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BILL NO.: Senate Bill 572
Electric Companies and Gas Companies – Rate Regulation – Alternative Rate Plans

COMMITTEE: Senate Finance

HEARING DATE: February 26, 2019

SPONSORS: Senator Feldman

POSITION: Oppose

At first glance, Senate Bill 572 may appear to be an innocuous bill, providing the Commission with additional methods to regulate gas and electric utilities. However, the bill actually upends the regulatory authority of the Commission, skews regulatory proceedings to favor the utilities at the expense of gas and electric customers, households and businesses alike, and overturns long-standing and effective approaches to utility regulation. The bill proposes to do this without prior study or measured consideration by the Commission and reports to the General Assembly, and structurally shifts the burden of proof from the utilities to other parties, and ultimately the Commission. The utilities will promote this approach under the guise of saving money for customers and promoting innovation in the face of “old school” regulation. The reality is otherwise. In effect, the bill proposes a solution in search of a problem. The Office of People’s Counsel (OPC) respectfully opposes Senate Bill 572.

Summary

This bill does not grant the Commission any new authority to adopt alternate forms of ratemaking. The Commission already has the authority under current law to adopt any of the forms of ratemaking described in the bill. Therefore, the bill is unnecessary if the goal is to allow the Commission to adopt alternate forms of ratemaking that the Commission finds are superior to other rate structures and adequately protect the customers' interest.

As discussed below, OPC has numerous concerns with the bill. Ratemaking requires a balancing of interests, particularly the customers' interest and the utility shareholders' interest. This bill would tilt that balance in favor of the utility shareholders by requiring the Commission to adopt rate structures proposed by the utilities without any assurance that the new rates would benefit customers or even offer the same level of protection that current rate structures provide. The bill also has procedural provisions that would limit the ability of parties, including OPC, and the Commission to conduct a full review the utilities' proposals and will limit the transparency of utility costs that go into rates.

There is no compelling reason for the General Assembly to direct the Commission to adopt the types of rate structures described in the bill. The Commission has already adopted changes to ratemaking and regulations that have resulted in improvements in reliability, cost savings from increases in energy efficiency and changes in how customers use electricity, advances in the interconnection of distributed energy resources, and proposals for utilities to pilot new time of use rates, to invest in electric vehicle charging infrastructure, and to invest in electric storage facilities. The Commission has the authority to adopt further changes to rate structures that it finds to be in the public interest.

The major changes to rate structures envisioned in the bill can have significant impacts on the incentives for utilities to control costs, on the incentives for utilities to implement public policy related programs, and on customer bill levels. All of these impacts should be fully vetted and considered before this type of change is adopted. Reviewing an alternate rate structure as part of a rate case proceeding, as required by this bill, would not allow for a full review of these type of changes. Any significant changes to the current approach to rate regulation should only be considered after a comprehensive assessment of the pros and cons of such approaches, with the involvement of all interested stakeholders, to ensure that the changes are of benefit to both utilities and the customers they serve, as well as the public interest.

Comments

The Public Utilities Article (PUA) allows the Commission to determine a balance of the interests of utility customers and utility shareholders is setting rates for utility service. Rates are required to be “just and reasonable.” PUA §4-201. The statute defines “just and reasonable” rate as one that is consistent with the public good and allows the utility an opportunity to recover its “necessary and proper” expenses and a “reasonable return” on property used to provide service. PUA §4-101. The statute allows the Commission discretion is how it determines rates that meet this standard. The Commission has generally used a fixed rate that it sets after a full evidentiary hearing in a base rate case. One of the advantages of a fixed rate is that it gives the utility an incentive to control costs of providing service between rate cases. The utility benefits in the near term from the cost efficiencies it is able to achieve and customers benefit when those cost efficiencies are incorporated into rates in the next rate case.

While the Commission has generally established fixed rates for utilities, it has the discretion under the statute to consider and implement different types of rate structures, including the alternate forms of regulation described in Senate Bill 572. The Commission has used this discretion in specific circumstances to adopt rate structures and regulations that have provided a variety of benefits to customers and the State. The Commission's authority to consider a variety of rate structures was made explicit by the General Assembly in 1999. As part of restructuring of the electric industry in Maryland, the General Assembly enacted PUA §7-505(c) (1), which expressly provides the Commission with the authority to "regulate the regulated services of an electric company through alternate forms of regulation." In fact, the Commission has recently docketed a proceeding to gather information on alternate rate structures used in other states.¹

Given existing law, there is no need for the General Assembly to expand the Commission's authority to consider alternate rate structures. Further, there is no compelling reason to mandate that the Commission radically change its approach to ratemaking. The Commission has used its discretion in setting rates to create benefits for customers and advance a variety of state policies, while allowing the utility a fair opportunity to earn a reasonable return.

