Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE
Revised

House Bill 662 (Delegate Barkley, *et al.*)
Economic Matters Finance

Gas Companies - Rate Regulation - Infrastructure Replacement Surcharge

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This bill authorizes gas companies to file a plan with the Public Service Commission (PSC) requesting authorization to include a surcharge on customers' bills to recover specified costs associated with proposed eligible infrastructure replacement projects. The bill specifies the required components of a plan; specifies how the cost of a project is calculated; and establishes a limit for the monthly surcharge that may be imposed of $2 per month for all gas customers. PSC may approve a plan if certain conditions are met; if PSC does not approve or deny a plan within 180 days, a gas company may implement the plan without PSC's approval. A gas company must file an annual amendment to a plan and PSC must take action within 120 days. The bill also specifies how a plan is accounted for in the event of a rate case; and how differences in the actual cost of projects in a plan and the amount collected from the surcharge are handled. PSC must review plan amendments on an annual basis.

The bill takes effect June 1, 2012.

Fiscal Summary

State Effect: Special fund expenditures from the Public Utility Regulation Fund increase by $308,200 for consulting, litigation, staff, and review expenses in FY 2013. Future year expenditures reflect inflation and annualization. Special fund revenues increase correspondingly from assessments imposed on public service companies. State expenditures (all funds) increase minimally beginning in FY 2013 as gas companies apply any approved surcharges, and public service companies pass on the cost of assessments to all customer classes. Even though the bill takes effect June 1, 2012, it is assumed that State finances are not materially affected in FY 2012.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
SF Revenue	$308,200	$165,800	$171,300	$175,600	$180,100
SF Expenditure	$308,200	$165,800	$171,300	$175,600	$180,100
Net Effect	$0	$0	$0	$0	$0

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

Local Effect: Minimal increase in local government expenditures beginning in FY 2013, as gas companies apply any approved surcharges, and public service companies pass on the cost of assessments to all customer classes.

Small Business Effect: Expenditures increase minimally beginning in FY 2013 as any surcharges and assessments are passed on to all customer classes.

Analysis

Bill Summary:

Infrastructure Replacement Surcharge

A gas company may file a plan and associated cost recovery schedule with PSC requesting authorization to include a surcharge on customers' bills to recover reasonable and prudent costs associated with proposed eligible infrastructure replacement projects. "Eligible infrastructure replacement" is defined as the replacement or improvement in the existing infrastructure of a gas company that is (1) made on or after June 1, 2012; (2) designed to improve public safety or infrastructure reliability; (3) does not increase the revenue of a gas company by connecting an improvement directly to new natural gas customers; (4) reduces or has the potential to reduce greenhouse gas emissions through a reduction in natural gas system leaks; and (5) is not included in the current rate base of the gas company as determined by the gas company's most recent base rate proceedings.

A plan for an eligible infrastructure replacement project must include (1) a timeline for completion of each proposed project; (2) the estimated cost of each project; and (3) an explanation of how the plan benefits customers. The monthly surcharge may not exceed $2 for each retail natural gas customer (all classes). PSC may approve a plan if it finds that the investments and estimated costs of eligible infrastructure replacement projects are reasonable and prudent, and designed to improve public safety or infrastructure reliability over the short and long term. PSC must approve the cost recovery schedule associated with a plan at the same time that it approves a plan. The surcharge applies for five years from the date of initial implementation of an approved plan.

The bill specifies requirements for calculating the estimated cost of a project and requires inclusion of the pre-tax rate of return on the gas company's return on the investment in the project; depreciation associated with the project; and property taxes associated with the project. The bill specifies how the pre-tax rate of return must be calculated.

Before PSC takes final action on a plan, PSC may hold a public hearing on the plan. PSC must take final action to approve or deny a plan within 180 days after a gas company files a plan. If PSC does not take final action to approve or deny a plan within that time period, a gas company may implement the plan without PSC approval. If a plan is implemented without PSC approval, the gas company must refund to customers, with interest, any amount of the surcharge that PSC later determines is unjustified. Unless a plan is filed in conjunction with a base rate case, PSC may not consider any other revenue requirement or ratemaking issue when reviewing a plan for approval or denial.

Any adjustments for return on equity based on an approved must only be considered and determined in a subsequently filed base rate case.

Continuous Oversight

A gas company must file an amendment to the plan with PSC each year to adjust the amount of the surcharge in order to account for any difference between the estimated cost of the projects in a plan and the amount recovered under the surcharge. PSC must take final action to approve or deny an amendment within 120 days after an amendment is filed. A gas company must provide a refund on customers' bills, including interest, if the actual cost of the projects in a plan is less than the surcharge. If the actual cost of the projects in the plan is more than the amount collected under the surcharge, and PSC determines that the higher costs were reasonably and prudently incurred, PSC must authorize the gas company to increase the surcharge to recover the difference, subject to the monthly limits specified in the bill.

PSC may review a previously approved plan, and if it determines that an investment or cost of a project no longer meets the requirements of initial approval, it may reduce future base rates or surcharges, or alter or rescind approval of specified parts of the plan.

Base Rate Proceeding Changes

In a base rate proceeding subsequent to the approval of a plan, PSC must take into account any benefits realized by the gas company as a result of an approved surcharge. Within five years of the initial implementation of an approved plan, the gas company must file a base rate case application. If a plan approved by PSC is still in effect at the time of the base rate case, any eligible infrastructure costs included in new base rates (incurred costs) must be removed from the surcharge; however, the surcharge mechanism must continue for eligible future infrastructure project costs that are not included in the base rate case.

If PSC establishes new base rates for a gas company that includes costs on which a surcharge is based, the gas company must file a revised rate schedule with PSC that subtracts those costs from the surcharge.

