

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 448
Finance

(Senators Pipkin and Rosapepe)

**Constellation Energy Group, Inc., and Baltimore Gas and Electric Company -
Return of Transition Costs**

This bill requires the Public Service Commission to require Constellation Energy Group, Inc. to return to Baltimore Gas & Electric Company (BGE) \$975 million in transition costs recovered during the settlement agreements implementing electricity deregulation. BGE must use the return of the transition costs to reduce electricity rates for its residential customers, in a manner approved by PSC.

The bill takes effect June 1, 2008.

Fiscal Summary

State Effect: None. The bill would not directly affect State operations or finances.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland. Maryland's traditional local electric utilities were required to transfer their electric generation assets to unregulated subsidiaries or sell these assets to unaffiliated companies. Restructuring also introduced "customer choice" of supply services and set a mandated rate reduction and a cap on the reduced rates. All rate cap restrictions have now expired for residential, commercial, and industrial

customers except for Allegheny Power's residential standard offer service (SOS) customers. With the expiration of price caps, customers are subject to market rates. The electric utilities now provide residential and commercial SOS service based on market rates.

Background: PSC and multiple stakeholders undertook restructuring settlements with the four large investor-owned utilities (IOUs) to implement the 1999 electric industry restructuring legislation. Separate restructuring settlements were agreed to not only with BGE, but with the other three large IOUs that operate in the State: PEPCO; Potomac Edison (Allegheny); and Delmarva. Legislative Services notes that the restructuring settlements occurred after the decision to deregulate the electricity market in Maryland. Restructuring settlements were designed to implement electric restructuring, as enacted by the General Assembly.

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. Retail electric prices have increased throughout the Baltimore/Washington, DC region that encompasses both BGE and PEPCO service territories.

Prior to restructuring, the local electric utility, operating as a regulated, franchised monopoly, supplied all end-use customers within its service area with the three principal components of electric power service: generation; transmission; and distribution. With Maryland's restructuring of the electric power industry, generation of electricity is offered in a competitive marketplace. The principal purpose of the asset divestiture requirement of the Restructuring Act was to support the development of a robust and competitive market for generation services by eliminating the utility's incentive to favor its own generation resources. Retail customers are supplied power via competing electricity suppliers or are provided power supplies through the electric distribution company via SOS, procured at competitive rates.

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 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 required 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.

Transition Cost Recovery

The rationale for allowing electric utilities to recover transition costs is based on the so-called “regulatory compact.” This is the notion that the utility agrees to make all the investments necessary to stand ready to serve all customers at all times with highly reliable electricity supplies. In exchange for providing reliable service and serving all customers, the electric utility has the opportunity to realize a fair return on all prudently incurred investments. PSC, as the regulatory body, reviewed and approved utility investments supporting these purposes; therefore, the investments are deemed prudent. As a result, the public has an obligation to permit the utility to recover approved costs.

One of the more complex issues in enacting electric utility industry restructuring was the treatment of transition costs or benefits, the difference between the book value and market value of an electric company's generation assets, subject to adjustments for reasons of public policy. Deregulation allowed an electric company to recover certain prudently incurred transition costs but those costs had to be under a PSC-approved transition plan, developed in accordance with fact-finding and evidentiary proceedings, and subject to full mitigation. An electric company with verified recoverable transition costs could institute a competitive transition charge that applied generally to customers located in the electric company's service territory. An electric company was able to transfer its generation facilities or generation assets to an affiliate, but the transfer could not affect or restrict PSC's determination of the value of a generation asset for purposes of transition costs or benefits.

As part of the transition cost determination, PSC was required to consider, the following factors in determining transition cost relating to investment in a generation asset: (1) the prudence and verifiability of the investment; (2) whether the investment is used and useful; (3) whether the loss is one of which investors can be said to have reasonably borne the risk; and (4) whether investors have already been compensated for the risk. The settlement agreement with PSC provided BGE with after-tax transition costs to be recovered from customers, which began July 1, 2000 and ended June 30, 2006.

Additional Information

Prior Introductions: SB 1099 of 2006, a similar bill, passed the General Assembly but was vetoed by the Governor.

Cross File: None.

Information Source(s): Department of Natural Resources, Exeter Associates, Public Service Commission, Office of People's Counsel, U.S. Department of Energy, Department of Legislative Services

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