- Pursuant to PUA §7-213, in 2012 the Commission implemented regulations that have imposed reliability standards on Maryland electric utilities. These standards have been revised to require increasing levels of reliability performance, which the utilities have generally met.
- The Commission has made several adjustments to its ratemaking approach to provide the utilities with compensation for the additional work undertaken to improve reliability. These have included allowing end of test year levels of rate base, allowing post-test year reliability spending into rates, and approving surcharges for programs to increase the rate of reliability improvement.

¹ Public Service Commission, Public Conference 51, *Exploring The Use Of Alternative Rate Plans Or Methodologies To Establish New Base Rates For An Electric Company Or Gas Company*.

- Pursuant to PUA §7-306, the Commission adopted regulations for the interconnection of solar generation under net energy metering. As of June 30, 2018, 772 MW of solar generation has been installed under the program, about half of the state-wide cap in the law.²
- The Commission has approved revenue decoupling mechanisms that provide utilities with revenue levels that are not dependent on weather-related usage levels. These mechanisms are intended to reduce risk for the utility and allow for the reasonable level of return for the utility to be lower.
- Pursuant to §7-306.2, the Commission has adopted regulations to implement the Community Solar Energy System Pilot Program. The pilot program will seek proposals for about 200 MW of solar generation in addition to the solar generation installed under traditional net energy metering.
- Pursuant to §7-211, the Commission has overseen the development of energy efficiency and demand response programs that have saved over 7.6 million MWH of electricity and reduced peak demand by 2,693 MW.³
- In 2016, the Commission instituted Public Conference (PC) 44, *In The Matter Of Transforming Maryland's Electric Distribution Systems To Ensure That Electric Service Is Customer-Centered, Affordable, Reliable And Environmentally Sustainable In Maryland*. In this proceeding, the Commission created workgroups to develop proposals for:
 - time-varying rate designs
 - utility involvement with electric vehicle charging infrastructure
 - reducing burdens on customers seeking retail choice alternatives
 - improving the interconnection process for distributed energy resources
 - programs to increase investment in energy storage facilities
 - Enhance understanding of utility distribution planning⁴

Many of these working groups have created proposals that have been considered and implemented by the Commission.

² Public Service Commission, *Report On The Status Of Net Metering In The State Of Maryland*, September 1, 2018.

³ Public Service Commission, *The EmPOWER Maryland Energy Efficiency Act Standard Report of 2018*, February 2018.

⁴ The Distribution System Planning working group has not yet been fully implemented.

- The Rate Design Working Group made a proposal for the utilities with advance metering infrastructure (smart meters) to implement pilot programs to measure the benefits of time-of-use (TOU) rates for residential customers. The Commission approved that proposal in 2017 and the utilities are currently recruiting customers to participate in the pilots.⁵
- The Electric Vehicle Working Group meetings resulted in a proposal for the utilities to provide incentives for residential and commercial customers to install certain types of charging infrastructure and for the utilities to own and operate electric vehicle charging stations in their service territories. The Commission generally approved the proposals⁶ and the program is being implemented by the utilities.
- The Energy Storage Working Group meetings resulted in a proposal for Maryland utilities to invest in energy storage units on a pilot basis. Under this program, the utilities would make proposals to implement storage units totaling between 5 and 10 MW of storage capability. This proposal is currently under consideration by the Commission.⁷
- The Interconnection Working Group meetings resulted in a number of proposed regulations to update the interconnection rules for DER. The first set of regulations have been adopted, and the group is continuing to work on additional changes, including standards for “smart inverter” technologies.

It is clear from just these examples that the Commission has exercised its rate setting authority in a measured and balanced way, using alternative rate approaches in specific circumstances, while supporting innovative programs.

The bill’s embrace of the concepts of formula rates, rates based on forecasts, multi-year rate plans, and “rate designs” or “other rate plans” that have no limitations, does not take into account the aspects of these plans that reduce or eliminate transparency in rate-setting, which are discussed below, and disfavor the interests of the customers that pay the bills. Instead of

⁵ Public Service Commission, PC44, Letter Order, November 28, 2017.

⁶ Public Service Commission Case No. 9478, Order No. 88997, January 14, 2019.

⁷ Senate Bill 573 would require the Commission to implement a pilot program for energy storage units that would be very similar to the proposal pending before the Commission.

strengthening the Commission's ability to balance the interests of utility customers and shareholders, Senate Bill 572 shifts the balance by favoring the interests of the utility shareholders with no discernible benefits for the customers in terms of service and the bills they pay. In fact, the bill ties the hands of the Commission to even attempt some control of costs to benefit customers.

