SB 510

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 510 (Senators Astle and Middleton)
Finance

Electric and Gas Companies - Rate Regulation - Infrastructure Investments

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This bill increases the maximum monthly surcharge – from $2 to $4 – that a gas company may charge a residential customer under a gas infrastructure replacement plan. The monthly surcharge for a nonresidential customer is likewise increased, as it is based off of the residential surcharge. The bill also establishes an application and review process for an electric system infrastructure investment plan that is similar to the existing gas infrastructure replacement plan, with a monthly residential cap of $4 and a proportional nonresidential charge that is also capped. The Public Service Commission (PSC) may approve a plan if it finds that the investments and estimated costs of infrastructure investment are (1) reasonable and prudent and (2) designed to deliver a benefit to the customer. PSC must approve cost recovery at the same time it approves a plan.

The bill takes effect June 1, 2016.

Fiscal Summary

State Effect: Special fund expenditures from the Public Utility Regulation Fund (PURF) increase by $242,100 for staff and related expenses in FY 2017. Future year expenditures reflect annualization and the elimination of one-time costs. Special fund revenues increase correspondingly from assessments imposed on public service companies. State expenditures (all funds) increase beginning in FY 2017 from higher gas and electric costs, as discussed below. Even though the bill takes effect June 1, 2016, it is assumed that State finances are not materially affected until FY 2017.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
SF Revenue	$242,100	$306,300	$318,000	$330,100	$342,800
SF Expenditure	$242,100	$306,300	$318,000	$330,100	$342,800
GF/SF/FF Exp.	-	-	-	-	-
Net Effect	$0	$0	$0	$0	$0

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

Local Effect: Local government expenditures increase beginning in FY 2017 as gas and electric companies apply any approved surcharges and public service companies pass on the costs of assessments to all customer classes.

Small Business Effect: Meaningful. Expenditures increase beginning in FY 2017 as gas and electric companies apply any approved surcharges and public service companies pass on the costs of assessments to all customer classes. For small businesses with relatively high utility usage, the cost is potentially significant.

Analysis

Bill Summary: The bill has two parts. First, the maximum monthly surcharge that a gas company may charge a residential customer under a gas infrastructure replacement plan is increased from $2 to $4. Under current law, the monthly surcharge for a nonresidential customer is based off of the residential surcharge – so it too is increased. The remaining current law for gas infrastructure replacement plans, as established by Chapter 161 of 2013, is unchanged. The bill also establishes an application and review process for an electric system infrastructure investment plan that is similar to the existing gas infrastructure replacement plan process.

Electric System Infrastructure Investment Plan

An electric company may file a plan and associated cost recovery schedule with PSC requesting authorization to include a surcharge on electric customers' bills to recover reasonable and prudent costs associated with proposed "electric system infrastructure investments." The estimated costs approved in the surcharge are collectible during the same time the electric system infrastructure investments are being made.

"Electric system infrastructure investment" means a capital investment in the electric system infrastructure that is (1) made on or after June 1, 2016; (2) designed to promote economic growth, environmental sustainability, or customer reliability; and (3) not included in the current rate base of the electric company as determined by the electric company's most recent base rate proceeding. (These criteria differ from eligible gas infrastructure replacements under a gas infrastructure replacement plan.)

A plan for an electric system infrastructure investment must include (1) a timeline for completion of the plan; (2) the estimated cost of the investment; (3) a description of customer benefits under the plan; and (4) any other information PSC considers necessary to evaluate the plan. The fixed annual surcharge may not exceed $4 per month for each residential electric customer. The fixed annual surcharge for nonresidential customers may not be less than the fixed annual surcharge for residential customers, but also must be capped. To create a surcharge cap for all customer classes, costs must be allocated between residential and nonresidential customers consistent with the proportions of total distribution revenues that those classes bear, as determined in the electric company's most recent base rate filing.

The bill specifies requirements for calculating the estimated cost of the electric system infrastructure investment and requires an electric company to include (1) the pre-tax rate of return on the investment; (2) depreciation associated with the investment; and (3) property taxes associated with the investment. The pre-tax rate of return must be calculated using the electric company's capital structure and weighted average cost of capital approved by PSC in the electric company's most recent base rate case.

