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Testimony from:
Michael Haugh, Senior Fellow of Energy and Environmental Policy, R Street Institute

In SUPPORT of SB 506 "An Act concerning Public Utilities – Regulatory Assets -Prohibition"

February 16, 2021

Senate Finance Committee

Chair Kelley, Vice Chair Feldman and members of the Finance Committee. I thank you for the opportunity to testify on this important topic. My name is Mike Haugh and I am a senior fellow in energy policy with the R Street Institute. R Street is a nonprofit, nonpartisan public policy research organization with a mission to engage in policy research and outreach to promote free markets and limited but effective government. I have been involved in energy policy for over 20 years, including eight years working for the Ohio Consumers' Counsel, the residential ratepayer advocate.

SB 506 is an important piece of legislation that will help all Maryland utility customers as they are facing unemployment, utility shutoffs and evictions. Some will say regulatory assets, rate of return and utility accounting are complex topics. Those are not the reason for this legislation, this legislation addresses one thing: utility greed.

As a little background, regulatory assets are set up when utilities incur expenses that are approved by the Maryland Public Service Commission (PSC) to be collected at a later date. Traditionally, utilities can earn a rate of return, or profit, on these assets until they start collecting the costs from customers.

Recently, utilities began to treat certain costs related to the COVID-19 pandemic as regulatory assets. These costs include employee sequestration, facility cleaning, personal protection equipment, lost late payment revenue and other related costs. Baltimore Gas and Electric's (BG&E) most recent report on its incremental COVID-19 costs for 2020 showed net costs of $17.7 million[1]. Given the recently approved 9.5 percent rate of return, this would equate to roughly $1.7 million in profits for BG&E.[2] Allowing a return on these expenses in turn allows a utility to profit on the misfortunes of others. There are too many entities attempting to take advantage of the pandemic, utilities should not be added to that list.

While utility customers are obviously experiencing financial difficulties during the pandemic, utilities are not experiencing the same issues. In its latest earning report Exelon, parent company of BG&E, stated:

> "BGE's third quarter of 2020 GAAP Net Income and Adjusted (non-GAAP) Operating Earnings remained relatively consistent with the third quarter of 2019, primarily due to regulatory rate increases, offset by an increase in various expenses. Due to revenue decoupling, BGE's distribution earnings are not affected by actual weather or customer usage patterns."[3]

Utilities are granted the ability to operate as a monopoly. Laws, rules and regulations protect them from many market and operational risks. Utilities should not be protected from all risks; they need to share in

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[1] Maryland PSC Docket PC53, item 115 https://www.psc.state.md.us/search-results/?q=pc53&x.x=9&x.y=5&search=all&search=rulemaking

[2] Holden Wilen, "Public Service Commission approves BGE rate hikes starting 2022," *Baltimore Business Journal*, Dec. 17, 2020 https://www.bizjournals.com/baltimore/news/2020/12/17/public-service-commission-approves-new-bge-rates.html#:~:text=The%20commission%20set%20BGE's%20return,%2C%22%20according%20to%20the%20PSC

[3] "Exelon Reports Third Quarter 2020 Results," Exelon Corporation, Nov. 3, 2020 https://www.exeloncorp.com/newsroom/exelon-reports-third-quarter-2020-results

the hardships that are being experienced by their customers. SB 506 provides a little bit of relief for customers and limits the profits utilities make as the result of the pandemic.

Thank you and I ask for a favorable report on 506 to help the utility customers of Maryland.

Opinion_ Will Ratepayers Bail Out Md. Utilities Du

Uploaded by: Kavulla, Travis

Position: FAV

Opinion: Will Ratepayers Bail Out Md. Utilities During COVID-19?

By **Guest Commentary** - July 14, 2020

Photo via Unsplash.com

Most Maryland businesses are suffering a loss from the economic downturn caused by COVID-19. Less demand exists for products they sell. Those providing a continuous service, from apartment rentals to broadband subscriptions, have seen an uptick in nonpayment. Few of these businesses will be made whole — except, perhaps, for one industry: Maryland's energy utilities.

Utilities' fortunes should be tied to the wider economy. Shuttered office buildings and small businesses mean fewer kilowatt-hours sold, and mass unemployment leaves ratepayers unable to pay what they owe to the power company. Yet, increasingly, the profits of Maryland's utilities are divorced from the rest of the economy. Indeed, in the midst of COVID-19, a low-key bailout of these companies already has begun and, unfortunately for Maryland ratepayers, it will be happening on their dime.

