ORDER NO. 80638

IN THE MATTER OF THE COMMISSION'S INVESTIGATION INTO A RESIDENTIAL ELECTRIC RATE STABILIZATION AND MARKET TRANSITION PLAN FOR BALTIMORE GAS AND ELECTRIC COMPANY.	* * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND CASE NO. 9052

Appearances:

Daniel P. Gahagan and Jeffrey P. Trout, for Baltimore Gas and Electric Company.

Patricia A. Smith, Theresa V. Czarski and William F. Fields, for the Office of People's Counsel.

Andrew N. Beach and Lloyd J. Spivak, for the Staff of the Maryland Public Service Commission.

M. Brent Hare, for the Maryland Energy Administration.

Joelle K. Ogg, for the National Energy Marketers Association.

Telemac N. Chryssikos and Kimberly J. August, for Washington Gas Energy Services, Inc.

Paul H. Harrington and Mindy L. Herman, for Potomac Electric Power Company and Delmarva Power & Light Company.

Philip J. Bray and John Munsch, for The Potomac Edison Company d/b/a Allegheny Power.

Carla G. Pettus, for Pepco Energy Services, Inc.

Donald R. Hayes, for Washington Gas Light Company.

Nancy A. White and Alvaro Mestre, for ISG Sparrows Point, LLC.

James J. Doyle, III, for Direct Energy Services, LLC.

Odogwu O. Linton, for Retail Energy Supply Association.

Michael C. Powell and Todd R. Chason, for Maryland Industrial Group and U.S. Gypsum Co.

Jeral A. Milton, for Eastalco Aluminum Company.

Gary R. Alexander and Chantel R. Ornstein, for Mirant Mid-Atlantic, LLC.

Brian R. Greene, for Amerada Hess Corporation.

Marta D. Harting and Brian M. Quinn, for Choptank Electric Cooperative, Inc.

Mark A. MacDougall, for Southern Maryland Electric Cooperative, Inc.

I. INTRODUCTION AND BACKGROUND

This case considers plans that would ease the transition of Baltimore Gas and Electric Company ("BGE") residential customers from their current capped rate levels to significantly higher market rate levels that are anticipated to commence July 1, 2006. An important starting point for this consideration is the fact that BGE was granted its last general rate increase in 1993, and the capped rate set to expire is 6.5 percent below the rates established in 1993.[1] The capped rate is now well below prevailing market rates. Meanwhile, the wholesale price of electricity and commodities used to produce electricity have moved dramatically

higher in the last few years. We are necessarily, therefore, confronted with a situation in which BGE customers are likely to see significant rate shock.

The Electric Customer Choice and Competition Act of 1999 ("the Act")[2] required as part of a transition to retail competition that residential base rates should be reduced between 3 percent and 7.5 percent as measured on June 30, 1999, and that all customers should receive a four-year rate freeze beginning with the implementation of customer choice.[3] The Act[4] permitted the Commission to consider and approve settlements that differed from those provisions such that a rate cap could be in effect for a different time period or an alternative price protection plan could be approved that the Commission determined was "equally protective of ratepayers."[5]

---

[1] Entered April 23, 1993, *Re Baltimore Gas and Electric Company*, 84 Md. PSC 145 (1993).

[2] Public Utility Companies Article of the *Annotated Code of Maryland*, § 7-501, *et seq.*

[3] Section 7-505(d).

[4] Hereinafter, all references to Code sections will be to this Act, unless specified otherwise.

[5] Section 7-505(d)(3).

In compliance with the Act, on November 10, 1999 the Commission issued Order No. 75757 in the BGE restructuring Case No. 8794/8804.[6] Order No. 75757 approved a settlement that included an overall 6.5 percent rate reduction and a rate cap effective through June 30, 2006 for BGE residential customers. The level of BGE's rate reduction for residential customers is similar to the restructuring transition period rate reductions for the other three Maryland investor-owned electric companies. However, the rate cap period was two years longer than the rate cap period for Potomac Electric Power Company ("Pepco") and Delmarva Power and Light Company ("DP&L") and two years shorter than the generation rate cap period for Allegheny Power ("APS").[7]

Beyond its provisions for the initial transition period to retail competition, the Act also contains numerous provisions that look ahead to the time period that follows the expiration of required residential rate reductions and caps. The Act anticipated

[6] Entered November 10, 1999 *In the Matter of the Baltimore Gas and Electric Company's Proposed: (A) Stranded Cost Quantification Mechanism; (B) Price Protection Mechanism; and (C) Unbundled Rates*, Case No. 8794, and *In the Matter of the Petition of the Office of People's Counsel for a Reduction in the Rates and Charges of the Baltimore Gas and Electric Company*, Case No. 8804, 90 Md. PSC 197 (1999); hereinafter "Order No. 75757."

[7] 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).

the development of a regional competitive electric wholesale market by removing all investor-owned electric company generation from the Commission's rate setting authority.[8] This provision transferred the risks and rewards of wholesale generation transactions that had formerly rested largely on ratepayers to the generation owners. To maintain consistency with this new framework for power supply, the Act specified that Standard Offer Service ("SOS") provided by an electric company must be "market price(d)."[9]

In Order No. 78400 and Order No. 78710,[10] in Case No. 8908, the Commission approved a process for the procurement and pricing of SOS following the end of the investor-owned utility generation rate cap periods. Central to the Case No. 8908 process is the "market price" requirement of the Act. The Case No. 8908 process has been in effect for Pepco and DP&L residential SOS for two years and the power supply procurement process for BGE, Pepco and DP&L residential SOS for the 2006-2007 service year has recently been completed.[11] The Federal Energy Regulatory Commission

---

[8] Section 7-509.

