SB 572

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 572 (Senator Feldman)
Finance

Electric Companies and Gas Companies - Rate Regulation - Alternative Rate Plans

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The bill requires the Public Service Commission (PSC) to allow an electric or gas company to use an "alternative rate plan" to establish new base rates if PSC finds that the plan results in a just and reasonable rate, subject to other specified requirements. An electric or gas company may not file an application for approval of an alternative rate plan before the bill's October 1, 2019 effective date.

Fiscal Summary

State Effect: Special fund expenditures increase by $1.2 million in FY 2020 and by $0.9 million to $1.0 million annually thereafter. Special fund revenues increase correspondingly from assessments imposed on public service companies. The effect on electric and gas prices paid by State agencies cannot be determined this time but is potentially significant.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
SF Revenue	$1.2	$0.9	$0.9	$1.0	$1.0
SF Expenditure	$1.2	$0.9	$0.9	$1.0	$1.0
Net Effect	(-)	(-)	(-)	(-)	(-)

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

Local Effect: Municipal electric companies may benefit from alternative rate plans authorized under the bill in the same way as other electric companies. The effect on electric and gas prices paid by local governments cannot be determined this time but is potentially significant.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary:

Alternative Rate Plans

"Alternative rate plan" means a plan to establish new base rates for an electric company or a gas company that include the use of:

- a fully forecasted test year, which is a rate that is based on forecasted costs, investments, and billing determinants for the effective period of the rate;
- multiyear rates;
- formula rates, which are rates that are periodically adjusted based on a predetermined formula and subject to annual reconciliation adjustments;
- rate designs, which are the methods used by an electric company or a gas company to charge for electric or gas service and produce the revenues necessary to recover the costs of serving each customer rate class, including a method designed to recover fixed and variable costs consistent with how the costs are incurred;
- other rate plans; or
- a combination of rate plans that meet the requirements of the bill.

It is the intent of the General Assembly that PSC adopt proposals by electric companies or gas companies to establish new base rates that use alternative rate plans that conform with the bill. In accordance with existing administrative processes for rate setting, PSC must allow an electric company or a gas company to:

- file for new base rates simultaneously with the proposed alternative rate plan; and
- use an alternative rate plan covering its full cost of service to establish new base rates, if PSC finds that the alternative rate plan results in a just and reasonable rate.

The bill establishes a follow up process for revised alternative rate plans in the event that PSC rejects an initial application for approval of an alternative rate plan. Applicants have 60 days to file a revised plan, and PSC has 60 days to review a revised plan once submitted.

An electric company or a gas company may terminate an alternative rate plan at any time. If this occurs, the rates in effect at the time of the termination remain in effect until PSC establishes new base rates for the company.

Performance Standards

An electric company or a gas company may file an alternative rate plan that provides for performance standards, subject to the approval of PSC, that are designed to achieve improvement or sustain results in electric company or gas company reliability and customer satisfaction. If PSC provides for a financial penalty for a company's failure to meet a performance standard, PSC must also provide a comparable financial incentive for a company exceeding any approved performance standard.

Treatment of Decoupled Revenues

For customer classes that are subject to revenue decoupling, an alternative rate plan must provide for the incorporation of adjustment amounts from revenue decoupling mechanisms approved by PSC.

Cost Deferrals into Regulatory Asset

To mitigate potential year-to-year customer rate volatility related to storm restoration, an alternative rate plan may create a regulatory asset, subject to PSC approval, that includes the deferral of operating and maintenance expenses related to restoration activities for storm outage events with the unamortized balance receiving rate base treatment.

Annual Formula Rate Reconciliations

An alternative rate plan that uses a formula rate must provide for an annual customer rate reconciliation that reconciles with interest the revenue requirement reflected in rates for the prior calendar year to ensure that customers are charged rates that reflect only the actual costs incurred by the electric company or gas company. The reconciliation must reflect actual costs for the prior calendar year and year-end values for rate base.

Cost Recovery

If the same costs are not simultaneously recovered through an alternative rate plan, an electric company or a gas company may continue to recover costs through riders or surcharges approved by PSC. The approval of an alternative rate plan may not affect the recovery of supply or transmission-related costs.

Return on Equity May Not be Reduced

PSC may not reduce the return on equity applied to an electric company or a gas company based on the election of an electric or gas company to propose an alternative rate plan. (The return on equity or "rate of return" is the portion of the revenue requirement that a utility ultimately keeps as profit.)