Creative accounting

In April, the Maryland Public Service Commission issued a ruling colloquially known as an "accounting order." Typically, accounting standards require businesses to report losses to shareholders as they occur. With an accounting order in hand, utilities are permitted to depart from that practice. Instead, they record on their books an offset known as a "regulatory asset." That is, a shareholder asset entirely backed by regulation's promise to leverage a utility's monopoly to recoup losses through surcharges at a later date that would not be possible in a competitive market.

At least 35 states either have granted utilities these writs or are poised to do so. The Maryland version lacks specifics, so consumers will have to guess what items are listed on Maryland utilities' running tab of COVID-19-related costs. If other states are a guide, the accounting order could encompass everything from uncollected late fees, to rising bad debt, to utilities' pension contributions.

Pay only for the energy you used—and then some

Another policy, known as "decoupling," goes further still. Simply put, decoupling allows utilities to charge consumers for electricity they never sold. This counterintuitive policy is permitted in 22 states, including some of those hardest hit by COVID-19 like Maryland, where it has been in effect since 2007 under the name "Bill Stabilization Adjustment."

Decoupling's advocates observe that utilities will be more likely to embrace energy efficiency programs if their revenues are decoupled from their sales volumes. Perhaps. But today, decoupling's practical effect is to shift the risk of a major economic downtown from a utility's shareholders to a utility's captive set of customers. With electricity use down 10% on times of peak usage in the regional electricity market that includes Maryland, that risk will be realized in the form of higher rates.

Travis Kavulla

Small businesses in particular will feel the hurt of this policy. Since their demand for electricity has fallen more significantly than other types of customers, decoupling's boomerang effect of higher rates will swing back at them with particular force in the years to come.

When regulation serves utilities — not customers

Consumer advocates have hit back on some of the most galling utility requests. Virginia's Attorney General has understatedly observed, "it is possible that utility management could simply share the financial burden with shareholders, as other businesses impacted by the pandemic have had to do." Yet for the most part, utility regulation is so obscure that it flies under the radar of the normal political process.

Besides, in this weird corner of politics, it is unfortunately commonplace simply to pay off the utility in the hopes that doing so will yield a social benefit — in the case of COVID-19, a moratorium on utility disconnects for nonpayment. While Maryland's utilities have proudly touted the suspension of disconnects and late fees on their websites, the situation gives meaning to the old saying "talk is cheap." Ultimately, it will be other consumers and not shareholders who pay for the tab for those who cannot afford to.

How to fix it

It doesn't have to be this way. Maryland is among more than a dozen states with restructured markets, where customers can choose from a number of energy suppliers. In the most advanced restructured market, Texas, regulated utilities remain in charge of owning and operating the network that delivers electricity. But all customers choose who will sell them electricity, and those companies bear the responsibility of billing customers. (Georgia has the same policy for natural gas.) Part and parcel of this structure is that retail energy providers — unlike monopoly utilities — do not have a captive set of customers they can use to recoup losses. By design, the competitive retail market absorbs the losses when customers cannot pay.

Texans have also not suffered a spate of disconnects. During the COVID-19 pandemic, the Public Utility Commission of Texas has adopted an Electricity Relief Program that prevents retailers from disconnecting customers facing hardship as a result of the pandemic. In exchange for continuing to provide electricity, electricity retailers obtain a partial reimbursement on bad debt, which still leaves their shareholders' skin in the game.

Maryland already has a restructured market in place. But it continues to be dominated by the utilities, who act as gatekeepers to the marketplace and still possess a monopoly on customer billing. Getting utilities out of this "default" role would unlock a primary advantage of the competitive market that today Marylanders aren't realizing: Making shareholders, not a monopoly's customers, take the risk of economic downturns or other unforeseen events that leave customers unable to pay their bills.

The state's policymakers and regulators already have a critical tool at their disposal to strike a balance that makes the private capital invested in the power sector bear some of the risk of doing business. Until that happens, it'll be energy consumers who pay — even for energy they didn't use.

— TRAVIS KAVULLA

The writer is vice president of regulatory affairs for NRG Energy, an electricity supplier.