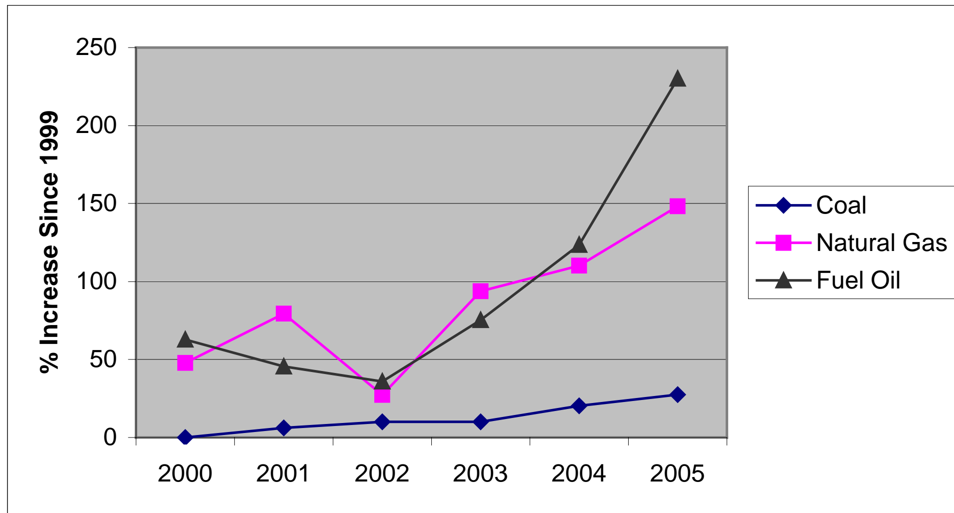
[9] Section 7-510.

[10] Entered April 29, 2003, *Re Competitive Selection of Electricity Supplier/Standard Offer Service*, Case No. 8908, 94 Md. PSC 113 (2003) and entered September 30, 2003, *Re Competitive Selection of Electricity Supplier/Standard Offer Service*, Case No. 8908, Phase II, 94 Md. PSC 286 (2003), hereinafter "Case No. 8908."

[11] Retail SOS prices effective July 1, 2006 for BGE and June 1, 2006 for Pepco and DP&L. APS residential power supply prices are capped through December 31, 2008.

("FERC") has strongly endorsed the competitiveness and even-handedness of Maryland's SOS bid process.[12]

The cost of fuel used to produce electricity is by far the largest factor in total operating cost for most generation facilities. Unfortunately, market prices for the fuels used to produce electricity have recently increased far beyond what could have been anticipated when the Act was passed and signed in 1999 or even when the Case No. 8908 process was finalized in 2003. The following graph shows the total increase in the producer price index since 1999 for fuels used by electric generators for calendar years 2000-2005.



The almost 150 percent price increase for natural gas and 230 percent price increase for fuel oil since 1999 provide a

[12] *Allegheny Energy Supply Company, LLC.*, 108 FERC ¶ 61,082, Order Granting Authorization to Make Affiliate Sales, Docket No. ER04-730-000.

dramatic explanation for the recent upward pressure on wholesale electric supply prices. Although coal prices increased "only" 28 percent, the generation fuel source at the margin[13] is natural gas or fuel oil for a growing percentage of electric generation. Consequently, the relationship between gas and fuel oil prices and wholesale electric prices (and the resulting price increases or decreases) is already close and is growing even stronger.

It has only recently become clear that the dramatic natural gas and fuel oil price increases that were related in large part to Hurricanes Katrina and Rita would not quickly subside and that those fuel price increases would most likely be reflected in residential SOS prices. In light of the possibility of dramatic bill increases for BGE residential customers beginning July 1, 2006, on January 3, 2006, Governor Robert L. Ehrlich, Jr. asked the Commission to investigate and take appropriate actions to address likely bill increases resulting from high wholesale energy prices and the expiration of far below market level rates for Central Maryland customers.

By letter Order, the Commission docketed Case No. 9052 on January 10, 2006.[14] The January 10 Order directed the Commission's Staff to file a proposal to ease the transition of BGE residential customers to market based rates. Dates for intervention

---

[13] The fuel used in the generator that is operated next in line as electric consumption increases.

[14] *In the Matter of the Commission's Investigation into a Residential Electric Rate Stabilization and Market Transition Plan for Baltimore Gas and Electric Company*, Case No. 9052, Order Initiating Proceeding.

of other parties and responsive testimony or proposals was also specified in the January 10 Order. The January 10 Order provided clear policy guidance to Staff and other parties on two key issues. Transition proposals would be limited to BGE and would not distort the SOS market price determined by the Case No. 8908 process.[15]

It is clear that fuel price increases and related wholesale market factors, not retail competition, is the cause of the price increases that will be seen by BGE customers. Since fuel cost changes were generally passed through to customer rates under the regulatory framework in place prior to the Act, the old regulatory framework would not have shielded customers from the current fuel price environment. The intent of the Act to create competitive electricity supply markets is clear.[16] While the rate cap period was an important element of the overall transition to competitive markets, the creation of competitive markets will not take place if SOS prices are kept artificially below real market levels. The Commission's Electric Choice Enrollment Monthly Report makes it clear that the development of competition was quite limited during the rate cap periods, and almost non-existent for BGE residential customers. Consequently, the Commission sought in its Order establishing this proceeding to consider a BGE rate

---

[15] On March 2, 2005, the Commission instituted a proceeding to consider a rate stabilization plan for residential customers of Pepco and DP&L. Further, the Commission will review the situation for Allegheny Power prior to the expiration of rate caps in 2009 and encourages the parties to Allegheny's last rate case to begin discussions.

[16] Section 7-504.

stabilization plan that would address the total bill impact of new power supply price levels for all residential customers, whether those customers continued on SOS or switched to a competitive supplier. A competitively neutral plan for BGE assures BGE residential customers time to adjust to higher bills and at the same time maintains for customers the opportunity to obtain the full benefit of competitive power supply offers that they may find more attractive than SOS.

By letter dated February 6, 2006, the Commission set a procedural schedule, including filing and hearing dates.[17] The February 6, 2006 letter also granted provisional party status and set February 14, 2006 as the date for objections to interventions.

The Commission Staff filed its Direct Testimony and Exhibits on January 23, 2006, which testimony included a proposed mitigation plan as directed by the Commission. Testimony was filed on February 13 by BGE, the Maryland Office of People's Counsel ("OPC"), the National Energy Marketers Association ("NEMA") and Washington Gas Energy Services ("WGES"). A number of letters were filed expressing interest in the proceeding.[18] Subsequently, on February 21, 2006, BGE filed a Motion to Strike certain passages from the NEMA and WGES testimony as beyond the scope of this proceeding, as the contested portions generally involved

---

[17] "Notice of Hearing and Oral Argument and Ruling on Petitions to Intervene."

[18] The APS and Pepco Holdings letters included additional comments.

interactions between marketers and utilities which issues are also the subject of other proceedings. A similar Motion was filed by Pepco and Delmarva on February 22, 2006.