Senate Bill 572 mandates that the Commission "SHALL ALLOW" an electric company or a gas company to use an alternate rate plan, and the Commission must approve the alternate rate plan if the plan "RESULTS IN A JUST AND REASONABLE RATE." (Page 3, PUA §412(C)). While the reference to a "just and reasonable" rate may seem to maintain the balance between customers and shareholders, this provision actually tilts the balance in favor of the shareholders. Senate Bill 572 would direct the Commission to allow a rate under an alternate rate plan as proposed by the utility if it results in a just and reasonable rate. However, that rate could be found to be just and reasonable even if the rate under the alternate rate plan is not better than the existing rate when balancing the interests of the utility shareholders and its customers. Therefore, the utility could propose a rate that is beneficial to its shareholders at the expense of the customers and this bill might force the Commission to allow the rate to go into effect. The statement of the intent of the General Assembly "THAT THE COMMISSION ADOPT PROPOSALS BY THE ELECTRIC COMPANIES" for alternate rate proposals would support this outcome. (Page 3, PUA §4-12(B)). As discussed above, under current law, the Commission has the flexibility to adopt ratemaking provisions to react to changing needs for the electricity grid. However, it would be detrimental to customer interests to simply find that at least one of the alternate rate plans described in the bill **must** be allowed if proposed by a utility.

There are also procedural provisions included in the bill that would also work to the benefit of the utility shareholders at the expense of the customers. The bill would also allow the utilities to file an alternate rate plan at the same time as a base rate case. (Page 3, PUA §412(C)). Maryland law requires that the Commission rule on a base rate case filing in about seven months. This is an accelerated timeframe for reviewing whether all of a utility's various operational and maintenance spending and capital spending are reasonable. Requiring that the Commission review a utility's rate base levels and an alternate rate plan within the statutory timeframe of a base rate case would not allow for sufficient time to fully vet the proposal and allow the Commission to fully review the proposal.

The bill also mandates a procedure for the utility to file a revised plan if the Commission rejects its proposal. (Pages 3-4, §7-412(C) (2)). Parties then have 60 days to comment on the plan and the Commission has 60 days to rule on the revised plan. This provision of the bill is unnecessary because there is a procedure under the PUA and the Commission's regulations for a party to request rehearing of a Commission order and to appeal the decision to the courts. Additionally, this provision of the bill would put restrictions on the Commission and parties to respond to a revised proposal from the utility on an accelerated basis. The requirements of this provision would not allow for full discovery of the revised proposal or an evidentiary hearing to fully vet the revised proposal. At the end of this accelerated procedure, the Commission would again be required to rule on whether the proposal resulted in just and reasonable rate.

The bill contains a number of provisions that tilt the balance of interests in favor of the utility. It contains a provision to allow utilities to defer operating and maintenance expenses or storm restoration into an account that gets included in rate base. (Page 4, PUA §4-212(G)).

Including the deferred amount in rate base would allow the utility to receive additional revenue from customers in the form of a return on that balance. This provision would take away an important restraint on utility spending – that utilities need to manage their spending within existing rate levels – and allow the utility to earn a return on whatever they spend.

Another example is formula rates. The bill also allows for a reconciliation that would allow the utility to raise rates to collect for spending in excess of what was projected for the year. (Page 5, PUA §4212(H)). The utility would be able to charge the customers interest in the excess spending. This gives the utility an incentive to increase spending instead of control spending to reasonable levels. With regard to multi-year plans, the bill would allow rate increases for certain expenses and investments – clearly giving the utilities the benefit of automatic increases, with no equivalent benefits for customers.

The bill also prohibits the Commission from reducing the return on equity for the utility as a result of the utility proposing an alternate rate plan. (Page 5, PUA §4-212(J)). Utility return on equity is set to reflect a fair return to shareholders based on the risk to the shareholders in investing in the utility. This provision of the bill would take away discretion from the Commission to find that an alternate rate plan would reduce the risk to the utility. For example, with a formula rate as proposed in the bill, the utility is guaranteed recovery of all its expenses and, if the utility spends more than projected for a year, it collects that additional revenue from customers, with interest. There would be grounds for a Commission to find that this type of a rate structure would reduce the risk to utility shareholders. If the Commission is prohibited from reflecting that reduced risk to shareholders in the return on equity, there would be a windfall for the shareholders at the expense of the customers.

Finally, the bill would allow the utility to terminate an alternate rate plan at any time. (Page 5, PUA §4-212(L)). The Commission should have the discretion to either terminate or continue an alternative rate plan if it finds that it is in the public interest. Additionally, under the bill, the rate in effect under the alternate rate plan would then stay in place until the Commission establishes a new rate. This is one-sided in favor of the utility because it would allow the utility to terminate the rate plan at a time when the rates are generous to the utility. That rate would stay in place, perhaps for a significant period of time, until the Commission established a new rate. If the Commission finds that the rate level of the time of the termination of the alternate rate plan was too high, the Commission would have a limited ability to require refunds to customers.

For the foregoing reasons, OPC recommends an UNFAVORABLE report on Senate Bill 572.