

Department of Legislative Services
 Maryland General Assembly
 2008 Session

FISCAL AND POLICY NOTE

House Bill 82 (Delegate Stukes, *et al.*)
 Economic Matters

**Public Service Companies - Electric Companies and Electricity Suppliers -
 Regulation**

This bill repeals specified provisions relating to the deregulation of electricity generation. The bill redefines electric companies, and reclassifies all electricity generation to the status of a public service company subject to regulation by the Public Service Commission. The bill imposes rate regulation and reporting requirements upon electric suppliers and electric companies. The bill also eliminates small commercial and residential Standard Offer Service (SOS).

The bill takes effect June 1, 2008, except the repeal of provisions regarding certain cost recovery by an electric company which takes effect January 1, 2010.

Fiscal Summary

State Effect: Special fund expenditures could increase by an estimated \$50,300 in FY 2009, for PSC to hire one public utility auditor to audit electric suppliers and the electric companies. Potential change in property tax revenues from a change in the category of property assessments.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenues	\$0	\$0	\$0	\$0	\$0
SF Expenditure	50,300	62,000	65,100	68,300	71,800
Net Effect	(\$50,300)	(\$62,000)	(\$65,100)	(\$68,300)	(\$71,800)

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

Local Effect: Potential change in property tax revenues from a change in the category of property assessments.

Small Business Effect: Potential minimal.

Analysis

Bill Summary:

Major Deregulation Provisions Changed

The bill makes the following major changes to the current electricity market structure:

- reclassifies electric companies to include all electricity generators, except for self-generators;
- requires an electric company and an electricity supplier to apply to PSC to adjust its rates and charges: 5% bandwidth is provided with respect to fuel rate cost adjustments. PSC must hold evidentiary hearings and investigate the application to determine whether the rate increase or decrease is justified and based on its findings may allow or disallow the rate change; and
- requires PSC to consider the need to meet existing and future demand for electric service before taking final action on an application for a certificate of public convenience and necessity.

Major Deregulation Provisions Unchanged

The bill leaves intact the following major provisions of the current electricity market structure:

- distribution, transmission, and generation charges must be separately stated on a customer's bill;
- the licensing requirements of an electricity supplier is retained;
- electricity customer choice of an electricity supplier is retained; and
- the Energy Universal Service Program is unchanged.

The bill also provides that the Department of Legislative Services may conduct an audit and study of the fuel procurement and purchasing practices of an electric company or electric supplier and examine an audit issued by or generated at the direction of PSC.

Current Law: The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland, and required Maryland's traditional local electric

utilities to transfer their electric generation assets to unregulated subsidiaries or sell these assets to unaffiliated companies. Regulated electric companies provide distribution services in their respective territories at regulated rates. Each electric company has to maintain the reliability of its distribution system in accordance to applicable PSC orders, tariffs, and regulations.

PSC regulates the construction and operation of power plants in the State. Entities planning to construct a generation facility must receive a Certificate of Public Convenience and Necessity from PSC before construction. With the elimination of the generation functions from regulation, PSC no longer determines the need for additional supply sources as was the case prior to implementation of restructuring.

In order to meet long-term, anticipated demand in the State for SOS and other electricity supply, PSC may require or allow an investor-owned electric company to construct, acquire, or lease, and operate, its own generating facilities, and transmission facilities necessary to interconnect the generating facilities with the electric grid, subject to appropriate cost recovery. Maryland small commercial and residential customers that do not take competitive service currently obtain power supply via SOS from their local electric company.

Other than an electric company providing SOS or a municipal cooperative serving its own customers, electricity suppliers operating in Maryland must first apply for and meet and abide by applicable standards (*e.g.*, financial integrity, accurate consumer information) before PSC issues a license to operate in the State. Electricity suppliers are not required to own generation resources, but can broker and procure energy supplies from the wholesale market.

Background: Under a regulated electric industry structure, PSC maintained authority over the investor-owned utilities including the regulation of bundled rates for generation, transmission, distribution, and other functions to serve electric customers. PSC ensured the quality of service, reviewed supply- and demand-side resource options, and provided for fair and equitable service to Maryland retail customers.

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland. Implementation of electric industry restructuring was predicated on the supposition that the emergence of a competitive retail market would put downward pressure on prices and provide consumers with lower cost power. What was envisioned (*e.g.*, lower prices and reduced costs) did not occur.

Maryland's traditional local electric utilities were required to transfer their electric generation assets to unregulated subsidiaries or sell these assets to unaffiliated

companies. One objective of divestiture was to provide the opportunity for competing electric suppliers, unaffiliated with the regulated electric companies, to supply end-use customers with electricity at lower costs. As a result, electricity suppliers use the transmission and distribution systems owned by the regulated electric companies to sell directly to residential customers. Qualifying electric suppliers may own electricity generation facilities or, may as well, operate without infrastructure investments to purchase power from the wholesale power market.

Restructuring therefore introduced “customer choice” of supply services, while simultaneously setting a mandated rate reduction and a cap on the reduced rates for various customer classes that decided not to shop. All rate cap restrictions have now expired for residential, commercial, and industrial customers except for Allegheny Power’s residential SOS customers. With the expiration of price caps, customers are subject to market rates. The modest levels of residential and small commercial shopping may reflect the fact that competitive suppliers have not been able to offer large savings when compared with historically capped and fixed SOS rates provided by the electric utilities.

