SB 954

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 954 (Senator Klausmeier)
Finance

Electric, Gas, or Gas and Electric Companies - Separation from Other Businesses

This bill directs the Public Service Commission (PSC) by July 1, 2010, to require a legal separation between each electric company's regulated businesses and any parent company of its regulated businesses and its nonregulated businesses or nonregulated affiliates to prevent cross subsidization between the electric company's regulated businesses and nonregulated businesses or affiliates. The bill also requires PSC to require, among other factors, functional, operational, structural, and legal separation between a gas company's regulated businesses or a gas and electric company's regulated businesses, any parent company of its regulated businesses, and its nonregulated businesses or affiliates by July 1, 2010. The legal separations required in the bill are to be construed to prevent cross subsidization between an electric company's regulated businesses, any parent company of its regulated businesses or nonregulated affiliates.

Fiscal Summary

State Effect: PSC can implement the bill's requirements with existing budgeted resources.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Pursuant to Chapter 3 of 1999, each electric company was required to establish a functional, operational, structural, or legal separation between each electric

company's regulated business and its nonregulated businesses or nonregulated affiliates on or before July 1, 2000.

Chapter 669 of 2000 required PSC to adopt consumer protection orders or regulations to license competitive natural gas suppliers. The law required PSC to adopt consumer protection orders or regulations and impose appropriate requirements for gas suppliers with applicable protections provided to electric customers by July 1, 2001.

The Code of Maryland Regulations (20.40.02.07) requires utilities with a core or noncore service affiliate to file a Cost Allocation Manual with PSC. A Cost Allocation Manual contains a compilation of policies and procedures for the allocation and assignment of costs that are shared between a utility and its affiliate. Utilities with core or noncore affiliates must also file a Ring Fencing Report annually, which must contain a summary of all measures to protect the utility's financial strength and credit ratings from the activities of core and noncore service affiliates as well as a corporate organizational chart identifying the utility and its core and noncore service affiliates.

Background: Maryland's Electric Customer Choice and Competition Act of 1999 initiated electric restructuring. The Act granted PSC authority to oversee the deregulation process, and PSC required the State's utilities to file restructuring plans, all of which it approved through settlement agreements. To facilitate competitive supply, utilities were required to functionally, operationally, structurally, or legally separate their regulated and nonregulated assets. As a result, Baltimore Gas & Electric Company (BGE) and Potomac Edison Company transferred their generation assets to affiliated companies. Delmarva Power and Light Company transferred its Crisfield generating assets to an affiliate and sold its Vienna plant. Potomac Electric Power Company (PEPCO) sold all its generation assets in an open and competitive auction that excluded company affiliates.

Ring fencing is defined as the legal walling off of certain assets or liabilities within a corporation, as in a company forming a new subsidiary to protect (ring fence) specific assets from creditors. Ring fencing as a concept includes a number of measures that may be implemented to protect the economic viability of utility companies and their affiliates within a holding company structure. Ring fencing measures are intended to insulate a regulated utility from the potentially riskier activities of an nonregulated affiliate. Insulating the utility is intended to ensure the financial stability of the utility and the reliability of its service.

As the electric energy industry and markets have been restructured in the U.S. over the last decade a number of issues have arisen with respect to the continued viability of the regulated activities of the utilities. Related to these viability issues is a concern for the continued reliability of electric and gas service to customers. The viability issues arose

when vertically integrated generation-transmission-distribution companies changed their corporate structure to conform to new market structure and regulatory requirements. One unintended result is that these alternative corporate structures have created opportunities for affiliates to engage in nonregulated activities that may place individual regulated utility companies at increased financial risk. Consequently, customers may also be placed at risk in terms of continued reliable and reasonably priced ("just and reasonable") electric or gas service. The holding companies that own regulated utilities that operate in Maryland are involved directly or through wholly owned subsidiaries in nonregulated activities, *i.e*. the parent or subsidiaries are not subject to regulations or oversight of PSC.

In February 2008, the Federal Energy Regulatory Commission (FERC) issued new rules under Section 203 of the Federal Power Act to ensure that ratepayers are protected against unauthorized cross subsidies by regulated utilities of their nonregulated affiliates and to accommodate greater investment in the electric utility industry. Under the new rules, wholesale power sales between such public utilities and affiliates with market-based rate authority will require FERC approval. In addition, such a public utility that sells nonpower goods and services to an affiliate with market-based rate authority or an nonregulated affiliate will be required to do so at a price that is the higher of either cost or market price. Lastly, a public utility subject to the rules will not be permitted to purchase nonpower goods or services from an affiliate at a price above market price, except that the public utility cannot receive nonpower goods and services from a centralized service company above cost.

Small Business Effect: Cross subsidization has a negative impact on small businesses that compete with nonregulated affiliates of electric companies or gas companies. To the extent that cross subsidization may currently impede fair competition, and the bill results in a decrease in cross subsidization, small businesses that offer competing services benefit.

Additional Comments: During electric restructuring pursuant to Maryland's Electric Customer Choice and Competition Act of 1999, utilities were required to functionally, operationally, structurally, or legally separate their regulated and nonregulated assets. The Act did not specify any particular mechanism for divestiture. Utilities were allowed to recover costs associated with the restructuring process over recovery periods of different lengths and for different types of transition costs, as authorized by PSC. As a result, PSC authorized competitive transition charges (CTCs) as a line item on customer bills.

If PSC requires a legal separation between a regulated electric, gas and electric, or gas company and its parent or affiliated company as required under the bill, PSC may allow the company to recover transition costs by authorizing a surcharge on customer bills. The necessity of awarding such transition charges, the amount of any possible transition charges, or the impact on gas or electric customer bills cannot be reasonably ascertained

at this time. Transition costs may include any shared costs that are allocated to both a regulated electric company and a nonregulated affiliate. These shared costs may include human resources, customer call centers, and information technology.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Public Service Commission, Department of Legislative Services

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