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Guest Commentary

SB 506 Kelley Testimony.pdf
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SENATOR DELORES G. KELLEY
Legislative District 10
Baltimore County

Chair
Finance Committee

Executive Nominations Committee
Rules Committee
Legislative Policy Committee

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TESTIMONY OF SENATOR DELORES G. KELLEY

REGARDING SENATE BILL 506 PUBLIC UTILITIES-REGULATORY ASSETS-PROHIBITION

BEFORE THE SENATE FINANCE COMMITTEE

February 16, 2021

Mr. Vice-Chair and Members:

Colleagues, Senate Bill 506 prohibits a utility from collecting a rate of return on regulatory assets created as a result of conditions established under a governor's declaration of a state of emergency.

In April, the Maryland Public Service Commission (PSC) issued an accounting order. In traditional business

accounting, businesses must report expenses and losses as they are incurred. An accounting order, like the one the PSC issued, authorizes

the creation of a regulatory asset. Utilities can place expenses into that regulatory asset with a degree of certainty that they will recoup those costs. There is also an expectation that the regulating body will grant a rate of return, or profit on those incurred costs.

Included in these costs are cleaning services and personal protection equipment, employee sequestration costs, employee benefit related costs, incremental facilities and vehicle cleaning costs, incremental security costs, incremental overtime costs, public relations & printing costs, and other costs. To a lesser extent, there are also savings. The net is then subject to a rate of return. To be clear, the bill allows the utilities to recover costs, but prohibits a rate of return, a profit.

As a result of COVID-19 many of our constituents have suffered. The pandemic has left many unable to make ends meet. Small businesses have struggled to keep the doors open, staff paid, and the lights on. The

thought of profit for these businesses is now but a distant memory. Small businesses across the state have few ways to recover expenses incurred as a result of COVID-19, let alone profit from them. However, our state's regulated utilities and their shareholders stand to profit from COVID-19, when nearly no one else is. Current law insulates the utility shareholder, protects them from the slightest risk.

What is so sacred about a utility shareholder that they cannot absorb the slightest loss? Certainly they can forgo the profit on costs incurred as a result of the pandemic. Senate bill minimizes the possibility that utilities might profit off of the pandemic, while still allowing them the ability to recover their costs.

In view of the aforementioned, I ask for a favorable report on Senate Bill 506.

SB506_FAV_KONCILJA.pdf
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SENATE BILL 506
PUBLIC UTILITIES – REGULATORY ASSETS – PROHIBITION
SENATE FINANCE COMMITTEE
FEBRUARY 16, 2021

TESTIMONY OF FORMER COLORADO PUBLIC UTILITY COMMISSIONER FRANCES A. KONCILJA

POSITION: FAVORABLE

Senate Bill 506 is, in my opinion, a necessary and reasonable protection of consumers that balances the interests of the shareholders of an investor- owned utility with the interests of the ratepayers.

It is un understatement to say that the Covid-19 pandemic has dealt an extraordinary blow to our economy. The loss of jobs and the inability of working people to pay for family necessities, including food, housing and utilities has been staggering. The Federal Reserve has ordered the country's 33 largest banks to suspend stock buyback programs, limit dividend payments to shareholders and submit plans for maintaining enough of the capital needed to survive an economic downturn. Investor- owned utilities, on the other hand, are taking none of these actions and regulators are not even exploring these actions. Instead, utilities are requesting that regulators around the country adopt accounting orders that will ultimately shift most of their COVID related costs to customers, while at the same time, retaining any benefits, such as low interest rates, reduced operating costs and possibly government loans. Under the utility approach, the shareholders get the benefits and ratepayers pay the costs. To add insult to injury, the utilities are asking for a rate of return or carrying costs on these "COVID costs." Senate Bill 506 simply makes it clear that investor -owned utilities will not make a profit on these costs.

How did we get to this absurd result that utility shareholders win, and utility customers lose, when governors were trying to protect utility customers? Knowing that the loss of jobs would make it almost impossible for residential and small business customers to pay their utility bills, governors around the country, including Governor Polis in my home state of Colorado, attempted to protect consumers from utility shut-offs by issuing executive orders pausing disconnections and ordering reconnections. The ink was barely dry on these orders when investor- owned utilities in Colorado and around the country requested seemingly benign "accounting orders" to shift the economic pain of the pandemic to their customers and ask for a "return" on these costs, while at the same time ignoring or rather pocketing the savings from the pandemic.