Current Law: PSC regulates gas distribution companies, including monitoring retail competition and customer choice, to ensure that safe, reliable, and affordable gas service is provided. Rates charged by a gas distribution company are specified in the company's tariff and are approved through an order made by PSC. Through the ratemaking process, a gas distribution company is allowed to charge just and reasonable rates for the regulated services it renders. If a gas distribution company incurs a cost to upgrade natural gas infrastructure and the company seeks to recover those costs, it is done through a base rate proceeding.

The regulation of pipeline safety occurs at both the federal and State levels. PSC regulates intrastate pipeline safety. PSC may enter and inspect, at reasonable times and in a reasonable manner, the pipeline facilities and the pipeline procedures of those involved with them, and books, records, papers, and other documents relevant to determining compliance with regulations. Whenever the commission finds a particular facility to be hazardous to life or property, it is empowered to require the person operating such facility to take those steps necessary to remove such hazards.

Background:

Case No. 9267 – Washington Gas Light Company – Infrastructure Surcharge

In Case No. 9267, Washington Gas Light Company (WGL) requested that PSC approve, in addition to a rate increase, an accelerated pipe replacement plan. WGL planned to spend $115 million over five years to replace piping infrastructure and sought to recover the costs through a customer surcharge. In a November 2011 decision, PSC declined to authorize the surcharge for the recovery of future pipe replacement expenses. PSC found that WGL has historically demonstrated the ability to replace its infrastructure when necessary to ensure safety and reliability, and that it can do so using traditional ratemaking procedures without compromising its ability to earn an appropriate return. WGL witnesses confirmed in the proceeding that WGL currently has the operational and financial ability to accelerate its pipe replacement plan. PSC authorized WGL to accelerate its plan, but cited that a surcharge would represent a fundamental shift from traditional ratemaking principles.

Natural Gas – Regulation, Pipeline System Incidents

The U.S. Department of Transportation, Office of Pipeline Safety (OPS) is the federal safety authority for ensuring the safe, reliable, and environmentally sound operation of the nation's pipeline transportation system. Natural gas pipelines in Maryland may include large-diameter lines carrying energy products to population centers, as well as small-diameter lines that may deliver natural gas to businesses and households. According to OPS, pipelines are by far the safest method for transporting energy products. However, when pipeline incidents occur they can present significant risks to the public and the environment. **Exhibit 1** shows the number of significant pipeline events in Maryland since 2002.

Exhibit 1
Maryland Significant Incidents – All Pipeline Systems

Year	Number	Fatalities	Injuries	Property Damage
2002	4	1	9	$840,612
2003	6	-	2	1,701,048
2004	3	-	-	3,920,914
2005	4	-	-	683,790
2006	2	-	-	386,753
2007	5	-	2	950,528
2008	2	-	1	163,143
2009	2	-	2	2,758,602
2010	-	-	-	-
2011	-	-	-	-
10-year Total	28	1	16	$11,405,390

Source: U.S. Pipeline and Hazardous Materials Safety Administration

State Fiscal Effect: Gas companies typically file for rate review every few years. This bill allows a gas company to seek cost reimbursement at any period, and requires PSC to review each proposal. As a result, the number of filings by gas companies that need to be evaluated and approved by PSC increases.

Special fund expenditures from the Public Utilities Regulation Fund increase by $308,224 in fiscal 2013, which accounts for a 120-day start-up delay. This estimate reflects the cost of hiring one half-time accountant and one half-time engineer at PSC to review and verify applications, calculate surcharges, and verify that infrastructure investments meet legislative criteria. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Additional costs are incurred by the Office of People's Counsel (OPC) for consulting and litigation expenses for additional cases brought before PSC.

Half-time Positions:	2
Salaries and Fringe Benefits	$48,326
Initial Case Litigations	$255,000
Other Operating Expenses	4,898
Total FY 2013 Administrative Expenditures	**$308,224**

Legislative Services notes that this estimate does not include costs for public hearings on proposed plans, which PSC may schedule under the bill. In addition, OPC advises that the additional caseload anticipated from the bill, if it were coupled with only a slight increase in other cases, might require the office to request an additional assistant people's counsel; any such costs are not included in the above estimate.

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 expenditures (all funds) increase minimally beginning in fiscal 2013 as gas companies apply any approved surcharges, and public service companies pass on the cost and assessments to all customer classes.

Additional Comments: In its testimony on a similar bill, SB 332 of 2011, PSC advised that currently ratepayers finance infrastructure projects through traditional ratemaking, based on work performed (and costs incurred), and that a surcharge as defined in the bill would be based on projected costs. This shifts financial risk from the gas or electric companies to the ratepayers, and decreases cost-containment incentives.

Statewide, the surcharge has the potential to generate a maximum of approximately $30 million annually assuming the maximum surcharge is assessed on all existing gas customers. The combined residential, commercial, and industrial gas customer base of the two largest gas companies – Baltimore Gas and Electric Company (BGE), and WGL – was 1.1 million in December 2011. Assuming a maximum monthly surcharge of $2 per customer, the surcharge generates $26.3 million annually ($15.7 million for BGE and $10.6 million for WGL). Additional surcharges levied by other, smaller, gas companies increase the statewide total. This surcharge would be applied directly to infrastructure replacement projects carried out by gas companies, as approved by PSC.

Additional Information

Prior Introductions: A similar bill, SB 332 of 2011, and its cross file, HB 856, were heard by the Senate Finance Committee and the House Economic Matters Committee, respectively, but subsequently withdrawn.

Cross File: SB 541 (Senators Astle and Kittleman) - Finance.

Information Source(s): Public Service Commission, Office of People's Counsel, State Department of Assessments, and Taxation; U.S. Department of Transportation; Department of Legislative Services

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