Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 778 (Senator Astle, *et al.*)
Finance

Public Utilities - Natural Gas Infrastructure Expansion and Reinforcement

This bill provides two methods for gas companies to expand their infrastructure to areas in the State without natural gas service. First, a gas company may defer "eligible expansion costs" for *subsequent* inclusion in base rates, subject to specified conditions, including review and evaluation of the costs by the Public Service Commission (PSC) during a base rate case. Second, a gas company is authorized to file two tariff schedules with PSC related to the extension of natural gas service to new customers. A gas company may file a tariff schedule that authorizes the company, at its discretion, to assume that 75% of the total number of potential customers during an extension evaluation of natural gas main pipeline or service line will convert to natural gas service. A gas company may also file a tariff schedule with PSC to recover net costs associated with extending a natural gas main pipeline and service line to specified customers through a monthly charge on the customer bill over specified timelines – including up to 30 years for a residential customer.

The bill takes effect June 1, 2016.

Fiscal Summary

State Effect: Special fund expenditures from the Public Utility Regulation Fund (PURF) increase by $310,800 in FY 2017 for PSC staff and consulting expenses for the Office of People's Counsel (OPC). Future year expenditures reflect ongoing costs. Special fund revenues increase correspondingly from assessments imposed on public service companies. The impact on State finances from additional gas infrastructure investment cannot be reliably estimated at this time. Although the bill takes effect June 1, 2016, it is assumed that State finances are not materially affected until FY 2017.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
SF Revenue	$310,800	$248,900	$256,700	$264,800	$273,300
SF Expenditure	$310,800	$248,900	$256,700	$264,800	$273,300
Net Effect	$0	$0	$0	$0	$0

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local governments are not directly affected. The effect on local government finances from additional gas infrastructure investment due to the bill cannot be reliably estimated at this time.

Small Business Effect: Meaningful. Small businesses may benefit from increased access to, and lower prices for connection of, natural gas service.

Analysis

Bill Summary:

Definitions

There are several interwoven defined terms in the bill: "expansion project," "eligible expansion purpose," "eligible expansion investment," and "eligible expansion costs."

"Expansion project" means a gas company's natural gas transmission pipeline, distribution main pipeline, system reinforcement facilities, and associated facilities that are constructed after June 1, 2016, for an eligible expansion purpose.

"Eligible expansion purpose" means an expansion project that is undertaken by a gas company in an area designated for future growth by the local jurisdiction or in the comprehensive growth plan for the local jurisdiction to provide:

- natural gas service to areas that lack adequate access to natural gas; or
- system reinforcement to facilitate an expansion project.

"Eligible expansion investment" means the total capital investment by a gas company in planning, developing, and constructing an expansion project, subject to the specified limit of no more than 0.5% of the gas company's net rate base on an annual basis, unless PSC approves a higher percentage. It includes, if applicable, an allowance for funds used during construction that is calculated based on the regulatory capital structure that PSC has authorized or approved in a settlement in the most recent base rate case for the gas company.

"Eligible expansion costs" means:

- any funds that qualify as eligible expansion investment;
- a return on the eligible expansion investment, which is calculated by multiplying the dollar amount of the eligible expansion investment by the rate of return that PSC

has authorized or approved in a settlement in the most recent base rate case for the gas company;

- a revenue conversion factor, including income taxes and an allowance for bad debt expense, applied to the required operating income resulting from the eligible expansion costs;
- a depreciation amount; and
- property taxes attributable to eligible expansion investment.

Recovery of Eligible Expansion Costs through Regulatory Asset and Base Rates – Subject to Annual Limit

Notwithstanding any other law, if a gas company undertakes an expansion project for an eligible expansion purpose that (if applicable) is consistent with specified location requirements, the gas company may defer eligible expansion costs for subsequent inclusion in rates. A gas company must account for actual monthly eligible expansion costs that are incurred on the cumulative eligible expansion investment as a "regulatory asset," subject to specified conditions, until PSC makes a determination in a subsequent base rate case. "Regulatory asset" has the meaning specified in federal law under the definition of "regulatory assets and liabilities."

Generally, the amount of incremental eligible expansion costs added to the regulatory asset for each year the gas company defers those costs may not increase by more than 0.5% of the gas company's net rate base, as established by PSC in the gas company's most recent base rate case. PSC may approve a higher percentage of the gas company's net rate base than was established in the most recent base rate case under specified conditions.

At the time a gas company establishes a regulatory asset under the bill, the gas company must file information with PSC to enable PSC to determine whether the deferral accounting mechanism is reasonable. During its review in a subsequent base rate case, PSC may also evaluate the accuracy and reasonableness of the level of deferred eligible expansion costs.

When a gas company files a base rate case, PSC must (1) incorporate the cumulative balance of the regulatory asset into the company's rate base and (2) concurrently set an amortization expense in the base rate to recover the unamortized balance.

Annual Reporting to PSC

If a gas company undertakes an expansion project and defers eligible expansion costs for subsequent inclusion in rates, the gas company must file an annual report with PSC that (1) describes any eligible expansion project that has been constructed and (2) summarizes the cumulative actual costs and the actual costs incurred in the previous year for the expansion project.