Hearing in this matter was held on February 28, 2006. At the commencement of the hearing, the Commission granted all petitions to intervene. Also, the Commission denied the Motions to Strike portions of the NEMA and WGES testimonies, but noted that portions of these testimonies may be beyond the scope of this case.

Following the hearings, all parties were provided an opportunity to file final remarks by letter on March 3, 2006. In addition to final comments by the above parties which confirmed their final positions in this matter, no other intervening parties expressed opposition to adoption of the staff mitigation plan in final comments, with the Retail Energy Supply Association indicating support for the plan.

All of the testimony and other evidence on the record, as well as the arguments and comments of the parties, have been carefully reviewed and considered by the Commission in rendering a decision in this matter.

II. PROPOSED MITIGATION STRATEGY

A. Staff's Mitigation Proposal

Pursuant to the Commission directive, the Staff filed testimony of Philip E. VanderHeyden, Staff Regulatory Economist. Mr. VanderHeyden's analysis indicates that market rates for electricity may result in total bill increases of approximately

40 percent to 81 percent to SOS customers upon expiration of the rate caps, which may represent rate shock to BGE residential customers. He therefore presented a proposed mitigation strategy that would allow customers the choice to participate in a plan to limit the initial impact of potential rate increases occurring upon the expiration of the rate freeze.

Under the Staff plan, initial increases would be limited to approximately 21 percent[19], with energy costs above that level deferred for recovery by BGE over a two-year period. The Plan also includes carrying costs to compensate the utility for the financing costs associated with the regulatory asset. Participation in the plan would be optional to individual residential customers, with Staff recommending that the default option include no mitigation. In other words, customers who wish to participate must affirmatively accept the mitigation plan. Staff considers its proposal a fair and equitable balancing of consumer and Company interests that will avoid problems of severe rate shock to customers by limiting the amount of initial increase with more gradual implementation of the higher rates, while also assuring fairness to the Company by providing full recovery of the deferred costs as a regulatory asset with a return earned on the deferred amounts. The plan would also be consistent with electric restructuring and competition as it

[19] The proposed initial increase of 21 percent under the Staff plan compares with very similar initial increases experienced by Pepco customers since the expiration of their rate freeze in 2004.

would be administered through the delivery service portion of the bill, and be competitively neutral.

The specifics of the plan proposed by Staff would work as follows. The plan would cover a period of two years, commencing in June 2006 and ending in May 2008. For the initial nine months ending February 2007, which period covers both a summer and winter period, customers who participate may have their bills mitigated to below market increases, with the customer bill showing both the actual usage and the deferred amounts. Following the initial nine-month period in which customer bills would be mitigated, the deferred amounts would constitute a regulatory asset to BGE and be recovered in customer bills over the succeeding 14-month period. The result of the plan is to avoid rate shock, so that increases are more gradually implemented rather than the higher rates above 21 percent that would otherwise be due in July 2006 upon the expiration of the rate caps. Customers who choose not to participate in the mitigation plan would pay the unadjusted rates effective July 2006 and therefore avoid the later charges for the deferred amounts in the regulatory asset.

In Mr. VanderHeyden's testimony, he includes calculations which show that the typical bill would increase by 21 percent for the first four months, starting in June 2006, and then such bills would gradually increase by higher amounts thereafter. The recovery of a portion of the regulatory asset will begin in the spring of 2007, which is also a "shoulder" period in which the typical residential user experiences a lower electric usage. The

recovery is limited in the summer of 2007, when consumer electric bills are typically higher. The remaining amounts to be recovered continue in the fall of 2007, again a shoulder period of the year, and continue through May 2008. The entire plan is designed to ensure a gradual transition to higher market prices consistent with customer consumption habits.

Mr. VanderHeyden states he intentionally selected a relatively short plan duration to protect the financial integrity of the Company and also to provide signals that generation prices will generally reflect market conditions. Furthermore, he believes the mitigation plan would minimize a potential intra-class subsidy, as some customers may participate during credit months but later move and no longer reside in the BGE service area. The plan would have a "true-up" provision at its conclusion whereby the class of participating customers as a whole would be responsible to pay the full costs of the deferred charges.[20] Mr. VanderHeyden notes that while problems of customer migration may not be totally avoided, including instances where customers move both out and into the service area during the plan period, the shorter period will minimize intra-class subsidies.

---

[20] The plan provides for a "true-up" at the end of the program as variations in kilowatthour use for other than normal weather will cause a mismatch between total mitigation credits and total recovery payments. The Staff plan anticipates that the difference between the two should be either collected (if full costs have been under-collected) or returned to customers (if the plan resulted in an over-collection to the utility) as an adjustment to the variable portion of the delivery service charge during the three months ended August 2008.

Also, while the price cap does not expire until July 2006, Staff recommends commencing the plan in June 2006, which is one month prior to the expiration of the rate cap freeze, as the early commencement will enable a further reduction to the total deferred amounts and holds down the full amount of subsequent increases.[21] Staff also recommends the Company be directed to work with the Commission's Office of External Relations to develop appropriate customer education and enrollment literature which will aid customers in choosing whether to accept the mitigation plan or continue regular billing without such mitigation.

Staff considers the Company's maximum exposure under the mitigation plan, in the event of full customer participation, to be approximately $248 million, of which approximately $98 million would be supported by accumulated deferred income taxes with the remaining $150 million to be supported by external funds. In addition, Staff proposes that the Company earn its authorized rate of return on deferred amounts as Staff believes the regulatory asset of deferred expenses should be afforded a return equivalent to other regulated assets. Staff contends the financial community will consider the mitigation plan as neutral to positive, and the plan would be equitable to the promotion of competition by attaching both the mitigation credit and recovery to the delivery service portion of the bill. Therefore, customers will see the higher

---

[21] Mr. VanderHeyden estimates a June start will save approximately $5.5 million in finance charges over the life of the program, calculated using the Company's authorized rate of return.

actual cost of generation they purchase, providing the opportunity to more fairly compare the SOS price with prices that may be offered by competitive retail suppliers. Also, by including the mitigation credit and deferred recovery payment on the delivery service portion of the bill, customers cannot enjoy the credit and then avoid repayment by discarding SOS service in favor of a new supplier as they would remain liable for the deferred recovery payment if they change suppliers as long as they remain customers in the BGE service territory.

B. Other Parties Responses

In response to the Staff proposal, the Company, People's Counsel, and several competitive suppliers have provided witnesses responding to the Staff plan.