What are the likely savings for the utilities-- Reduced operating costs during this economic downturn because numerous businesses are reducing operations, and some are closed—perhaps permanently; Lower cost of debt on some of their financing. (However, utilities will continue to collect the cost of debt from their last rate case, even if some of their actual cost of debt is much lower. If the differential is large enough, the utility will stay away from filing a rate case and absorb all of these savings to benefit shareholders); Utilities and or their unregulated entities may receive payments or other benefits from the various COVID relief bills.

However, none of these potential savings are even being discussed in these “accounting order” cases.

Is there a legitimate reason that utilities should make a profit on these costs? Let us look at how the utilities fared in the pandemic year’s earnings reports? Despite the claimed reduction in revenue and increased costs, the Colorado utilities beat their earnings projections and continued to declare dividends. I believe that your Maryland utilities also performed well.

Why should the utilities, as opposed to other businesses, be immune from many of the economic downturns from COVID? There is no indication that the utilities are doing any of the things that other companies are doing--freezing compensation, reducing or freezing executive compensation, delaying dividend payments to shareholders. Why is it in the public interest to allow utilities to keep COVID related savings for shareholders while customers bear the burden of the majority of the costs? Why should utilities earn a profit on these costs? There is no legitimate economic reason.

The utilities are correct in describing in their filings that the effects of COVID are unprecedented and unexpected. However, that is exactly why regulators should be cautious in approaching these requests and should also order the creation of a regulatory liability to track all of the savings. Once the regulators have all the information as to costs and savings, rational economic decisions can be made as to who bears or shares the **net** costs of this pandemic.

Senate Bill 506 will go a long way to protect consumers by making it clear that utilities cannot make a profit on the costs of the pandemic. Hopefully, your regulators will also look at the savings that benefited the utilities during this pandemic.

Thank you, Madame Chair. I ask for a favorable committee report on SB506.

Frances Koncilja is a former Commissioner on the Colorado Public Utilities Commission, finishing her term in March 2020. Before that, she had been a trial attorney, handling complex commercial disputes and bankruptcies. She is now advising clients at Koncilja Public Utility Law and Strategy, LLC and can be reached at fkoncilja@koncilja.com

SB 506 - Testimony of CUC (02-16-21).pdf
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Position: UNF

February 16, 2021

SENATE FINANCE COMMITTEE
SB 506 – Public Utilities – Regulatory Assets – Prohibition

Statement in Opposition

Chesapeake Utilities Corporation ("Chesapeake Utilities") respectfully OPPOSES SB 506 which prohibits a public service company from receiving a rate of return on a regulatory asset created as a result of conditions addressed by a State of Emergency declared by the Governor.

SB 506 overrides the Commission's authority and is unnecessary. The Maryland Public Service Commission ("the Commission") was specifically created to be the expert regulator in the extremely technical area of public utility law. The Commission is well-informed by its own expertise and specialized staff and is charged with appropriately balancing the interests of utilities and utility customers on all matters. A "regulatory asset" is a unique regulatory mechanism that allows public utilities to recover large/unusual costs incurred as a result of unexpected or unforeseen events. Regulatory assets are important tools that help to protect the financial integrity of public utilities and allow them to continue to provide consumers with cost-effective service at reasonable prices over the long term. The General Assembly should not usurp the Commission's jurisdiction in this area.

SB 506 impacts a utility's ability to earn its rate of return. Because Maryland public service companies are monopolies, in exchange they are heavily regulated. By law, Public utilities are granted the "opportunity" to a specific rate of return on their assets that are used and useful in providing service to customers. Utilities are not "guaranteed" a rate of return – only the "opportunity." This means that utilities must control their costs and make prudent decisions. The Commission reviews all costs incurred by a utility during periodic base rate cases. In this way, the Commission acts as a check on utilities to ensure they recover only prudently incurred costs. SB 506 would unilaterally prohibit utilities from earning their rate of return without regard to whether the company acted prudently or not. If unable to earn its return, a utility will be forced to file more frequent rate cases and potentially increase rates for all customers.