Expansion Located in Designated Growth Areas

If a local jurisdiction has adopted growth tiers under specified provisions of the Land Use Article, an expansion project may be deemed to support an eligible expansion purpose only if it is located in a Tier I, Tier II, or Tier III area. An expansion project may be deemed to support an eligible expansion purpose even if the full route or the location of natural gas transmission pipeline, distribution main pipeline, system reinforcement facilities, and associated facilities is not within a Tier I, Tier II, or Tier III area.

Tariff Schedules for Extensions of Natural Gas Service to New Customers

Notwithstanding any other law, a gas company may file a tariff schedule that authorizes the company, at its discretion, to assume that 75% of the total number of potential customers during an extension evaluation of natural gas main pipeline or service line will convert to natural gas service. PSC may, for good cause shown, authorize a higher percentage assumption.

A gas company may also file a tariff schedule with PSC to recover any "required contribution" and related costs associated with extending a natural gas main pipeline and service line to specified customers through a monthly charge on the customer bill over specified timelines. "Required contribution" means the incremental expenditures that a gas company is projected to incur that exceed the revenues that a gas company is projected to receive from extending natural gas main pipeline and service line to one or more residential, governmental, or commercial customers.

The recovery period may be up to 10 years for a commercial customer, 20 years for a governmental customer, and 30 years for a residential customer. The recovery of any required contribution must apply to the particular service location. Any new customer receiving service at the location at any point during the cost recovery period must first agree to the monthly charge before receiving the service.

The provisions related to required contributions may not be construed to prohibit PSC, for good cause shown, from (1) reducing or otherwise eliminating any required contribution or (2) extending the collection period.

Current Law/Background: PSC regulates gas companies, including monitoring retail competition and customer choice, to ensure that safe, reliable, and affordable gas service is provided. Rates charged by a gas distribution company are specified in the company's tariff and are approved through an order made by PSC. Through the rate making process, a gas company is allowed to charge just and reasonable rates for the regulated services it renders. Typically, if a gas company incurs a cost to upgrade natural gas infrastructure and the company seeks to recover those costs, it is done through a base rate proceeding (there are limited exceptions).

Regulatory Assets

Federal law defines "regulatory assets and liabilities" as assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determinations in one period under the general requirements of the Uniform System of Accounts but for it being probable (1) that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services or (2) in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required.

PSC authorized the use of a regulatory asset for Baltimore Gas and Electric Company's (BGE) advanced metering infrastructure (AMI) plan. Under this cost recovery mechanism, eligible costs associated with BGE's AMI plan were placed in a deferred account for subsequent inclusion in base rates – subject to PSC approval and review. BGE has not yet been authorized by PSC to recover the costs, but it is seeking recovery in its current base rate case.

Regulatory Asset versus Infrastructure Surcharge

Chapter 161 of 2013 established an application and review process for gas infrastructure replacement plans with an associated monthly surcharge on customer bills (typically known as the STRIDE surcharge). That surcharge is collected at the same time as the eligible infrastructure expenditures occur. Under the bill, costs deferred into the regulatory asset are not recovered until a subsequent base rate case.

Natural Gas Use in the State

There are approximately 1.1 million residential natural gas customers in the State. However, the State's electric companies have 2.2 million residential customer accounts. Therefore, approximately 1.1 million residential customers in the State have electric service but not natural gas service. According to a report by the Regional Economic Studies Institute at Towson University, households using natural gas may save annually, on average:

- $806 more than households using heating oil;
- $1,172 more than households using electricity; and
- $1,705 more than households using propane.

The report also indicates significant savings for nonresidential customers and includes a discussion of the fiscal and economic impacts of a hypothetical gas infrastructure expansion in the State. The report can be found on Towson University's website.

State Fiscal Effect: Special fund expenditures from PURF increase by $310,785 in fiscal 2017, which accounts for a 30-day start-up delay. This estimate reflects the cost of PSC hiring one engineer, one auditor, and one *half-time* regulatory economist to evaluate additional filings made by gas companies under the bill. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Additional costs, estimated to be at least $100,000 in fiscal 2017, are incurred by OPC for consulting expenses for expert witnesses brought before PSC.

Positions	2.5
Salaries and Fringe Benefits	$196,191
Consulting Expenses	100,000
Other Operating Expenses	14,594
Total FY 2017 Administrative Expenditures	**$310,785**

Future year expenditures reflect salaries with annual increases and employee turnover, the elimination of start-up costs, and annual increases in ongoing operating expenses. Future year expenditures also include $50,000 annually for OPC to contract with expert witnesses.

Special fund revenues increase correspondingly from assessments imposed on public service companies to recoup costs incurred by PSC and OPC as authorized under current law.

The effect on State revenues and expenditures from additional gas infrastructure investment due to the bill cannot be reliably estimated at this time.

Even though the bill takes effect June 1, 2016, it is assumed that State finances are not materially affected until fiscal 2017.

Additional Information

Prior Introductions: None.

Cross File: HB 1324 (Delegate Barkley, *et al.*) - Economic Matters.

Information Source(s): Office of People's Counsel, Public Service Commission, Towson University, Department of Legislative Services

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