1. BGE Response and Recommendations

Mark D. Case, Vice President-Business Performance Strategy and Regulatory Services for BGE, testified in response to the Staff proposal. Mr. Case states the Company has serious concerns about Staff's mitigation proposal, stating that deferring the long-scheduled transition to market rates is not only bad

public policy, but may also threaten the financial integrity of the Company.[22] Mr. Case notes that the Staff proposal potentially involves hundreds of millions of dollars that the Company would need to finance as the Company purchases wholesale power from the lowest bidder through the competitive RFP process. He notes there have been large increases in global energy prices, which are wholly beyond the control of the Company, and other sources of energy (including home heating oil, propane, and gasoline) have experienced significantly greater price increases than the levels anticipated for electric supply with no transition mechanisms instituted. As a matter of policy, Mr. Case believes it is important for customers to see proper price signals so that informed choices can be made with respect to energy consumption and conservation. In addition, he notes the Company already offers customers a budget billing program which smoothes out billing amounts from month to month and allows customers to anticipate and budget their energy costs, thereby effectively providing a phase-in of market prices.

Mr. Case argues that the Staff mitigation plan, by providing a deferral of initial price increases, may result in customers not receiving the proper price signals needed to make appropriate decisions about costs and benefits of conservation and efficiency. Furthermore, inequities may arise in that customers

[22] However, Exhibit MDC-1, a press release dated January 25, 2006 from Fitch Ratings and attached to Mr. Case's testimony, states: "Fitch believes the proposed rate stabilization plan would be neutral to the credit ratings of Baltimore Gas & Electric Co. (BGE) given the probable recovery of such costs over the two-year period."

who remain in the service territory end up bearing the deferred costs of customers who move out during or immediately after the initial credit period for which billings are artificially decreased. Also, the deferral plan is harmful to the utility as it would negatively impact cash flow, increase coverage ratios, and potentially affect credit ratings. In this regard, Mr. Case notes that Staff's proposed deferral amount is approximately double the Company's annual electric distribution earnings, thereby constituting an excessive burden upon the Company.[23] Furthermore, to the extent other parties may propose even larger amounts of deferred charges or longer periods of deferral than the Staff proposal, the negative impacts would increase to the Company. Mr. Case cautions that in the event energy prices would experience further increases, the plan's proposal to delay the initial amount of increase expected during the first several months of the plan for deferred collection to the latter months would then be exacerbated by further increases in energy prices also experienced in later periods.

While the Company expresses concerns and opposition to the mitigation plan, Mr. Case indicates certain measures would be necessary in the event a mitigation plan is adopted. Mr. Case notes there are significant costs for implementing the plan, including CIS programming costs, mailing costs, communication and

[23] Mr. Case estimates the peak deferred revenue amount may be $248 million under the Staff proposal, which is approximately double BGE's total annual electric distribution earnings.

advertising costs, enrollment costs, and additional customer contact costs for handling customer inquiries and complaints. He estimates such costs would amount to several million dollars, depending on the enrollment option and the volume and method of customer response. He recommends that if the Commission adopts a deferral plan as proposed by Staff, the Company must be provided recovery of these incremental costs which should be included in the regulatory asset established under the proposal. He contends that failure to include such costs would signal to the financial community that the program is punitive to the Company. Mr. Case further states that any feasible program would have to balance initial credits against the subsequent payback on a class-wide basis rather than customer-by-customer, as he states it is not technologically possible, especially within the time allowed, for a "true-up" of any program on a customer-specific basis.

With respect to other recommendations, Mr. Case recommends that any deferral be as short as possible, and certainly no longer than the two-year period proposed by Staff. He notes that a short deferral period reduces costs to customers in the long run through reduction of carrying costs, while also reducing risk concerns and intergenerational equities. Mr. Case also recommends that the initial increase should be larger than the 21 percent suggested by Staff, as the Company recommends a 30 percent or more initial increase will ensure prices better reflect the market and also hold down the size of the deferred balance that ultimately must be repaid, which maximum amount of deferral should be limited

to $150 million. Finally, the Company indicates program elements should avoid customer confusion, and the Company strongly supports providing customers the option to participate or not. Customer choice in the program allows customers the option of whether to participate in this departure from normal billing practices and will also reduce customer complaints after implementation of the program. In this regard, the Company believes that the market price option should be the default option, as it appears quicker and less costly for implementation. The Company also argues this procedure will also assure only customers who genuinely want to participate in the program will do so, thereby reducing customer dissatisfaction.[24]

Mr. Case emphasizes that in the event a program is adopted, it is critical that the utility be kept whole, and strongly supports recovery of the costs as a normal regulatory asset subject to normal returns as proposed by Staff as the best and strongest signal to the financial community that the program does not mark an abrupt deterioration of the regulatory environment in Maryland. Mr. Case notes that the increase in supply costs are estimated to be approximately $800 million to $900 million annually based on Staff's projections, which amount is approximately five

---

[24] Mr. Case states the Company believes a Commission order is needed by early March to be able to implement Staff's proposed program starting with the first billing group in June, and questions whether a plan could be started at that time if an "opt-out" option is chosen by the Commission (*i.e.*, customers would be participants in the mitigation plan unless they "opt-out"). Mr. Case states the Company can implement the plan with either opt-in or opt-out, but the Commission must be aware of the effects of which procedure is adopted.

times the Company's annual earnings. He notes the size of the deferral will require it be financed with a mixture of debt and equity, if the Company is to maintain its proper equity ratio, and the Staff's plan would have the purchase power deferred balance grow to approximately $248 million, which exceeds the Company's short-term bank credit lines. In the event that there is uncertainty as to full cost recovery, the Company notes this may result in lowering its credit rating and increasing the total utility costs to everyone's detriment, as well as impacting the Company's future ability to adequately respond to unexpected events, such as possible future hurricane events.[25]

2. Office of People's Counsel Response and Recommendations

The Office of People's Counsel presented Jonathan Wallach, Vice President of Resource Insight, Inc., as its consultant who testified in response to the Staff proposal. OPC clearly states that it does not object to the concept of a rate stabilization plan, although OPC's testimony is somewhat vague as to the precise terms the OPC would find appropriate.