Not all emergencies are the same, and SB 506 attempts to impose a "one size fits all" rule. SB 506 would prohibit a return on a regulatory asset incurred during any state of emergency. While it is true that the Governor declared the current state of emergency in response to COVID 19, the Governor has declared numerous emergencies in the past for many different reasons. For example, the Governor has frequently declared emergencies in response to hurricanes, derechos and other extreme weather events that cause significant damage to a utility's distribution system. SB 506 does not distinguish between emergencies. Eliminating the utilities' opportunity to earn a return on costs incurred during all emergencies will lead to more frequent rate cases and higher borrowing costs.

For the reasons stated above, Chesapeake Utilities respectfully requests that your Committee give SB 506 an unfavorable report.

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SB 506 Public Utilities Regulatory Assets - Prohib

Uploaded by: Case, Mark

Position: UNF

An Exelon Company

Position Statement

OPPOSE
Finance Committee
02/16/2021

SB 506 Public Utilities – Regulatory Assets – Prohibition

Baltimore Gas and Electric Company (BGE) opposes *Senate Bill 506 Public Utilities – Regulatory Assets – Prohibition*. Senate Bill 506 prohibits a public service company, in its utility operations, from collecting a rate of return on a regulatory asset created as a result of conditions addressed by a state of emergency as declared by the Governor.

When a utility company seeks a regulatory asset it is often in response to a need to timely address system expenses related to emergencies such as storm response or the current pandemic. Regulatory assets benefit utility customers by smoothing out cost increases due to such emergencies. A regulatory asset is often recovered over multiple years vs. immediately in order to minimize customer impact.

The Public Service Commission (Commission) has the authority to approve or deny a return on the costs in a regulatory asset, based on case-specific facts. The Commission is charged with reviewing all of the components of a regulatory asset and given the expertise of the Commission, is rightly charged with making a case-by-case evaluation. In fact, the Commission ordered in BGE's most recent rate case that some costs could be included in BGE's COVID-19 regulatory asset, but were ineligible to earn a return. This demonstrates appropriate Commission oversight and evaluation of that regulatory asset.

Additionally, the rate of return on a regulatory asset is simply another cost incurred by the utility. In fact, in a regulatory asset, the rate of return often reflects the cost of "loaning" the money to cover the cost the asset. The arrearages included in the COVID-19 regulatory asset are essentially interest free loans to customers and the rate of return will help to compensate the company for the use of those funds, similar to an interest rate on a mortgage.

While the rationale for the bill is unclear, what is clear is that the bill could have meaningful unintended consequences impacting important system and emergency response. Discretion should be left to the Commission to make a case-by-case determination regarding a return on costs in a regulatory asset. Utilities should be encouraged to find solutions to emergent and urgent problems and address cost recovery for those related expenses with the Commission.

For these reasons, BGE respectfully requests an unfavorable report by the Committee on this legislation.

Sandy Grace | Charles Washington | Allyson Black | 410.269.5281

SB 506 Columbia Gas Testimony MD 2021 - OPPOSED.pd

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Position: UNF

Columbia Gas of Maryland
A NiSource Company

OPPOSE – Senate Bill 506
Public Utilities – Regulatory Assets – Prohibitions
Senate Finance Committee

Columbia Gas of Maryland, Inc. opposes Senate Bill 506, which prohibits any public service company ("public utility") from receiving a rate of return on a regulatory asset created as a result of conditions addressed by a State of Emergency declared by the Governor. Columbia Gas opposes this Bill because it is arbitrary, interferes with the Public Service Commission ("PSC") discretion in matters related to cost recovery for public utilities, and it unreasonably denies a public utility the opportunity to fully recover prudently-incurred costs that relate to a declared State of Emergency.

Public utilities create a regulatory asset to defer costs presently being incurred to a future period for recovery. Regulatory assets are unique to public utilities and *must* be authorized by the PSC. Further, it is the PSC that determines what costs are to be included in the regulatory asset, the time period over which the public utility will recover the costs from its customers (*i.e*., over how many years), and whether the regulatory asset earns a rate of return (*i.e*., interest on the deferred costs). Typically, regulatory assets are only authorized for costs that are considered extraordinary, meaning that the costs are unusual, unexpected, and not expected to recur in the ordinary operations of business. For example, regulatory assets have been authorized for costs associated with major storm damage. Most recently, the PSC has authorized public utilities to establish regulatory assets for incremental costs due to the COVID-19 pandemic (*See* Order No. 89542 entered on April 9, 2020; Case No. 9639).