In Maryland, the regulated electric companies provide operational control of their transmission systems to an independent regional transmission organization, known as PJM Interconnection. In part, PJM operates the wholesale, bulk power markets and maintains transmission grid reliability. The wholesale power market is overseen by the Federal Energy Regulatory Commission. With the restructuring of Maryland’s electricity market, most power plants in the State operate as independent power producers. These electric generators supply power through the transmission grid to satisfy electric supplier loads throughout the region. Except for self-generators, generators in Maryland typically do not serve retail customers directly.

Prompted by increases in the price of electricity and the slow development of a competitive market for residential electricity supply, the General Assembly convened in special session on June 14, 2006 to consider comprehensive legislation to address electric industry restructuring, standard offer service, rate stabilization plans, and the makeup of PSC.

During the 2006 special session and 2007 session, the General Assembly requested that PSC provide input with regards to obtaining a reliable power supply for the State at reasonable and stable costs going forward. As described below, PSC is to consider the major options that need to be evaluated (*e.g.*, methods of procurement for SOS service, whether the electric companies should be in the businesses of building generation) to determine if and what possible improvements upon the current electricity market structure can be undertaken for the benefit of retail customers.

PSC Reports and Proceedings

Chapter 5 of the 2006 special session mandated PSC to complete several reports to assist the General Assembly in assessing the impact of electric restructuring on the State and in altering it for the benefit of consumers. PSC was required to study actions taken to implement restructuring and study the impact of potential changes such as reregulating electric generation or allowing local aggregation. The majority of the studies required by the bill were not completed by the start of the 2007 legislative session, leaving much uncertainty as to the ideal structure of the electric industry in the State. Accordingly, Chapter 549 of 2007 was enacted to require PSC to initiate new proceedings to review and evaluate certain requirements of Chapter 5 of the 2006 special session, including the review and evaluation of any orders that were issued under the 2006 enactment. The Act also required PSC to conduct additional studies and complete reports on electric industry reregulation, assess the availability of adequate transmission and generation facilities to serve the electrical load demands of all customers in the State, and consider the implications of establishing an office of retail market development and establishing a long-term goal for energy efficiency and conservation, among many other matters.

A preliminary report identifying the issues relating to options for reregulation as required by Chapter 5 of the 2006 special session, including discussion of costs and benefits of returning to a regulated electric supply market was due and provided in December 2007. An additional PSC report was supplied in January 2008. A final report containing the complete set of evaluations, findings, and recommendations required under Chapter 5, as amended by Chapter 549 of 2007, is due December 1, 2008.

State Fiscal Effect: The extent to which the reregulation of electricity supply will affect the assessed value of utility property is uncertain at this time. Since 1999, most electric generating plants in Maryland have been sold or transferred to unregulated entities. Currently, the State Department of Assessments and Taxation (SDAT) treats these plants as *nonutility generators*, except for Southern Maryland Electric Cooperative's Chalk Point plant, PECO's Conowingo hydroelectric plant, and A&N Electric Cooperative's Smith Island plant, all of which are assessed as *operating utility property*.

Nonutility generators are assessed differently than the properties that have remained a part of utility operating units. For the electric generating plants that are not part of utility operating units, the real property is assessed by the local State assessment office. These properties are valued similarly to other commercial and industrial real properties using regular valuation method. Personal property of electric generating plants is assessed centrally by SDAT based on original cost less standard depreciation. In comparison, public utilities are centrally assessed by SDAT using the unit method including income

and cost approaches to value. The assessments for real property and personal property are allocated before certification to local governments.

The sale of the utility generators set the market value for the nonutility generators. The plants for all the utilities except for SMECO, A&N, and PECO have transferred outside of the operating units, some to unrelated entities. The effect of this bill, by allowing the potential repurchase of generating assets, is uncertain. Operating property of a public utility has always been assessed at 100% of its value. When the State went to 100% assessments for real property, the rate applied to both operating utility real and personal property was adjusted to 2.5 times the real property rate. One result of deregulation and the sale of utility generator plants to nonutility generators has been that the real property of these plants, which is a small percentage of the property compared to personal property, is taxed at a lower rate. However, those sales have resulted, in some cases, in a higher value for the property for assessment purposes.

Even though utilities are valued in a different manner, it cannot be determined whether the property would be valued higher or lower under the ordinary valuation method. Public utility real property is taxed at a higher rate than ordinary taxpayers, but the increased tax that they pay on their real property as utilities could be more than offset by a higher value that their property might have under ordinary valuation methods but the overall fiscal impact is uncertain – it could be positive, negative, or neutral.

State Expenditures: Special fund expenditures could increase by an estimated \$50,307 in fiscal 2009. This estimate reflects the cost of hiring one public utility auditor to audit electric suppliers and the electric companies as required under the bill. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	1
Salary and Fringe Benefits	\$45,072
Operating Expenses	<u>5,235</u>
Total FY 2009 State Expenditures	\$50,307

Future year expenditures reflect a full salary with 4.4% annual increases and 2% annual increases in ongoing operating expense.

Additional Information

Prior Introductions: SB 972 and HB 1736, similar bills, were introduced in the 2006 session. SB 972 received a hearing in the Senate Finance Committee and; HB 1736 was referred to the House Rules and Executive Nominations Committee. No further action was taken on either bill.

Cross File: None.

Information Sources: Town of Berlin, Town of Easton, Montgomery County, Department of Natural Resources, Department of the Environment, Maryland Department of Planning, Exeter Associates, Maryland Energy Administration, Office of the People's Counsel, Public Service Commission, State Department of Assessments and Taxation, Department of Legislative Services

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Analysis by: Michael P. Lee

Direct Inquiries to:
(410) 946-5510
(301) 970-5510