Current Law: A public service company, which includes an electric or gas company, must charge just and reasonable rates for the regulated services that it renders. Generally, PSC has the power to set a just and reasonable rate of a public service company, as a maximum rate, minimum rate, or both. A "just and reasonable rate" means a rate that:

- does not violate any provision of the Public Utilities Article;
- fully considers and is consistent with the public good; and
- except for rates of a common carrier, will result in an operating income to the public service company that yields, after reasonable deduction for depreciation and other necessary and proper expenses and reserves, a reasonable return on the fair value of the public service company's property used and useful in providing service to the public.

Notwithstanding any other provision of law, PSC may regulate the regulated services of an electric company through alternative forms of regulation. PSC may adopt an alternative form of regulation if it finds, after notice and hearing, that the alternative form of regulation (1) protects consumers; (2) ensures the quality, availability, and reliability of regulated electric services; and (3) is in the interest of the public, including shareholders of the electric company. Alternative forms of regulation may include price regulation, revenue regulation, ranges of authorized return, rate of return, categories of services, or price indexing.

Background: Generally, utility base rates are established based on historic/verified/approved costs incurred by the utility in a recent "test year" used for that purpose. Those costs are used in conjunction with a utility's authorized rate of return and forecasted sales to determine rates. There are limited exceptions, such as the recent statutory framework established for gas companies, known as the gas infrastructure replacement surcharge, which allows gas companies to collect certain costs associated with accelerated infrastructure replacement as they occur. Outside of the gas infrastructure surcharge, PSC has also authorized other alternative forms of cost recovery on a limited basis.

On February 14, 2019, PSC provided notice of its initiation of Public Conference 51 on Alternative Forms of Rate Regulation to allow affected stakeholders and interested persons to submit information and comments on various alternative rate plans that may have been implemented in other states. PSC also expressed interest in whether other states, in implementing alternative rate plans, required additional staff resources or staff with different skills than previously utilized prior to implementation. The conference will be held on April 30, 2019.

State Fiscal Effect: The bill likely results in several new rate case filings beginning in fiscal 2020. Rate cases are resource intensive on PSC and the Office of People's Counsel (OPC), and the types of cases contemplated by the bill are particularly so. The skillset necessary to evaluate existing data is fundamentally different from the skillset necessary to evaluate forecasted estimates, and the bill contemplates annual formula rate reconciliations/adjustments.

PSC advises that it requires nine additional staff to handle the expected volume of alternative rate cases and new forms of evaluation: four auditors, three regulatory economists, an engineer, and a staff attorney. OPC estimates that it conservatively requires $75,000 per rate case for expert witness testimony. These are assumed to occur in fiscal 2020, although some costs could occur later if any of the major companies delay filing an alternative rate plan. Additionally, OPC estimates $25,000 per annual formula rate reconciliation/adjustment.

Both PSC and OPC are funded through the Public Utility Regulation Fund (PURF) and are authorized to recoup costs through assessments on public service companies.

Accordingly, special fund expenditures for PURF increase by $1,212,480 in fiscal 2020, which accounts for the bill's October 1, 2019 effective date. This estimate reflects the cost of PSC hiring nine staff to handle the expected work and analysis associated with alternative rate cases. It includes salaries, fringe benefits, one-time start-up costs, ongoing operating expenses, and information technology costs associated with forecasting. Additional costs ($600,000) are incurred by OPC for consulting expenses for expert witnesses brought before PSC.

Positions	9
Salaries and Fringe Benefits	$512,376
PSC Information Technology Costs	35,000
OPC Consulting Expenses	600,000
Other Operating Expenses	65,104
Total FY 2020 Administrative Expenditures	**$1,212,480**

Future year expenditures of $0.9 million to $1.0 million annually reflect full salaries with annual increases and ongoing operating expenses, plus $200,000 annually for OPC to contract with expert witnesses during rate reconciliations for the assumed eight alternative rate plans.

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.

State/Local/Small Business Effect: The bill represents a fundamental shift in the way electric and gas rates are determined. The effect on electric and gas prices, paid by all utility customers, including government agencies and small businesses, cannot be reliably estimated at this time but could be significant.

Additional Information

Prior Introductions: None.

Cross File: HB 653 (Delegate D.E. Davis, *et al.*) - Economic Matters.

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

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