PSC may approve a plan if it finds that the investments and estimated costs of the electric system infrastructure investment are reasonable and prudent and designed to deliver a benefit to the customer (these criteria differ from a gas infrastructure replacement plan). PSC must approve the cost recovery schedule associated with a plan at the same time that it approves a plan. Costs recovered may relate only to the electric system infrastructure investment within the approved plan. The surcharge applies for five years from the date of initial implementation of an approved plan.

PSC must take final action to approve or deny a plan within 180 days after an electric company files a plan. PSC may hold a public hearing before taking final action on the plan. If PSC does not take final action to approve or deny a plan within that time period, an electric company may implement the plan without PSC approval. If a plan is implemented without PSC approval, the electric company must refund to customers, with interest, any amount of the surcharge that PSC later determines is not reasonable or prudent. PSC must take final action to approve or deny an amendment to an approved plan within 120 days after an amendment is filed.

Unless a plan is filed in conjunction with a base rate case, PSC may not consider an unrelated revenue requirement or ratemaking issue when reviewing a plan for approval or denial. Any adjustments for return on equity based on an approved plan must only be considered and determined in a subsequently filed base rate case.

Continuous Oversight

An electric company must file a reconciliation to an approved plan with PSC each year to adjust the amount of the surcharge in order to account for any difference between the actual cost of a plan and the actual amount recovered under the surcharge. An electric company must provide a refund on customers' bills, including interest, if the actual cost of a plan is less than the amount collected under the surcharge. If the actual cost of a 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 electric company to increase the surcharge to recover the difference, subject to the limits specified in the bill.

PSC may review a previously approved plan, and if it determines that an electric system infrastructure investment no longer meets the requirements of initial approval, it may reduce future base rates or surcharges or alter or rescind approval of that part 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 electric company as a result of an approved surcharge. Within five years of the initial implementation of an approved plan, the electric 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, electric system infrastructure investment costs included in new base rates must be removed from the surcharge; however, the surcharge mechanism must continue for future electric system infrastructure investment costs that are not included in the base rate case.

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

Current Law/Background: Chapter 161 of 2013 established an application and review process for gas infrastructure replacement plans. The maximum residential surcharge is $2 per month, and the monthly surcharge for a nonresidential customer is based off of the residential surcharge; it may not be less than the fixed annual surcharge applicable to a residential customer account, but also must be capped so that costs are allocated proportionately between residential and nonresidential customers.

The electric system infrastructure investment plan established by the bill is similar to the gas infrastructure replacement plans; however, there are two substantive differences, as noted above: (1) the eligible types of projects; and (2) the reasons for which PSC may approve a plan.

Under the gas infrastructure replacement plan, "eligible infrastructure replacement" is defined as the replacement or improvement in the existing infrastructure of a gas company that (1) is made on or after June 1, 2013; (2) is 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 proceeding.

Under the gas infrastructure replacement plan, 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.

Gas Infrastructure Replacement Plans

PSC denied several separate requests for surcharge mechanisms by public service companies prior to the enactment of Chapter 161 of 2013. Subsequent to the Act, all three of the State's major gas companies applied to PSC and have been authorized to implement gas infrastructure replacement plans, which include cost recovery surcharges. Summary data for residential customers is in **Exhibit 1**.

Exhibit 1
Monthly Residential Gas Infrastructure Replacement Surcharge
2016

Gas Company	Monthly Residential Surcharge
Baltimore Gas and Electric Company	$1.35
Columbia Gas	2.00
Washington Gas Light Company	1.22

Notes: Washington Gas Light Company has a separate monthly surcharge for residential nonheating/noncooling customers, which is $0.63 in 2016. The Columbia Gas residential surcharge would be $4.02 if not for the $2.00 cap.

Source: Public Service Commission

Combined, these three gas companies have approximately 1.07 million residential customers. Doubling the authorized residential surcharge doubles the maximum amount that the gas companies can collect from these customers – from $25.8 million under current law to $51.5 million under the bill. Assuming a two-to-one ratio of residential revenues to nonresidential revenues (generally consistent with recent base rate filings), the maximum amount collectible from residential and nonresidential natural gas customers doubles from $39.0 million to $78.1 million annually under the bill. The Department of Legislative Services (DLS) notes that these revenues are not necessarily "additional" revenues. Some or all of the revenues could also be collected – although at a later date and also subject to PSC approval – in base rates.

