STATE OF MARYLAND
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BILL NO.:	**House Bill 1324** **Natural Gas Infrastructure Expansion and Reinforcement**
COMMITTEE:	**Economic Matters**
HEARING DATE:	**March 10, 2016**
SPONSORS:	**Delegates Barkley, et al.**
POSITION:	**Oppose**

House Bill 1324 seeks to promote natural gas expansion in Maryland. The Bill does this by providing a statutory mechanism to expand natural gas infrastructure for gas service to certain local "growth tiers" and to individual customers who wish to convert to natural gas service. The Bill also creates a statutory presumption that such investment is prudent. Finally, the Bill creates methods to recover the costs of expansion and conversion through a regulatory asset and eventually through base rates. The Office of People's Counsel (People's Counsel or OPC) opposes House Bill 1324 because:

1. **The Bill is unnecessary. The gas companies have always had the ability to expand their areas of service and to recover the costs of expansion through rates if they have a "business case" for the expenditures.**

2. **While customers may benefit from projects that are PROVEN to be cost effective, this Bill unreasonably shifts the risk of cost recovery for a gas utility's miscalculation of costs or revenues from the utility to all of its customers. Since the utilities benefit from expansion projects through a return (profit) on the increased capital investment (in rate base), it is unfair to customers to shift the risk of unprofitable projects to them.**

3. **The Bill significantly curtails the authority of the Public Service Commission to determine whether the expansions are in the public interest and whether they result in just and reasonable rates.**

4. **The RESI Report which purports to support the Bill appears to suffer from important methodological problems. The inputs, assumptions and conclusions need to be carefully examined, preferably in a formal proceeding before the Commission.**

5. **The Bill relies on long-term projections of low natural gas prices. While gas prices have reached historic lows recently as a result of new technologies and drilling in shale areas, there is no assurance of continued low prices.**

6. **There are significant additional costs related to conversion that customers bear (replacing appliances and interior pipes, for example).**

7. **The Bill provides for lengthy periods for payment of customer contributions towards the investment (30 years for residential customers). While this may assist individual customers with the "payback" issue, future owners will be required to pay these costs or lose access to gas service.**

8. **Natural gas generating facilities have become a preferred alternative to fossil fuel generation for economic reasons and as a means to reduce greenhouse gas emission. However, the General Assembly and the Commission should consider whether it would be more in keeping with other expressed State goals to create incentives to convert generation to natural gas rather than investing in expanded gas distribution infrastructure.**

The Bill Presents a Number of Ratemaking Issues That May Harm Customers

With the passage of the STRIDE law, gas utilities are permitted to collect the costs of accelerated and incremental repair and maintenance of the existing gas distribution systems. House Bill 1324 would add another means to bypass long-standing regulatory treatment of capital investments, this time for line extensions and individual gas conversions. The Bill's purpose is to allow utilities to invest in the expansion even when the utility does not have a business case to do so, by shifting risk to its customer base. As noted above, despite this shift, the Bill curtails Commission authority to evaluate the prudence of expansion projects. Under the Bill, the Commission has no ability to evaluate and approve expansion projects in advance;

further, the projects are not subject to any prudence review before being added to rate base in a rate case.[1] Based upon the language in the Bill, the Commission can only evaluate the reasonableness of the deferral mechanism itself.[2] In a great departure from the traditional role of the Commission, the Bill gives *de facto* delegation of authority for project prudence determinations for line extensions to a "local jurisdiction." [3]

As drafted, the Bill also creates a number of changes to the ratemaking process, which may result in customers paying rates that are not "just and reasonable." First, the deferral of eligible expansion costs associated with line extension projects has few practical constraints. This authority arises from the fact that the bill does not require that utilities provide a "business case" necessary to support the project approval decision or require adherence to a business marketing plan to ensure anticipated levels of new customers take service from the new pipe within the expected time frame.

Second, the deferral mechanism means the company will not be required to depreciate the plant investment prior to the next rate case, as it normally would under traditional ratemaking, and can earn a return of and on all of its investment. Additionally, unlike current ratemaking, the companies can accumulate a return on eligible costs regardless of whether project is completed and in service, fully used and useful, and prior to new plant being placed into rate base. These three features are significant financial benefits to a company, especially for a line extension project which by its nature has some risk that new customers will not join as forecast in the business case.

