SB 72

Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 72 (Chairman, Finance Committee)
(By Request – Departmental – Public Service Commission)

Finance

Gas Companies - Alternative Forms of Regulation

This departmental bill authorizes the Public Service Commission (PSC) to regulate a gas company through alternative forms of regulation. The bill also provides that a gas company that passes on to its customers specified costs may justify its costs through an incentive mechanism that shares specified costs among ratepayers and shareholders.

Fiscal Summary

State Effect: The bill's changes could be handled with existing budgeted resources.

Local Effect: None.

Small Business Effect: PSC has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

Analysis

Bill Summary: PSC may regulate a gas company through alternative forms of regulation including:

- price regulation, including a price freeze or cap;
- revenue regulation;
- ranges of authorized return;
- rate of return;

- categories of services; or
- price indexing.

PSC may adopt any of these alternative forms of regulation if it determines, after notice and hearing, that the alternative:

- protects consumers;
- encourages the quality, availability, and reliability of regulated gas services; and
- is in the interest of the public, including shareholders of the gas company.

A gas company may justify its costs that are passed on to its customers through an incentive mechanism that provides for sharing specified costs among ratepayers and shareholders. The cost to be shared is the difference between "total commodity costs" and a predetermined benchmark that is outside the control of the gas company. The difference shared among the ratepayers and shareholders may be positive or negative. Total commodity costs for both flowing and stored gas is defined to include: gains and losses, variable transportation costs, and costs of ancillary activities.

Current Law: PSC has the authority to set a just and reasonable rate of a public service company. A just and reasonable rate is a rate that considers the public good and will result in an operating income to the company that yields a reasonable return on the fair value of the company's property. This is frequently referred to as the rate-of-return method.

A gas or electric company that directly passes on to its customers changes in fuel costs, costs of purchased power, or costs of purchased gas must verify and justify the adjusted costs to PSC each month.

Background: Telephone companies may be regulated under almost identical alternative regulation. In 1996, PSC adopted a price cap formula method of rate regulation for Verizon-Maryland, Inc.

According to PSC, the current rate-of-return methodology for establishing rates served customers well until Maryland moved toward deregulation of the gas industry. The current method has come under criticism from economists because this method can have negative consequences in the following ways:

- a disincentive to become more efficient because regulators may reduce the companies total level of profits if per unit costs are lowered;

- a disincentive to invest in new technologies that are more risky as regulators may not allow sufficient rate of return to offset higher risks; and
- an incentive for companies to over-invest in capacity since costs may be recoverable.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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ncs/jr

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