Existing Electric Surcharges for Reliability Improvements

In 2013, PSC authorized monthly surcharges similar to those in the bill for Baltimore Gas and Electric Company (BGE), Delmarva Power and Light (DPL), and Pepco. DPL and Pepco were each granted conditional approval for a "Grid Resiliency Charge" in July 2013, and BGE was granted conditional approval to implement an Electric Reliability Investment (ERI) initiative with an associated surcharge in December 2013. In Order No. 85724, with respect to its conditional approval of Pepco's Grid Resiliency Charge, PSC found that:

> a properly defined tracker proposal, when aligned with specific and measurable milestones and expenditures, can be appropriate to support the projects that are required to address the immediate challenges to improving reliability in Maryland. Although the proposals for trackers presented … to date have been lacking in certain areas, the need for accelerated reliability work coupled with an aligned cost recovery mechanism is in our view justified, and indeed beneficial to ratepayers, under certain circumstances.

In a follow-up order related to the BGE ERI initiative (Order No. 86270), PSC concluded that:

> [its] foremost objective with permitting the ERI surcharge for the five conditionally approved programs is to provide a mechanism that facilitates the acceleration of electric reliability which improves the overall customer experience, yet ensures that the utility is held accountable for demonstrating measurable performance improvements to justify contemporaneous ratepayer investment.

DLS notes the following:

- PSC continually emphasized reliability in authorizing the surcharges for BGE, DPL, and Pepco;
- the PSC orders authorizing the BGE and Pepco surcharges also contained dissenting opinions from one or more commissioners;
- other parties to the cases were in disagreement as to the justification and/or need for the surcharge mechanisms; and
- the current monthly residential surcharges for BGE, DPL, and Pepco are 18 cents, 9 cents, and 14 cents, respectively.

Electric System Infrastructure Investment Plans

The surcharge cost recovery mechanism is an attractive financing tool for public service companies; it is likely that most of the State's electric companies will apply for electric system infrastructure investment plans at some point.

Combined, the State's electric companies had 2.2 million residential customer accounts and 255,700 nonresidential customer accounts in December 2013. While unlikely (at least initially), the maximum monthly residential surcharge of $4 generates $106.5 million annually from this number of residential accounts. Assuming a 50/50 split between residential and nonresidential distribution revenues (generally consistent with recent rate cases for BGE and Pepco), the maximum amount collectible by the State's electric companies from approved plans is $213.0 million annually. DLS notes that these revenues are not necessarily "additional" revenues. Some or all of the revenues could also be collected – although at a later date and also subject to PSC approval – in base rates.

State Fiscal Effect: Public service companies typically file for rate review every few years – although recently many of the State's larger utilities have been filing annually or close to annually. This bill allows an electric company to seek cost reimbursement at any period, and requires PSC to review each proposal. As a result, the number of filings by electric companies that need to be evaluated and approved by PSC increases.

Special fund expenditures from PURF increase by $242,135 in fiscal 2017, which accounts for a 30-day start-up delay. This estimate reflects the cost of hiring one utility auditor and one engineer at PSC and one assistant people's counsel at the Office of People's Counsel (OPC) to handle the increased workload generated by additional filings. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	3
Salaries and Fringe Benefits	$227,691
Other Operating Expenses	14,444
Total FY 2017 PURF Expenditures	**$242,135**

Future year expenditures reflect full salaries with annual increases and employee turnover, the elimination of start-up costs, and annual increases in ongoing operating expenses. Estimates do not assume any change in the expected frequency of base rate cases filed with PSC. Estimates also do not include any additional contractual costs for expert witness testimony for OPC, as OPC advises that it can accommodate expert witness testimony costs within its existing budget.

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 beginning in fiscal 2017 as gas and electric companies apply any approved surcharges to their customers and public service companies pass on the cost of assessments to all customer classes. The amount cannot be reliably estimated at this time – the residential surcharges are capped at $4 each, but State accounts are not residential accounts. State government buildings use approximately 1.5 million megawatt-hours of electricity and 50 million therms of natural gas per year.

Additional Information

Prior Introductions: None.

Cross File: HB 546 (Delegate Barkley, *et al.*) **-** Economic Matters.

Information Source(s): Public Service Commission, Office of People's Counsel, Department of General Services, Baltimore Gas and Electric Company, Department of Legislative Services

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