Mr. Wallach states that Staff's primary objectives — to spread the impact of market-based SOS rates over time while preserving price signals and financial integrity, resulting in cost

[25] Mr. Case noted that Hurricane Isabel caused approximately $70 million in damages to the Company's electric system in a matter of days, and the Company needs to quickly be able to purchase poles, transformers, and other equipment, as well as pay salaries of crews brought in from other utilities to help with system restoration which required the maintenance of unused credit lines.

deferral through distribution credits over a limited time span — are reasonable objectives. However, he states a number of specific elements raise concerns, and he therefore presents potential modifications while preserving Staff's basic approach and objectives. Importantly, Mr. Wallach does not recommend adoption of any specific model at this time, as the actual SOS prices and bill impacts are not yet known at the time of his filing, nor are the costs to implement a deferral mechanism. In this regard, he recommends that if the Commission finds a deferral mechanism is in the public interest, a second phase be established immediately following issuance of the order in the initial phase of this proceeding. In Phase II, the Company should be directed to file a detailed deferral scheme and implementation plan based upon the final retail SOS prices that will result from this year's SOS procurement process.

In reviewing Staff's mitigation plan, Mr. Wallach raises concerns regarding varying credits or surcharge amounts on a monthly basis as that may unreasonably increase price volatility for customers and also significantly increase billing complexity and billing costs. He recommends devising a deferral mechanism that achieves Staff's objectives but employs seasonal rather than

monthly credits and surcharges.[26] Mr. Wallach further contends that a two-year deferral period with recovery of deferred amounts at the authorized rate of return is extremely generous as it compensates shareholders for risks associated with guaranteed recovery over a two-year deferral period at the same rate afforded substantially greater risk associated with utility plant investment over decades-long amortization periods. He therefore recommends a lower rate is appropriate for these deferred balances.

Mr. Wallach also suggests that it may be appropriate to impose an exit fee or reconciliation charge on departing participants (which would also be applicable for any participant switching to a competitive supplier) rather than the Staff proposal which recovers deferred amounts from remaining participants in the plan. During his cross-examination, however, Mr. Wallach acknowledged that implementation of the Staff plan through the distribution charge, which continues participation of customers even if they switch suppliers as long as they remain on the BGE system, responds to his concerns for an exit fee. He further clarified OPC's position in this regard, indicating that he preferred giving customers enrolled in a rate stabilization program an opportunity to "buy their way out" of the program. (T. 148.)

---

[26] Mr. Wallach also notes concern that the Staff proposal does not specify how credits or surcharges may be applied to budget billing customers. During the course of the hearing, BGE Witness Case indicated that budget billing customers could be included in the mitigation plan program, with the levelized budget bill also including a deferred amount calculation. (T.94-95.)

Mr. Wallach also expressed concerns regarding the proposal to increase SOS rates on June 1, 2006, noting it would complicate efforts to educate consumers regarding the program. He also states that the expedited implementation of the program in June may conflict with key provisions of the restructuring settlement agreement in Case No. 8794 which maintained the price cap through that month. Therefore, imposition of the surcharge prior to July 1, 2006 may prevent full recovery of the revenue reduction due customers pursuant to the settlement agreement. He observes that Staff proposed to expedite implementation of its mitigation program to further reduce rate impacts, but suggests that extension of the deferral period from two to three years would achieve similar goals. Also, a three-year program combined with a lower rate of return on deferred balances would allow additional deferrals in the first year to further mitigate the full bill impacts while still holding carrying costs to reasonable levels. Furthermore, extension of the program to three years provides additional flexibility in the event that future SOS prices are higher than assumed by Staff. However, Mr. Wallach emphasizes that he does not recommend establishment of a three-year plan duration at this time (or adoption of seasonal values), as he does not know what the actual costs for implementation will be until final SOS

prices are known, as he recommends a Phase II for final resolution of outstanding issues.[27]

3. Responses of Competitive Suppliers (NEMA and WGES)

NEMA, a national non-profit trade association representing wholesale and retail marketers of natural gas, electricity, and energy, and financially related products, presented Craig G. Goodman, President of NEMA. Mr. Goodman notes support for the Commission objective to consider a transition plan that would reflect market-based price signals for electric supply, while mitigating effects of rate shock on the non-by passible portion of customers' bills, as noted in the January 10, 2006 Commission letter instituting this proceeding. He believes it is critical that the choice program be designed and implemented in a manner that permits competitive new investments in the BGE market in a sustainable, continuous, cost-effective and competitively neutral manner so that residential customers can benefit from new options. Mr. Goodman applauds the Staff proposal as an impressive blend of

[27] Issues suggested by Mr. Wallach that may be necessary for resolution in a Phase II also include: costs of implementing a deferral mechanism, including a mechanism for recovery of such costs, which may depend upon the magnitude of such costs and the expected participation in the voluntary program; management of the opt-in process (which opt-in process is supported by OPC); consumer education regarding the deferral mechanism and opt-in process; stranded cost recovery for customers who leave BGE's service territory before the end of the deferral period, for which Mr. Wallach suggests an exit fee; stranded costs from participants that switch to competitive suppliers; true-up mechanism implementation; and deferrals for budget billing customers.

complex economics, consumer protection, and executive leadership that effectively addresses issues of equity and efficiency, which issues are raised by the extended utility rate freeze which occurred during a period of rising energy prices. He notes that without such a proposal, short-term utility price spikes occurring following the duration of the price cap could result in unaffordable costs for many average homeowners. NEMA supports the Staff proposal, while offering certain further recommendations to enhance the mitigation proposal, as he considers this proceeding an opportune time to revise billing policies between the utility and competitive suppliers.

Mr. Goodman recommends competitively neutral consumer education. He expresses concerns that consumer education related to the mitigation strategy not be used to confer unfair competitive advantages as advertising Standard Offer Service, as there must be assurance that choices must be conveyed to customers in a competitively neutral fashion. He recommends that all stakeholders be permitted to review and offer input on consumer education materials to ensure a competitively neutral message, further recommending a process to permit stakeholder input after the Commission renders its decision in this case.

Finally, Mr. Goodman expresses concerns that continued uncertainty about market structure persists and inhibits competitive investment as well as supplier entry and participation in the Maryland market. He seeks elimination of barriers and delays with regard to program uncertainties, and notes that in the event the

Company claims an inability or unwillingness to perform the required technological system redesigns, the Commission should solicit offers of assistance from the services and technology industry segment.