Third, whether intended or not, the Bill creates a risk of double collection of return. The deferred eligible expansion costs formula contains a return component, which is transformed into

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[1] Section 4-211(C) (2)(II)(2).
[2] Section 4-211(C)(2)(II)(1).
[3] Section 4-211(B)(2)(I).

a regulatory asset, and the regulatory asset must be subsequently added to rate base with an amortization expense to recover the remaining balance. The Bill is silent on whether and how new base rates will be set in regards to the new rate base balance. While this issue could be resolved in the base rate proceeding, the Bill will create added and unnecessary ratemaking complexity.

Additionally, the treatment given costs of expansion under the Bill raises other important regulatory accounting issues that need to be resolved. Some examples include: the treatment of accumulated deferred income taxes (ADIT); the potential overlap with STRIDE cost recovery; and the risk that intergenerational subsidies exists between line extension customers who elected the service on new lines but later leave the service territory, perhaps generating bad debt for any unpaid portion of the Required Contribution. Bad debt is an element of Eligible Expansion Costs that would eventually be recovered from the other customers, further increasing their rates.

Furthermore, this Bill, in concert with existing STRIDE programs and other existing ratemaking mechanisms, significantly reduces the risk to utilities. However, there is no provision for the Commission to take into account this reduction of risk in determining an overall return on utility investment.

The "Analysis" supporting the Bill Appears to Suffer from Methodological Problems That Should Be Resolved in an Evidentiary Hearing.

OPC has only had a limited time to review the Towson University RESI analysis relied on to support the Bill. However, OPC has had enough time to determine that the inputs, assumptions and conclusions deserve further, intense scrutiny. The analysis relies almost exclusively on information supplied to RESI by the utilities themselves and the American Gas Association, in addition to U.S. Energy Information Administration data. First, while RESI seemed to focus almost exclusively on the state and local economic benefits of gas expansion in

Maryland, there is very little, if any, analysis of the rate impact on gas customers generally as a result of the projected expansion. Second, some of the fuel prices used as benchmarks to compare against natural gas appear to be inflated, thereby making the case for natural gas appear more attractive.[4] Third, while natural gas prices are at a low point currently, there is no recognition in the Report that natural gas prices have been volatile throughout the decades; there is no assurance that natural gas prices will remain this low over even a five year time horizon. Fourth, the analysis focuses on fuel savings but does not appear to factor in increased distribution costs when making the savings potential calculation. While OPC has not had an opportunity to gather conversion cost data, the assumption of $6500 in conversion costs per household seems low in light of the quotes OPC is aware of in the BGE territory. Furthermore, it is not clear whether the $6500 assumption has been "grossed up" to take into account the rate base/rate impact. Finally, even RESI acknowledges that it did not take into account all costs to ratepayers of expansion. Specifically, the costs of in-home conversion (or business conversion) can be quite significant. Appliances and heating systems need to be replaced and pipe needs to be installed in the home to reach them.[5]

OPC therefore respectfully requests an unfavorable report on House Bill 1324.

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[4] For example, the Report indicates it used a price of $2.42 per gallon for heating oil. The February 15, 2016 Maryland heating oil average price is now $2.29 per gallon. Heating oil prices have declined about 25% from one year ago. Likewise, the Report used a comparison price of $2.67 per gallon for propane. While Maryland specific information for February 15 was not get available, the average U.S. residential propane price is $2.033 per gallon, down nearly 14% from last year. Finally, the Report used an average electricity price of a little over 14 cents per kilowatt hour. OPC cannot verify how RESI determined this average but notes that current Standard Offer Service prices are about 9.4 cents per kilowatt hour in the BGE and PEPCO service areas and about 7.3 cents in the Potomac Edison area. See Report, p. 18, footnotes 25 through 30; "Maryland Residential Heating Oil Price," https://ycharts.com/indicators/Maryland_residential_heating_oil_price; "US Residential Propane Price", https://ycharts.com/indictors/us_residential_propane_price. (Y charts uses the U.S. Energy Information Administration as its resource).

[5] In fact, this is one of the primary reasons that customers ultimately decide not to switch to natural gas.