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BILL NO.:	**Senate Bill 771** **Electric Cooperatives – Rate Regulation – Fixed Charges for Distribution System Costs**
COMMITTEE:	**Senate Finance**
HEARING DATE:	**February 21, 2017**
SPONSORS:	**Senator Middleton**
POSITION:	**Oppose**

Senate Bill 771 makes a significant change to the existing ratemaking process used to establish the design of rates for utility customers served by electric cooperatives. The Bill adds a new Section 4-307, which mandates that the Public Service Commission (Commission) approve a fixed charge as proposed by an electric cooperative under certain circumstances. For the reasons stated in this testimony, the Office of People's Counsel opposes Senate Bill 771.

Background. A substantially similar bill was introduced last year as Senate Bill 1131. Subsequently, at the request of Senator Middleton, the Chair of the Senate Finance Committee, and Delegate Jameson, the Vice-Chair of the Economic Matters Committee. the Public Service Commission retained a consultant, Synapse Energy Economics, Inc., ("Synapse") to address the rate design impacts of an increased fixed charge for customers of SMECO and Choptank Electric Cooperative, including low-income and low-usage customers. Synapse submitted a report to the Commission on January 5, 2017, and comments by interested parties, including OPC, were submitted on January 24, 2017. The Commission submitted a Final Report, including both the Synapse Report and the comments, to Chair Middleton and Vice-Chair Jameson on January 31, 2017. While the Synapse Report contained both a detailed discussion of rate design and a specific analysis of the rate structures of SMECO and Choptank Electric Cooperative, Synapse did not make specific recommendations for rate design for the cooperatives.

Bill Requirements. The Bill imposes a legislatively mandated result for the Commission to follow in designing rates for utility customers and limits the Commission's discretion to minimize potentially negative rate design impacts on customers. First, the Bill defines "fixed charge" as a charge that recovers a fixed cost through a fixed dollar amount" (Bill, page 2, lines 1-2). Second, the Bill defines "fixed costs" to include "*all costs* associated with an electric cooperative's distribution system that do not vary by kilowatt hour," (Bill, page 2, lines 3-4), and lists certain examples of these costs. The electric cooperative cannot seek an increase that is "more than $2.50 greater than the current fixed charge in effect 1 year before the effective date of the proposed increase." (Bill, page 2, lines 29-31). An increase in the fixed charge can be proposed in a base rate case or "a revenue-neutral rate design filing." (Bill, page 3, lines 1-3), and shall include "appropriate cost of service data" and "set a reasonable charge". (Page 3, lines 6-7). Ultimately, the Commission "*shall* approve a proposed fixed charge" if the proposal meets the requirements of the new Section (Page 3, lines 10-11).

OPC Concerns. Rate design issues have usually been the most esoteric of issues in rate cases heard by Commissions. However, on a national level, there has been a new public focus as utilities have sought significant, and in some cases, aggressive, increases in fixed charges. Utilities have been pursuing higher fixed charges for a variety of reasons, asserting that they will lower the companies' risk of lower sales or revenues due to energy efficiency and distributed generation, weather, or economic downturns. In 2015 and 2016, many of these requests were denied in full, or granted only in small part after evidentiary proceedings.

These issues are of significant concern to consumer advocate organizations, like OPC, that are parties in these rate cases, as reflected in a resolution of the National Association of State Utility Consumer Advocates (NASUCA).[1] However, concerns also have been raised by non-typical parties, including those interested in energy efficiency, renewable energy and net energy metering issues. While the interests of consumer groups and environmental groups are not aligned on all issues, there is a general agreement that increases in fixed charges need to be carefully assessed in rate case proceedings, and should not be unduly or routinely increased.

Bill Definition of Fixed Costs. A fixed charge is also referred to as a "customer charge" or facilities charge in Maryland. For residential and most commercial customers, a utility rate is divided between a monthly fixed charge and a volumetric rate (which varies by the customer's monthly usage). As part of any rate case, the Commission must design the rates, which is "the process of translating the revenue requirements [costs of service] of a utility into the prices paid by customers."[2]

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[1] See NASUCA Resolution 2015-1, "*Opposing Gas and Electric Utility Efforts to Increase Delivery Service Customer Charges*" at www.nasuca.org.
[2] "Distributed Energy Resources Rate Design and Compensation," (NARAC, November 2016), pages 19-20 at www.naruc.org.

This process has consistently been described as "more art than science."[3] As part of that process, the Commission makes a decision about apportioning costs between "fixed costs" and variable or volumetric rates. Typically, there is general agreement about costs related to meters, billing and collection and customer assistance related costs. Other costs related to the distribution system can be the subject of strong disagreement among utilities, consumer representatives and other stakeholders - are the costs viewed more in the short term (typically a fixed cost) or the long term (typically viewed as variable). Importantly, the fixed charge, as used in Maryland and elsewhere, has not been used to collect all costs related to a utility's services and distribution system.

OPC is concerned that by the Bill's definition, all non-varying fixed costs, including but not limited to all costs associated with meters, certain parts of the distribution system, must be accepted by the Commission in establishing fixed rates. This is contrary to the manner in which rate structures have been designed in Maryland and elsewhere. Further, the definition of fixed costs includes a variety of cost categories that either are not clear, are overly broad (e.g. direct customer expenses; administrative and general expenses), or fail to reflect that some types of costs are typically recovered only in part through fixed charges. Ultimately, this severely limits the ability of customers and their representatives, like OPC, to present analyses and arguments about what is an appropriate and reasonable rate design for the customers.