Senate Bill 506 makes a sweeping prohibition against public utilities earning a rate of return on any regulatory asset created in connection with a declared State of Emergency, and this is unreasonable. As described earlier, regulatory assets are created to address extraordinary costs. Hurricanes, pandemics, and other catastrophes could certainly trigger a public utility to seek PSC authority to create a regulatory asset, and could certainly result in a State of Emergency being declared by the Governor. To deny a public utility the ability to earn a rate of return on the regulatory asset merely because a State of Emergency was declared is arbitrary. To be clear, there is no guarantee that the PSC will authorize a public utility to earn a rate of return on a regulatory asset. The discretion to determine whether a regulatory asset earns a rate of return is properly vested with the PSC, which considers various factors, such as the types of costs making up the regulatory asset, and whether those costs were prudently incurred by the utility. There is no justification for removing the PSC's discretion in matters relating to regulatory assets. Furthermore, denying public utilities the ability to earn a rate of return on regulatory assets may prevent public utilities from fully recovering its costs, since it is the rate of return that compensates the public utility for such expenses as borrowing costs and the deferral of the costs being recovered over an extended period of time.

For the reasons set forth above, Columbia Gas opposes Senate Bill 506 and urges an unfavorable report.

February 16, 2021

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SB 506 -- Regulatory Assets.pdf

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Position: UNF

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February 16, 2021

SB 506: Public Utilities Regulatory Assets – Prohibition

Committee: Senate Finance

Position: OPPOSE

Southern Maryland Electric Cooperative (SMECO), a member-owned electric cooperative based in Hughesville that provides electricity to more than 166,000 customers in Charles, St. Mary's, Calvert and southern Prince George's County, opposes SB 506. This bill prohibits a public service company from receiving a rate of return on a regulatory asset created as a result of conditions addressed by a state of emergency as declared by the Governor.

SMECO opposes this bill because it is arbitrary, interferes with the Public Service Commission (PSC) discretion in matters related to cost recovery for utilities and it unreasonably denies a public utility the opportunity to fully recover prudently incurred costs that relate to a state of emergency. Regulatory assets benefit utility customers by smoothing out cost increases due to storm response or other emergencies like the current pandemic. A regulatory asset is often recovered over multiple years vs. immediately in order to minimize customer impact.

The PSC has authority to approve or deny a return of the costs, the time period over which the public utility will recover the costs from its customers and whether the regulatory asset earns a rate of return. The return on the regulatory asset is intended to make the utility whole not produce a profit for the utility. Utilities incur borrowing costs to provide their essential services. It would be unfair to require the utilities to finance these costs at their expense.

Moreover, this bill is deeply unfair to an electric cooperative like SMECO. If the intent of the bill is to try and prevent shareholder profits, this hurts SMECO's customers. As an electric cooperative, SMECO is not-for-profit and our customers are our owners. We don't have shareholders. Any revenue that we recover over and above expenses is reinvested into our electric system or given back to our members in the form of capital credits.

Any legislative proposal – such as SB 506 – that precludes a utility from recovering its actual prudent costs, including the cost of capital, violates the regulatory system that has been in place for many years. For this and the reasons stated above, SMECO requests an unfavorable report on SB 506.

For more information, contact: Tom Dennison, SMECO

Government and Public Affairs Manager

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SB 506 Regulatory Assets - Prohibition - Oppose_.p

Uploaded by: Mayhew, Kim

Position: UNF

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OPPOSE – Senate Bill 506
SB 506 – Public Utilities – Regulatory Assets - Prohibition
Finance Committee
Thursday, February 16, 2021

Potomac Edison opposes **Senate Bill 506 – Public Utilities – Regulatory Assets - Prohibition.** Senate Bill 506 prohibits a public service company from receiving a rate of return on a regulatory asset created as a result of the declaration of a state of emergency by the Governor.

Unfavorable

Potomac Edison, a subsidiary of FirstEnergy Corp., serves approximately 270,000 customers in all or parts of seven Maryland counties (Allegany, Carroll, Frederick, Garrett, Howard, Montgomery and Washington Counties). FirstEnergy is dedicated to safety, reliability and operational excellence. Its ten electric distribution companies form one of the nation's largest investor-owned electric systems, serving customers in Ohio, Pennsylvania, New Jersey, West Virginia, Maryland and New York.

