power and Light Company
Standard Offer Service Administrative
Charge

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Case No. 9226

In the Matter of the Review of the
Potomac Electric Power Company
Standard Offer Service Administrative
Charge

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Case No. 9232

REBUTTAL TESTIMONY

OF

RICHARD J. HUDSON, JR.

On Behalf of

Retail Energy Supply Association

April 18, 2014

Brian R. Greene
GreeneHurlocker, PLC
Eighth and Main Building
707 East Main St., Suite 1025
Richmond, Virginia 23219
Tel: 804.672.4542
Fax: 804.672.4540
BGreene@GreeneHurlocker.com

Counsel for the Retail Energy Supply Association

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1 **I. INTRODUCTION AND BACKGROUND**

2 **Q. PLEASE STATE YOUR NAME AND TITLE.**

3 A. My name is Richard J. Hudson Jr. I am employed directly by ConEdison Solutions as the
4 Director of Regulatory and Legislative Affairs. I am also the Pennsylvania State
5 Chairman for the Retail Energy Supply Association (“RESA”).¹

6 **Q. ARE YOU THE SAME RICHARD J. HUDSON THAT TESTIFIED**
7 **PREVIOUSLY IN THIS PROCEEDING ON BEHALF OF THE RESA?**

8 A. Yes, I am. I submitted testimony on February 18, 2014 (“February testimony”).

9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?**

10 A. I will respond to the certain issues and statements presented in the Reply Testimony of
11 Jonathan Wallach (“Wallach Testimony”), submitted on April 1, 2014 by the Office of
12 People’s Counsel (“OPC”). More specifically, I will respond to OPC’s proposal, as
13 discussed Mr. Wallach, to eliminate the Administrative Adjustment component of the
14 standard offer service (“SOS”) Administrative Charge for Potomac Electric Power
15 Company (“Pepco”) and Delmarva Power and Light Company (“Delmarva Power”).² I
16 will also touch upon OPC’s proposal to set the return component to include only the
17 return on the Companies’ SOS-related cash working capital (“CWC”).

¹ RESA’s members include: AEP Energy, Inc.; Champion Energy Services, LLC; ConEdison Solutions; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; GDF SUEZ Energy Resources NA, Inc.; Homefield Energy; IDT Energy, Inc.; Integrys Energy Services, Inc.; Just Energy; Liberty Power; MC Squared Energy Services, LLC; Mint Energy, LLC; NextEra Energy Services; Noble Americas Energy Solutions LLC; NRG Energy, Inc.; PPL EnergyPlus, LLC; Stream Energy; TransCanada Power Marketing Ltd. and TriEagle Energy, L.P. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

² Pepco and Delmarva Power are referred to collectively herein as “the Companies.” Also, the term “Settling Parties” refers to RESA, Pepco, Delmarva Power, and Staff.

1 **II. ADMINISTRATIVE ADJUSTMENT**

2 **Q. WHAT IS YOUR REACTION TO MR. WALLACH'S PROPOSAL TO**
3 **ELIMINATE THE ADMINISTRATIVE ADJUSTMENT COMPONENT OF THE**
4 **SOS ADMINISTRATIVE CHARGE?**

5 A. RESA disagrees with Mr. Wallach's proposal and his reasoning. As I explained in my
6 February testimony, the Administrative Adjustment is an essential element of the
7 Administrative Charge because it acts as a proxy for the full scope of costs that should be
8 reflected in SOS rates but which the Companies instead recover through their distribution
9 service base rates. Retail supplies incur numerous costs associated with the provision of
10 electric retail service which are similar to the types of costs that the Companies incur in
11 their provision of SOS. While retail suppliers must recover all of their costs through the
12 prices they charge to their customers, the Companies' full cost of providing SOS is not
13 reflected in their SOS rates. The Administrative Adjustment, with its credit mechanism,
14 helps to address this inequity.

15 **Q. MR. WALLACH SEEMS TO ARGUE THAT THE COMPANIES DO NOT**
16 **RECOVER ANY SOS-RELATED COSTS IN BASE RATES. (SEE WALLACH**
17 **TESTIMONY AT 19). HOW DO YOU REACT TO THAT ARGUMENT?**

18 A. I do not agree. In its initial testimony in this very proceeding, Staff proposed an Allocated
19 Cost mechanism that would address the fact that the Companies recover SOS-related
20 costs through their base rates. Staff proposed to strip a portion of certain costs out of
21 base rates and allocate those portions to SOS, which would provide a more certain and
22 transparent proxy for SOS-related cost recovery. OPC replied to Staff's testimony with
23 estimates as to the impact that Staff's proposal would have on the Administrative Charge.
24 OPC's conclusion was that Staff's proposal would dramatically increase the
25 Administrative Charges. Therefore, Staff is on record that the Companies incur costs in

1 providing SOS that are recovered through base rates. Moreover, assuming OPC was
2 correct and the Allocated Cost proposal would lead to much higher Administrative
3 Charges, then the proposed Settlement Agreement should be viewed as reasonable and in
4 the public interest because it would lead to Administrative Charges, and an
5 Administrative Adjustment, that are a continuation of what is in place today and are less
6 than the Allocated Cost proposal.