The Bill Limits Discretion of Commission to Consider Other Factors in Rate Design. The Bill also precludes the Commission from considering other factors that it has taken into account when approving rate structures for utilities.

[3] Id.

Consistent with the decisions of a large number of Commissions in other states, the Maryland Commission has looked at other factors in addition to the cost of service studies when designing utility rate structures. Of significance for Maryland, these factors include Maryland's public policy goal of reducing energy usage through energy efficiency and conservation, codified in the EmPOWER Maryland law, as well as the broader GHG emissions reduction goal reflected in the Greenhouse Gas Reduction Act. The Bill also would limit the Commission's ability to consider other well-recognized rate design principles, including gradualism, which have been applied in recent rate cases. For utility customers, significant increases in fixed charges also can reduce their ability to control their own usage and therefore their own utility bills.

Impact of Increased Fixed Charges on Low-Income and Low-Usage Customers. OPC continues to be concerned about the impact of increased fixed charges on low-income customers, low-usage customers and customers who are attempting to reduce their electricity usage through adoption of energy efficiency measures. The Commission has recognized in numerous cases that utility customers have no ability to avoid high fixed charges through reduced usage. The Synapse Report indicates that more than half of the customers of the electric cooperatives receiving bill assistance through the Electric Universal Service Program ("EUSP") would face a bill increase as a result of increasing the fixed charge.[4] The Report also states that the average usage of the EUSP customers is slightly higher than average for the system. OPC notes, however, that more than half of the EUSP customers would be negatively

[4] Specifically, the Synapse Report states that 52.3% of Choptank EUSP customers and 54% of SMECO EUSP customers have usage lower than the overall residential customer average and would experience higher bills with a higher fixed charge.

impacted by higher fixed charges. In addition, only a portion of customers with limited incomes (and eligible for EUSP) actually received EUSP assistance. While we do not know all the reasons for lack of participation, it is reasonable to expect that the customers with higher usage, and thus higher utility bills, are more likely to seek EUSP assistance with those bills, thus skewing the average usage data.

The Commission Has Already Authorized a Rate Mechanism to Address Utility Revenue Loss Concerns. Another factor to consider is the so-called Bill Stabilization Adjustment (BSA), a revenue decoupling mechanism that the Commission has authorized for BGE, Pepco, Delmarva Power and SMECO, at their request. The BSA generally makes the Utility or cooperative whole for changes in revenue arising from its electric sales. Since fixed charges provide greater revenue stability and reduced risk, the argument that increases in customer charges are needed to assure a degree of utility revenue stability carries little or no weight, particularly when this option has been authorized by the Commission.

The Synapse Report Does Not Support the Mandatory Changes.

Changes in the energy industry may introduce new factors to consider when determining a reasonable rate structure for a utility and its customers. However, these factors can be readily addressed by the Commission within the classic principles of rate design authored by James Bonbright, the author of the still-classic "Principles of Public Utility Rates."[5] Senate Bill 771 unnecessarily limits the ability of the Commission to apply those principles, even if the bill is limited to electric cooperatives.

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[5]"Principles of Public Utility Rates", 2nd Ed., James Bonbright et al. (1988), pages 383-384; see also "Caught in the Fix" at page 42 for a summary list of the principles.

However, if the Committee is inclined to support a bill to add certain rate design requirements for electric cooperatives only, OPC would recommend that certain provisions be amended to provide more protections for the consumer members of the cooperatives. These include modifications to the definition of "fixed cost," additional evidentiary requirements for consideration of a fixed charge proposal outside of a full rate case, recognition of Commission approval of the cost of service study used by the electric cooperative, and recognition of Commission authority to consider other well-recognized rate design principles in approving a fixed charge, and removal of the mandate "shall." These recommendations are set forth in the Attachment to this testimony.

OFFICE OF PEOPLE'S COUNSEL
PROPOSED AMENDMENTS TO SENATE BILL 771

Definition of Fixed Costs – Section 4-307(a) (3)

At PAGE 2, LINE 3, STRIKE "all" before "costs"

At PAGE 2, LINE 3, ADD AFTER "costs", "as determined by the Commission,"

At PAGE 2, LINE 5, STRIKE "including:"

At PAGE 2, STRIKE LINES 6 through 16.

Fixed Charge Proposal and Commission Procedures

At PAGE 3, LINE 3, after "filing" ADD "subject to discovery, testimony and cross-examination in an evidentiary hearing."

At PAGE 3, LINE 6, after "by" STRIKE "appropriate" and ADD "a" before "cost" and after "service" ADD "study approved by the Commission" and STRIKE "and"

At PAGE 3, LINE 9, after "customers" STRIKE "." and ADD "; and"

At PAGE 3, INSERT AFTER LINE 9: "(3) Take into account State goals regarding energy conservation and demand reduction, customer interest in controlling energy usage and ratemaking principles of gradualism and fairness."

At PAGE 3, line 10: REPLACE "shall" with "may"