FirstEnergy requests an Unfavorable report on SB 506 for the following reasons.

- Regulatory assets, which are typically put in place to mitigation rate impacts to customers, require a rate of return to be included in order to allow public service companies like Potomac Edison to recover their prudently incurred costs. Public service companies must spend money to provide service to customers but, defer recovery of those monies over some extended future period of time. The inclusion of a rate of return on a regulatory asset does nothing more than make the public service company whole for costs it incurs but cannot recover until some future date.
- Recovery of reasonable and prudent costs is essential to the safe, reliable and cost-effective provision of utility services both during and outside of emergency situations.
- Senate Bill 506 if passed would prohibit a public service company like Potomac Edison from recovering costs it prudently incurs to meet the needs of the customers it has the privilege of serving.
- The passage of SB 506 would negatively impact a public service company's ability to recover the costs it incurs not only because of the COVID-19 pandemic but also because of other emergencies such as a severe weather event. This inability to recover prudently incurred costs would be viewed negatively by the financial community and interfere with a public service company's ability to raise necessary capital or to raise it at a reasonable price.

For the above reasons, Potomac Edison respectfully request an **Unfavorable** vote on Senate Bill 506.

2021 PHI Testimony SB 506 PU Regulatory Assets Pro
Uploaded by: McGowan, Kevin
Position: UNF

February 16, 2021

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Oppose Senate Bill 506

Senate Bill 506 – Public Utilities Regulatory Assets - Prohibition

Potomac Electric Power Company (Pepco) and Delmarva Power & Light Company (Delmarva Power) oppose **Senate Bill 506 – Public Utilities Regulatory Assets - Prohibition.** Senate Bill 506 prohibits a public service company from receiving a rate of return on a regulatory asset created as a result of conditions addressed by a state of emergency as declared by the Governor in accordance with the provision of law.

As drafted, Senate Bill 506 could be interpreted to apply not only to the COVID-19 regulatory asset, but also regulatory assets established in response to future major storms (i.e. hurricanes, derechos) and other states of emergency. Regulatory assets benefit utility customers by smoothing out cost increases due to storm response or other emergencies like the current pandemic. A regulatory asset is often recovered over multiple years vs. immediately in order to minimize customer impact. The Public Service Commission (PSC) has authority to approve or deny a return on the costs in a regulatory asset, based on case-specific facts. The PSC is charged with reviewing all of the components of a regulatory asset and given the expertise of the PSC, is rightly charged with making a case by case evaluation. In fact, in BGE's most recent rate case order, the Commission would not allow some costs BGE proposed in its COVID-19 regulatory asset and the Company was not able to earn a return on those costs. This demonstrates appropriate Commission oversight and evaluation of that regulatory asset.

The rate of return on a regulatory asset does not necessarily reflect profit. In fact, in a regulatory asset, the rate of return often reflects the cost of "loaning" the money to cover the cost of the asset. The arrearages included in the COVID-19 regulatory asset are essentially interest free loans to customers and the Rate of Return will help to compensate the company for the use of those funds, similar to an interest rate on a mortgage.

In two recent orders on the subject, the PSC confirmed the logic supporting the recovery of COVID-19-related expenses through a regulatory asset. Relevant provisions include:

a. *In response to the significant financial implications that utilities could face in complying with emergency orders related to COVID-19, the Commission authorized the utilities to create a regulatory asset to record the incremental costs related to COVID-19 prudently incurred to ensure that Maryland residents have essential utility services. The Commission additionally found that deferral of such*

costs is appropriate because the current catastrophic health emergency is outside the control of the utilities and is a non-recurring event. (BGE MYP Order 89678)

b. *The Commission acknowledges the potential for significant financial implications that compliance with these emergency orders may have on Maryland Utilities and service providers. Consequently, in light of the extraordinary circumstances and in an effort to minimize adverse financial impacts to Maryland Utilities, the Commission authorizes each Utility to create a regulatory asset to record the incremental costs related to COVID-19 prudently incurred beginning on March 16, 2020, by the Utility to ensure that Maryland residents have essential utility services during this period.1 The Commission finds that the creation of the regulatory asset for COVID-19-related expenses will facilitate the recovery of those costs prudently incurred by the Utilities in their efforts to serve customers during this period, and the Commission finds that deferral of such costs is appropriate because the current catastrophic health emergency is outside the control of the Utility and a non-recurring event. (Regulatory Asset Order 89542)*

No other jurisdiction that we are aware of across the United States has blanketly prohibited utility recovery of emergency-related (i.e., COVID) costs. Although various jurisdictions have deliberated on the type and magnitude of emergency costs recoverable by utilities, no jurisdictions have made a determination that overarchingly restricts utilities from recovery of all COVID-related or other "emergency" costs.