Harry A. Warren, Jr., President of WGES, a licensed retail supplier in Maryland, also provided testimony in this proceeding. In his testimony, Mr. Warren notes that the BGE residential SOS price has not been adjusted to reflect wholesale market prices in the PJM market since July 1, 2000, and no competitive retail electricity supply market for residential customers has developed in the BGE service area. He states that WGES applauds the Commission's decision to implement a proposal within a regulatory framework that will not jeopardize the continued development of the State's competitive marketplace, and states that he believes Staff has developed a mitigation plan that will be competitively neutral and not undercut development of the competitive retail electricity supply market if implemented properly. He specifically states the Staff proposal to defer and collect SOS mitigation amounts as distribution service credits and surcharges does not affect the SOS rate, and therefore meets objectives of not harming retail competition as well as making BGE whole. Also, as residential customers will continue to see the full SOS price on their bills, with winning wholesale bidders supplying BGE paid according to accepted bid prices, he believes the SOS rates will be accurately developed and represented on

bills. Further, the development of the competitive retail market will not be stymied by the mitigation plan.

Mr. Warren also specifically notes support for the two-year period of the plan, noting the plan is a one-time adjustment designed to cushion the effect of a six-year rate freeze, so that gradualism principles apply and generation price signals will be preserved while cushioning customers against an immediate large price spike. He further supports the voluntary features of the plan, so long as it is implemented in a truly competitively neutral way, which he believes is captured by the Staff proposal. However, WGES would also not object to a program participation methodology, whereby the rate stabilization plan option would serve as the default option. To further assure competitive neutrality, Mr. Warren suggests competitive suppliers be afforded the opportunity to participate in the development of consumer education and enrollment literature and communications, so that there is no impression that SOS is in fact being promoted. In addition to supporting the mitigation plan, Mr. Warren notes that other measures under consideration with regard to draft regulations concerning retail suppliers could also help mitigate price spikes

to residential customers through offerings of electricity supply services by competitive suppliers.[28]

4. Utility Comments

While no other parties have presented testimony, The Potomac Edison Company, Potomac Electric Power Company, and Delmarva Power and Light Company have submitted comments in this matter. These companies are utility companies providing electric distribution service to customers located in other areas of Maryland, and these utilities note distinctions between the circumstances of BGE and their own service territories and SOS history. For example, Potomac Edison notes that generation rate caps for its residential customers will expire at the end of 2008, at which time it anticipates significant price increases to its residential customers. Potomac Edison notes its customers will then transition from generation rates that have been capped since 2000 to market-based generation rates effective January 1, 2009.[29] The utility also notes support for the concept of affording customers a plan to mitigate rate shock through a series of smaller rate increases prior to the expiration of generation rate caps, rather than a

---

[28] These suggestions are the subject of draft regulations in Administrative Docket No. RM-17. In its final post-hearing comments, WGES requests RM-17 proceed forward in an expeditious manner.

WGES also notes a concern regarding budget billing customers who switch to competitive service may experience delayed price signals (until the next budget billing "true-up" period) in its final comments on the mitigation plan.

[29] The Potomac Edison plan was approved in Case No. 8797, *Re The Potomac Edison Company,* Order No. 75851, 90 Md. PSC 439(1999).

significant increase due to a "flashcut" full increase at the time generation rate caps expire. As its rate cap does not expire for over two and a half years beyond the BGE expiration, Potomac Edison indicates the need is not as immediate to consider a mitigation plan for its customers, and suggests the Commission address its situation in the future before the expiration of its rate caps at the end of 2008. Potomac Edison also supports the current electric supply procurement rules now in place in Maryland resulting from Case No. 8908, stating the process has worked well and has yielded competitive generation rates.

Delmarva and Pepco filed a joint comment in this proceeding,[30] and urge that mitigation plans be considered in company-specific proceedings due to the unique nature of service areas and specific capabilities of the individual utility billing and customer information system. These utilities note that approximately 25 percent of their residential customer base moves annually in the Pepco Maryland service territory, and 24 percent moves in the Delmarva Maryland territory. Due to these high move in/move out percentages, these utilities claim there would be a potential large increase on remaining customers required by a significant true-up at the end of any mitigation deferral period. Furthermore, the utilities indicate difficulties in tracking customers on the basis of their participation due to the billing systems presently

---

[30] Pepco and Delmarva merged in 2002, which merger was approved by Order No. 77685 in Case No. 8890, 93 Md. PSC 134 (2002).

in place, and question whether they could accommodate the option feature of Staff's mitigation plan. Finally, these utilities note widespread public awareness of rising energy prices, and suggest an initial increase of 30 percent should be considered as not unreasonable under current market conditions, rather than the 21 percent initial limit of the Staff mitigation plan.

III. ADOPTION OF MARKET MITIGATION PLAN

Upon review of the record in this proceeding, including the evidence and comments expressed herein, the Commission finds that adoption of a rate stabilization plan is in the public interest and consistent with our duty to ensure that the transition to a competitive electricity supply market shall be orderly, fair to various stakeholders, and provide economic benefits to all customer classes.[31] The record is clear that the price freeze enacted for the BGE service area has capped prices at a reduced rate for a six-year period and resulted in substantial savings to BGE residential customers during this period, estimated to be approximately $ 1 billion. As the price freeze is to expire on July 1, 2006, it is clear that electric rates under Standard Offer Service will significantly increase, with the exact amount of increase dependent upon the final results of the Company auction.

[31] Electric Customer Choice and Competition Act of 1999, Public Utility Companies Article, § 7-505(a).

The estimates in this proceeding indicate the potential changes to SOS electric bills may increase between 40 percent to 81 percent based upon Staff's analysis. Understandably, immediate billing increases of such amount can prove unaffordable to many electric customers at one time, especially if the actual full price increase is at the upper end of the projected range. This situation does not result from electric restructuring or the fault of the utility, BGE, in any respect, but results from the long period of frozen reduced rates which has benefited customers and the significant increased costs for generation that are now in effect. As a result, the Commission agrees it is appropriate to institute a program to provide protection to customers from sudden rate shock. Therefore, we conclude it is appropriate to provide customers an option to more gradually implement these large increases as compared to the current bills experienced through the price cap regime.