7 **Q. MR WALLACH PRESENTS TESTIMONY ABOUT THE CONCERNS OF**
8 **VARIOUS SETTLING PARTIES IN CASE NO. 8908 WHEN THEY DESIGNED**
9 **THE ADMINISTRATIVE ADJUSTMENT. (WALLACH TESTIMONY AT 17-**
10 **18). DO YOU HAVE A RESPONSE TO THAT?**

11 **A.** Yes. While I personally did not participate in the settlement discussions in Case No.
12 8908, I have reviewed the Commission's Order No.78400 approving the prior settlement.
13 While I have no doubt that various settling parties in Case No. 8908 had different
14 interests, the Commission was clear about the intent and impact of the Administrative
15 Adjustment. On page 10, footnote 27 of the Order, the Commission described the
16 Administrative Adjustment as "a mechanism used to adjust the cost of SOS (generation)
17 while holding harmless customers through a commensurate credit." The Commission
18 concluded that the Administrative Adjustment "is designed to have a neutral impact on
19 the customer whether or not they shop for electric supply, which should stimulate
20 Maryland's retail electric market." Order No. 78400 at 85; *see also* p. 26, fn. 82. Finally,
21 the Commission held that, "the crediting mechanism in the Administrative Adjustment is
22 appropriate because all customers are treated equally thereby avoiding cross-subsidies."
23 Order No. 78400 at 93.

24 **Q. MR. WALLACH TESTIFIES THAT THE RECOVERY OF A PORTION OF SOS-**
25 **RELATED COSTS THROUGH DISTRIBUTION RATES DOES NOT PROVIDE**

1 **A SUBSIDY TO SOS CUSTOMERS. (WALLACH TESTIMONY AT 19). HOW**
2 **DO YOU REACT TO THAT TESTIMONY?**

3 A. The recovery of SOS-related costs from any source other than SOS rates results in SOS
4 rates that do not include the full cost of SOS and are therefore below-market rates. If
5 SOS-related costs are being paid for by all distribution customers, regardless of whether
6 the customers shop for electricity, then distribution rates are subsidizing SOS rates and
7 holding SOS rates at an artificially low level. It also means that customers who have
8 chosen to shop for their electricity with a retail supplier continue to pay, through their
9 distribution rates, for SOS even though they are not SOS customers. Thus, they are
10 paying too much for their generation service because they must pay their retail supplier
11 and they also must pay for a portion of SOS even though they are not SOS customers.

12 As an example of a joint and common cost, a supplier must maintain a call center to
13 handle customer inquiries, and must recover the cost of that call center through the prices
14 it charges to its customers. The Companies maintain a call center that handles
15 distribution and SOS-related inquiries, but the Companies recover 100% of the cost of the
16 call center through their distribution base rates; no portion of the call center is recovered
17 through SOS rates. Therefore, distribution rates subsidize the SOS rates, as SOS rates are
18 not designed to recover the Companies' full costs of providing SOS. Moreover, without
19 the Administrative Adjustment and corresponding credit mechanism, a shopping
20 customer would be required to pay for two call centers – the supplier's and the utility's
21 (from whom the customer is not even taking supply service). As the Commission held in
22 Order No. 78400, the Administrative Adjustment, with its crediting mechanism,
23 addresses this subsidization problem and allows for a neutral impact upon customers.

1 Q. MR. WALLACH CLAIMS THAT THE ADMINISTRATIVE ADJUSTMENT
2 ARTIFICIALLY INCREASES THE SOS RATE AND THEREFORE VIOLATES
3 § 7-510(c)(3)(ii)(2) OF THE PUBLIC UTILITIES ARTICLE. (WALLACH
4 TESTIMONY AT 21). HOW DO YOU RESPOND?

5 A. It seems clear that Mr. Wallach has not considered the full text of the statutory section,
6 which says that:

7 ... an electric company continues to have the obligation to provide standard offer
8 service to residential and small commercial customers *at a market price* that
9 permits recovery of the verifiable, prudently incurred costs to procure or produce
10 the electricity plus a reasonable return. (Emphasis added).

11 As I stated in my February testimony, without either an Administrative Adjustment/credit
12 mechanism or a full unbundling (or a different mechanism such as Staff's Allocated Cost
13 proposal), the Companies would be offering SOS at rates that do not include the full costs
14 of the Companies' services, and retail suppliers would be in the unreasonable and
15 unenviable position of marketing against an SOS rate that is, in effect, a discounted,
16 below-market, artificially low price. This scenario would violate § 7-510(c)(3)(ii)(2)
17 because the Companies would not be providing SOS "at a market price."

18 III. RETURN

19 Q. UNDER OPC'S PROPOSAL, THE COMPANIES' RETURN FOR SOS WOULD
20 BE LIMITED TO THE RETURN EARNED ON SOS-RELATED CWC
21 CALCULATED USING THE SHORT-TERM DEBT RATE OF 3.25%. (SEE
22 WALLACH TESTIMONY AT 12-15). DO YOU HAVE A RESPONSE TO THAT
23 PROPOSAL?

24 A. Yes. As I stated in my February testimony, RESA supports the return in the Settlement
25 in part because it strikes the right balance between proper SOS pricing under Maryland
26 law and it would not appear to incentivize the Companies to keep customers on SOS. I

1 also stated that retail suppliers would expect to earn a return in excess of those in the
2 Settlement, yet OPC has proposed to reduce the returns even further. Specifically, OPC
3 would reduce the Settlement's proposed return of 1.3 mills per kWh to zero. The
4 Companies' only return would be on the CWC, which would amount to 0.29 mills per
5 kWh for Delmarva Power and 0.26 mills per kWh for Pepco. OPC's proposal is
6 unreasonable because retail suppliers have very real CWC needs and they must also earn
7 a return, all of which must be recovered through the prices they charge to their customers.
8 OPC's proposal with respect to eliminating the return and allowing only for a return on
9 CWC would require retail suppliers to compete against a discounted, artificially low,
10 below-market SOS price. OPC's proposal is a step backwards and would harm the
11 further development of the competitive electricity market by making it more difficult for
12 suppliers to enter and remain in the Maryland market. This result would harm Maryland
13 customers by decreasing the number of products and services available to them in the
14 market.

15 **IV. CONCLUSION**

16 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

17 **A. Yes.**