The return on the regulatory asset is intended to make the utility whole not produce a profit for the utility. Utilities incur borrowing costs to provide their essential services. It would be unfair to require the utilities to finance these costs at their expense. Moreover, in its review of such costs in base rate cases, the PSC will assess and determine if the costs were prudently incurred and provided a benefit to customers.

Any legislative provision that precludes a utility from recovering its actual prudent costs, including the cost of capital (or money), violates the regulatory compact that has been in place for many years. This creates uncertainty and will be viewed negatively by rating agencies, directionally impacting the cost of borrowing. No other states have proposed such punitive actions as a result of the COVID pandemic, and Maryland should not be the first to do so.

For the above reasons, Pepco and Delmarva Power respectfully request and unfavorable vote on Senate Bill 506.

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STATE OF MARYLAND

PUBLIC SERVICE COMMISSION

February 16, 2021

Chair Delores G. Kelley
Senate Finance Committee
3 East, Miller Senate Office Building
Annapolis, MD 21401

RE: SB 506 - INFORMATION – Public Utilities - Regulatory Assets - Prohibition

Dear Chair Kelley and Committee Members:

Senate Bill 506 would prohibit a public service company from collecting a rate of return on a regulatory asset associated with a declared state of emergency. A regulatory asset is an accounting treatment that allows a utility to defer certain costs on its balance sheet so that they can eventually be capitalized and recovered over time. In general, a regulatory asset is used for extraordinary and unanticipated costs. This treatment recognizes that a utility has expended capital for the benefit of customers and is likely to be allowed to recover those costs in the future. The Commission has concerns with this bill for two reasons, as it will: (1) create a disincentive for spending on emergency recovery; and (2) likely result in higher costs to ratepayers.

The best, and most likely, example of how SB 506 would function in practice is a large scale weather event such as a derecho or hurricane. The 2012 derecho resulted in over 400,000 outages in the Pepco service territory and cost over $40 million in restoration costs. In two separate rate cases, the Commission reviewed Pepco's spending for prudency and required an independent audit to verify all costs. Ultimately Pepco was able to recover those costs, with an authorized return, over several years to minimize the impact on ratepayers. This bill would prohibit a public service company in a similar situation from earning a return on that expenditure while awaiting recovery.

The Commission also has concerns with SB 506 because it would treat costs associated with declared states of emergency differently than every other dollar spent for the benefit of utility customers. The core of the Commission's duty as an economic regulator is an agreement that a public service company has an obligation to provide an essential service to everyone within its franchise and in exchange, the Commission will provide the company with sufficient revenues to recover the monies spent for the benefit of customers, as well as a reasonable return on that invested capital. This is what is known as the regulatory compact. Under this bill, a public service company would have a financial disincentive to spend on disaster recovery.

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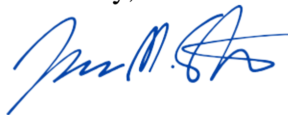
Finally, while this bill intends to reduce the amounts that ratepayers will pay for the identified regulatory assets -- it is more likely to have the opposite effect. Maryland's public service companies must raise significant amounts of capital from investors and through debt offerings. Ratings agencies closely watch legislative activity and will view SB 506 as an indication that Maryland does not intend to allow its utilities to earn a return on all monies spent to benefit customers. As a result, the ratings agencies may downgrade Maryland's utilities to indicate they are higher risk. If that happens, any reasonable investor will demand a higher rate of return on the company's entire investment. To use the example above, this bill may allow ratepayers to save some interest, over 5 years, on $40 million in storm-related costs but could easily cause them to pay a higher rate, indefinitely, on over $3.5 billion in rate base.

The Commission appreciates the opportunity to provide this information on SB0506. Please contact the Commission's Director of Legislative Affairs, Lisa Smith, if you have any questions.

Thank you for your consideration.

Sincerely,



Jason M. Stanek
Chairman