In this proceeding, Staff has proposed a mitigation plan to more gradually implement increased prices with a limited duration of approximately two years. The plan would be voluntary in that customers have the choice whether to participate or not, although customers who participate will remain in the plan even if they subsequently switch suppliers as long as they remain on the BGE distribution system. The plan also protects the financial integrity of BGE by creating a regulatory asset for the deferred amounts that will be fully recovered by the Company with the inclusion of carrying costs, although Staff recommends such carrying

costs should be at the authorized rate of return, which level of return is disputed by OPC. We are also fully aware that BGE has expressed serious concerns about the necessity for any mitigation proposal, noting policy, financial, and implementation concerns. The record in this case, however, shows the Staff plan to be consistent with the policies of electric restructuring and competitively neutral, and the evidence shows that rating agencies indicate the proposed Staff rate stabilization plan would be neutral to the credit ratings of the Company given probable recovery of costs over a two-year period.[32] We also note that OPC indicates adoption of a mitigation plan should await the actual determination of SOS prices and bill impacts after the generation bidding is fully known and declines to support the specifics of the Staff plan in its final comments. However, OPC also indicates support for the basic approach of Staff's proposal as reasonable in its evidence proffered in this proceeding. (OPC Exh. No. 4, at 12). The competitive suppliers and others who testified in this proceeding also support the basic Staff approach, and none of the other numerous intervening parties have indicated opposition to the mitigation plan in final comments.

In its final comments, OPC states it does not support the Staff plan at this time as it believes elements are not fully developed and unacceptable risks are presented for residential customers. Instead of a separate mitigation plan, OPC suggests the

[32] BGE Exhibit No. MDC-1 of witness Mark D. Case.

Company be directed to limit budget billing levels to a maximum 30 per cent increase this summer, with a gradual rise to new rates over 12 months, with any under-collection by customers then spread over the next 12 months.

While reservations have been expressed by various parties to specific aspects of the Staff plan, our consideration of the record leads us to conclude that a rate stabilization plan along the basic principles espoused by Staff is in the public interest. Furthermore, we find it is necessary to adopt and accept the basic plan proposal at this time, as modified herein, as any delay would jeopardize implementation in a timely fashion and significantly reduce the benefits of the mitigation plan proposed by Staff. We therefore find and conclude that the Staff plan should be adopted at this time as a fair and reasonable proposal that will benefit customers who wish to participate by significantly reducing their initial liability for increased rates upon the expiration of the rate cap, while providing full price signals to such customers regarding their actual energy use which will promote competition. We further find the plan is fair to the Company by allowing subsequent recovery of such deferred charges with an appropriate return, which return is further discussed below in this Order. Also, while we will adopt the basic thrust of the Staff proposal to allow deferral of costs for such customers who choose to participate with subsequent recovery over a defined limited period, we also find that certain modifications to the Staff proposal should be made as noted herein.

A. Commencement of the Plan

As to the basic program, we find that an optional rate stabilization plan to reduce the initial increase upon the expiration of the market caps and more gradually spread such increased costs over a limited period is in the public interest, and must be adopted at this time as any delay will significantly reduce the benefits of such plan. In this regard, we note the Staff plan proposes commencement with the June 2006 billing month, which initial month is under the rate freeze. Staff proposes commencement in June as it will reduce the impact upon customers for those who choose to participate.

People's Counsel questions the program commencement in June as it is under the rate cap freeze. In addition, BGE raised implementation and customer education problems associated with a June start date.

While we appreciate the Staff proposal to commence in June to reduce the overall impact of future price rises, we note the Company has expressed reservations regarding adequate implementation of a plan by that timeframe, including sufficient opportunity for consumer education and customer enrollment. In light of the novel nature of this plan and the need to adequately inform customers of their options, we find that a July 2006 implementation is more practical and will be adopted. However, this date of implementation is not meant to reflect upon possible implementation of potential plans for other utilities in the future, as the voluntary nature of the plan appears to avoid violations of price

cap settlements and allow implementation prior to the termination of price freezes if customers choose to participate.

B. Length of Mitigation Plan

As noted previously, Staff proposes a two-year plan, which is supported by the Company and marketers. OPC suggests a longer period provides greater flexibility and should be considered.

We find the Staff proposal for an approximate two-year plan period to be fair and reasonable, and it will also be adopted. The Staff plan is of limited duration, thereby limiting the effects upon both ratepayers and the Company, with the evidence on the record indicating that the limited duration will also protect the financial integrity of BGE while providing customers a real opportunity to smooth out the anticipated bill increases over a reasonable two-year period. The gradual implementation of increased costs will cover both the initial high cost summer air conditioning period and initial heating period for the coldest months of the first winter of the plan, and allow customers to defer the anticipated high costs of these initial cooling and heating seasons over a reasonable period without unnecessarily delaying the repayment period to the utility so that it will not be harmed financially. Furthermore, the limited duration of the period reduces the effect that a longer phase-in period would have for customers migrating in and out of the system. We therefore find the two-year period is reasonable, with the first eight months ending in February 2007

customer bills to be mitigated to below market increases as proposed by Staff, with recovery of such deferred amount over the 15-month recovery period ending in May 2008, also as proposed by Staff, with a final true-up then occurring as proposed by Staff.

We are also mindful, however, of the special hardships which low-income customers bear. Therefore, for customers participating in the Electric Universal Service Program ("EUSP Program"), we believe an additional plan should be provided, and direct a three-year program be developed for such customers. This would be an additional plan for the existing EUSP Program due to the personal circumstances of these customers. These customers will receive a three-year plan unless they elect to receive the market price.

C. Carrying Costs Issue

Staff notes in its mitigation plan that BGE's electricity procurement expenses will become a balance sheet asset. Staff concludes that this regulatory asset "should be afforded the same return opportunity as any other asset." Therefore, Staff says that the appropriate carrying cost should be BGE's weighted average cost of capital, adjusted for the effect of income taxes.[33]

BGE concurs with Staff's proposal to address carrying costs. According to BGE, recovering these costs as a normal

[33] Staff would use BGE's weighted average cost of capital authorized in Case No. 9036, Baltimore Gas and Electric Company's recent 2005 gas base rate proceeding.

regulatory asset, with normal returns, "is the best and strongest signal the Commission could send to Wall Street that this program does not mark an abrupt deterioration of the regulatory environment in Maryland." BGE also notes that the size of the deferral will require it to be financed with a mixture of debt and equity, if BGE is to maintain an appropriate equity ratio. BGE says it would be imprudent to "max-out" its short-term credit facilities for this kind of purpose.[34] BGE also states that substantially increasing its debt ratio could increase the cost of financing BGE's future capital needs and the cost of replacing the bonds that are maturing in the next year. BGE concludes that establishing the rate for carrying costs at a lower rate would be perceived as abnormal and unfair.

