STATE OF MARYLAND
OFFICE OF PEOPLE'S COUNSEL
Paula M. Carmody, People's Counsel
6 St. Paul Street, Suite 2102
Baltimore, Maryland 21202
410-767-8150; 800-207-4055
www.opc.state.md.us

BILL NO:	**HOUSE BILL 856** **Gas Companies-Infrastructure Replacement-Surcharge**
COMMITTEE:	**Economic Matters**
HEARING DATE:	**March 9, 2011**
SPONSORS:	**Delegates Barkley, *et.al***
POSITION:	**Oppose**

House Bill 856 amends the Public Utilities Article (PUA) to require the Maryland Public Service Commission (PSC) to approve gas utility surcharges up to $2 per month per residential customer ($24.00 per year). The purpose of the surcharge is to fund replacement or improvement of existing gas infrastructure and the revenues must be targeted to, among other things, improve public safety or reliability. The Office of People's Counsel (OPC) **OPPOSES** House Bill 856.

This type of surcharge violates long-standing principles of ratemaking law and policy, subjects residential ratepayers to unwarranted distribution rate increases without an evidentiary hearing, and eliminates the ability of the Commission to balance the interests of the utility shareholders and ratepayers in setting rates. While the bill is framed as a safety measure, in fact it is a revenue measure favoring the gas utilities.

Under the PUA, utility companies have an obligation to "furnish equipment, services, and facilities that are safe, adequate, just, reasonable, economic and efficient..." PUA § 5-303. The utility is compensated through the approved rates it charges its customers. Those rates have been subject to PSC review and approval for over one hundred years. By law, the PSC is required to determine the "just and reasonable rate" that may be charged. PUA §§4-101 *et. seq*. The determination of the just and reasonable rate requires an evidentiary process, in which opposing parties may seek discovery and provide testimony and evidence for the Commission's consideration. This process allows stakeholders like the PSC Technical Staff, OPC and representatives of other customer classes to scrutinize the utility's "case" for a rate increase, and present opposing testimony. The PSC thus gets the benefit of a full assessment of the utility's revenue, expenses and appropriate profit level before deciding the reasonable rates for the utility to carry out its business responsibilities and have an opportunity to earn the designated profit level.

House Bill 856 would result in a complete by-pass of the Commission's ratemaking process for a specific type of utility expense. There is no reason to do this. The ratemaking process has worked well for decades. Evidence and testimony introduced by OPC and other parties during the evidentiary ratemaking process have often resulted in utility rate requests being dramatically reduced by the PSC.[1] Rate cases provide the opportunity for OPC and its

[1] For example, the PSC recently granted BGE only $30.9 million of its alleged $92.2 million electric rate deficiency, and $9.75 of its $30.4 million gas rate request (Case 9230). In PEPCO's most recent rate case,

witnesses to point out areas of utility over-reaching or mistake. This bill would remove that opportunity and impair the PSC's ability to ensure that rates are "just and reasonable."

Furthermore, the basis for the Bill is flawed. The Bill states that "the purpose of this section is to *promote* gas infrastructure improvements in the State by establishing a mechanism for gas companies to promptly recover investments in eligible infrastructure replacement." §4-210 (B). However, there is no indication anywhere that gas companies are not already doing necessary improvements without having the ability to impose a surcharge on customers, or that gas utilities are not recovering prudently incurred costs for infrastructure investments. If the utility rates are not adequate, the utility has the ability to request a rate increase. What it cannot do is fail to maintain a safe and reliable system.

The Bill also presents practical utility ratemaking problems. First, if passed, the surcharge would arguably make gas utilities less risky as an investment. However, the Bill provides for no mechanism for the Commission to reflect, as it should, that reduction in risk through a reduced authorized rate of return. In fact, §4-210 (G) explicitly *prohibits* the Commission from reflecting the reduction in risk in rates. That section alone reveals that the Bill is a revenue

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the PSC granted only $$7.8 million of its $38 million rate request (Case 9217). In 2007, WGL's rate increase request for $33.8 million was reduced to $20.56 million, including an authorization to recover certain costs related to the repair and replacement of couplings on its system, and the hexane facilities built to address the leaks on the distribution system. (Case 9104).

enhancer for the gas utilities. Furthermore, it is unclear whether the Commission could *ever* reflect the reduction in risk in subsequent rate proceedings. In OPC's opinion, this inability to reflect lack of risk through a reduction to the authorized rate of return will subject residential ratepayers to unjust and unreasonable rates for the foreseeable future.

Gas utilities' core responsibility is to provide safe and reliable service, and to operate and maintain its system accordingly. Thus, the infrastructure safety and reliability improvements contemplated by this Bill are not new or unique. In fact, they are the *sine qua non* of providing gas distribution service: on-going and routine expenditures. Even if a gas utility faces a major and sudden need for reliability or safety improvements (and there is no evidence of such a problem in Maryland), utility regulatory accounting requires that these rising expenses be normalized, that is, the rates should reflect only capital expenditures that are in excess of the Company's normal capital spending.

Allowing recovery of costs through this particular surcharge mechanism is also contrary to the requirement that utility rates reflect reasonable costs. For example, §4-210(E) (1) (III) removes *any* Commission discretion to review the reasonableness of the costs. The wording is clear that all the Commission may do is "approve the plan" if the plan includes the required elements of § 4-210(D). It merely requires that the utility submit a plan saying the costs are "reasonably incurred." With no mechanism for the Commission to review the reasonableness of the costs, OPC believes that residential ratepayers will be put at significant risk of being charged unreasonable rates. There will be no mechanism to ensure that the work is necessary, no mechanism to ensure that the work is done at least cost and no mechanism to ensure that utilities do not engage in self–dealing with affiliates.

The Bill also removes from consideration the usual requirement that a utility may only bill each class of customers its actual cost of providing service (plus a return). Under this Bill, residential customers might well be caused to improperly subsidize the costs to serve other classes of customers (or vice versa).

In the past few years, gas and electric utilities in Maryland and other states have sought surcharges and other direct pass-through mechanisms for a variety of expenses – infrastructure improvements, pension costs and uncollectible expenses, for example. OPC believes that approval of this bill would open the door for other utilities to seek surcharge recovery for other expenses, and undermine the ratemaking process that has served both customers and shareholders by requiring the PSC to balance their interests.

For these reasons, OPC recommends an UNFAVORABLE REPORT.