OPC asserts that Staff's proposal "is extremely generous." This is because Staff's proposal would compensate shareholders for the risk associated with guaranteed recovery over a two-year deferral period at the same rate as utility plant, which has a substantially greater risk over a decades-long amortization period. OPC says the deferred generation costs that will be recovered are significantly less risky than other regulated investments because: the deferred costs will be recovered over a much shorter time period than typical investment; a true-up is proposed

[34] BGE notes that under Staff's plan the purchased power deferred balance quickly grows to about $248 million. However, BGE currently only has bank credit lines totaling $200 million. Testimony of Mark Case, at 27 and 28.

to ensure full recovery; and unlike other regulated assets, Staff presumes that under-collection of deferred costs from customers leaving the system will be recovered from remaining customers. Consequently, OPC concludes that the risk associated with the recovery of deferred generation costs is minimized, thus reducing the return required to appropriately compensate for that risk. OPC contends that no return is necessary on the deferred amounts as BGE receives a separate payment for providing SOS service pursuant to the settlement agreement in Case No. 8908. However, in the event a return is granted on the deferred amounts in this proceeding, OPC recommends establishing an interest rate in line with BGE's actual costs to finance the deferral, and its witness notes the recently authorized rate on BGE customer deposits of 4.12 percent.

The Commission has carefully considered this issue and concurs with OPC that the risk associated with the deferred generation balance is much less than for normal utility assets. BGE is provided guaranteed full cost recovery of the deferred balance plus reasonable carrying costs.[35] The deferral is for less than one year with recovery of costs occurring within two years. Moreover, short-term interest rates are much less than BGE's overall cost of capital. Staff witness VanderHeyden testified that short-term interest rates currently range from 4.5 percent to 5.0 percent. (T. 82.) Inasmuch as the risk factors relating to

[35] Other implementation costs will be recoverable or not pursuant to traditional cost recovery principles.

typical utility plant are absent for recovering this short-term deferred generation balance, the Commission finds that a rate of 5.0 percent is an appropriate just and reasonable rate for the carrying costs.

D. Mitigation Plan Acceptance Procedure

According to Staff, participation in the mitigation plan should be voluntary. BGE concurs. Staff recommends that the program be offered to customers with market pricing serving as the default option. In other words, customers would need to affirmatively elect to participate. On the other hand, with the rate stabilization program as the default option, the program would automatically enroll customers, unless they affirmatively elect not to participate. BGE notes that there are merits and challenges with either option serving as the default plan. BGE states that it can implement the mitigation plan using either enrollment method.

The Commission has carefully considered the merits of the two methodologies and adopts the rate stabilization plan as the default option. The Commission is concerned that as the transition date approaches, some customers, particularly the most vulnerable, may become confused. The Commission does not want anyone to miss the opportunity to participate in the program if they so desire. As BGE notes, with the rate stabilization plan serving as the default option, the approach requires no action on the part of consumers who wish to participate. Staff has noted that customers "will pay exactly the same as either participants or non-

participants except for the carrying charges." Finally, WGES notes that it does not object to either method because "the plan would still be competitively neutral and would not affect the development of the competitive market since it focuses on the distribution rates." For these reasons, the Commission directs that the rate stabilization plan will serve as the default option for BGE residential customers, subject to customer requests not to participate.

E. Consumer Education

According to Staff, the Company should be directed to work with the Commission's Office of External Relations to develop appropriate customer education and enrollment literature. Since BGE anticipates customer confusion regarding the program, BGE plans to notify customers about the mitigation plan through a bill insert and a stand-alone mailing. BGE also plans to issue a press release. Both WGES and NEMA recommend that all stakeholders, including competitive suppliers, be permitted to participate in the development of customer education and enrollment material. They emphasize that the consumer education message must be competitively neutral and not confer any advantages to advertise or promote SOS.

The Commission recognizes that consumer education is vital to the successful implementation of the mitigation plan adopted herein. Therefore, the Commission directs its Office of External Relations to work expeditiously with BGE and all other interested parties in developing appropriate customer education and

enrollment material. Specifically, the Consumer Education Advisory Board formed by the Electric Customer Choice and Competition Act of 1999, which includes the Office of People's Counsel, the Office of Home Energy Programs, utility companies, supplier representatives, consumer groups, business owners, and State and local officials is a useful resource to this effort. Therefore, BGE and OER shall work with the Consumer Education Advisory Board in developing this consumer education plan.[36] A compliance filing outlining the consumer education plan, including the outreach efforts, billing issues and timelines should be provided by March 31, 2006.

F. Marketer Concerns (Billing, Payment, Etc.)

In adopting Staff's basic proposal, we are encouraged that the testimony of the marketers in this proceeding, the National Energy Marketers Association and Washington Gas Energy Services, do not contest the competitive effects of the Staff mitigation proposal or its duration. These competitive suppliers acknowledge that full recovery of SOS rates will occur, and SOS customers may choose a competitive supplier but still receive mitigation credits which promotes development of the competitive retail market. The energy marketers and advocates do, however, make specific recommendations with regard to billing and payment matters as well as customer lists and customer education, which

[36] We also encourage BGE to work with the Commission's Office of External Relations to resolve problems for those customers with special circumstances.

they believe should be addressed in this proceeding. While these are important issues, we believe those issues relating to marketer-utility interactions are best addressed in other proceedings, such as the pending rulemaking regarding these matters.

IV. CONCLUSION

In conclusion, the Commission finds that the rate stabilization plan, as proposed by Staff and modified herein, shall be accepted to provide residential customers an opportunity for a more gradual implementation of market based rates upon the expiration of the BGE price cap on July 1, 2006. We find the plan will promote competition and uphold the financial integrity of the utility, and is in the public interest.

The Company shall consult with the Office of External Relations and the Consumer Education Advisory Board to develop a consumer education plan, and report back by March 31, 2006 as to the education plan and enrollment details to implement the rate stabilization plan by July 1, 2006.

IT IS, THEREFORE, this 6th day of March, in the year Two Thousand Six, by the Public Service Commission of Maryland,

ORDERED: (1) That a rate stabilization plan for residential customers of Baltimore Gas & Electric Company, as proposed by the Commission Staff and modified herein, is hereby accepted in accordance with the findings of this Order.

(2) That Baltimore Gas & Electric Company shall report to the Commission by March 31, 2006 as to the consumer

education plan and enrollment details for the rate stabilization plan.

____

____

____

____

____

Commissioners