

**STATE OF MARYLAND  
OFFICE OF PEOPLE'S COUNSEL**

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**BILL NO:** **Senate Bill 08**  
**Gas Companies-Infrastructure Replacement Surcharge**

**COMMITTEE:** **Finance**

**HEARING DATE:** **January 23, 2013**

**SPONSORS:** **Senators Astle and Middleton**

**POSITION:** **Oppose**

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Senate Bill 8 would amend the Public Utilities Article (PUA) to allow a natural gas company to submit a plan to the Public Service Commission (PSC) to recover the costs of gas distribution infrastructure replacements or improvements through a surcharge mechanism. If the Commission approves the plan, it must approve the company's proposed cost recovery mechanism.<sup>1</sup> The purpose of the surcharge is to provide "up-front" funding to gas utilities for replacement or improvement of existing gas infrastructure. Natural gas companies have a core responsibility to provide safe and reliable service to customers and the public, and the Office of People's Counsel (OPC) appreciates the importance of safe and reliable service for our customers, and understands that the bill is intended to address concerns about the ability of the natural gas

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<sup>1</sup> Bills were introduced in 2011 (SB332/HB856) and 2012 (SB541/HB662).

companies to ensure the operation of their gas distribution systems in a safe and reliable manner. However, OPC respectfully does not agree that a surcharge mechanism, in addition to base rates, is needed to ensure the delivery of safe and reliable service by natural gas companies. Instead, a *mandated* surcharge to accompany an approved infrastructure replacement project reduces protections for customers that are built into the current rate setting process.

### **Reasons for OPC Opposition**

1. Gas infrastructure improvements and the maintenance of a safe and reliable gas distribution system can be accomplished without the imposition of a surcharge
  - See PSC Case 9267 (WGL rate case) Order No. 84475, November 14, 2011
2. The ratemaking process protects the interests of both the shareholders and customers, while a mandated surcharge shifts financial risk to the customers
  - Gas companies can file a rate case at any time if they believe their current rates are not adequate to carry out their core service, safety and reliability obligations
  - Rate cases give both the utilities and the customers an equal opportunity to “present their case”
  - Rate cases give the Commission the benefit of a full assessment of the revenues, expenses and appropriate profit level (return on equity) when setting reasonable rates
  - The surcharge is a significant amount in total dollars and as a percentage increase to distribution rates:
    - The bill includes a fixed cost cap of \$2/month for residential customers during the 5-year Plan. (Page 4, lines 20-21). There is no limit on annual changes to the surcharge within that cap.
    - Recent PSC approvals of base rate increases for residential gas and electric customers after full evidentiary hearings:
      - WGL, Case 9267 (less than 1/3 of request granted; 1.07% increase in residential rates)

- Delmarva Power, Case 9285 (45% of request granted; 3.11% increase in residential rates)
- Pepco, Case 9286 (26% of request granted; 1.69% increase in residential rates)

3. The Commission already has the authority to permit the use of a surcharge mechanism, or some other protective measure, if public safety and reliability or the company's financial health is at risk

- In PSC Case 9267 (WGL), the Commission acknowledged it has the ability to approve a surcharge, if the company demonstrates the need. The Commission, after a review of expert testimony and extensive hearings, determined that WGL was able to implement an Accelerated Replacement Plan and allocate the necessary funds, without financial harm or inability to acquire capital
  - WGL has implemented the Plan without the surcharge
- The Commission has the ability to use other ratemaking tools to address increased expenses related to reliability improvements to distribution systems, including adoption of post-test year adjustments for reliability plant additions, as they did in PSC 9192 (DPL rate case) in 2009.

4. The bill would lock in a company's rate of return as reflected in current base rates, and add the surcharge to those rates, for up to 5 years, once the Commission approves the company Plan and the surcharge (Page 5, lines 3-5)

- The bill takes away the Commission's discretion to consider the impact of a surcharge on a company's risk, in deciding a reasonable return on equity, at the time the surcharge is adopted
  - Fiscal Note, p. 8
- The Commission is prohibited from considering the impact of a proposed surcharge on the overall risk profile of a gas company until a subsequent base rate case. If a company does not file for 5 years, this means that the company could be earning an unreasonable return for 5 years, and customers will pay unreasonable rates for service

5. The bill takes away the Commission's discretion to consider the relationship between costs reflected in existing revenue requirements (and

6. existing rates) and the surcharge mechanism, and order adjustments “if it is not related to the Plan” (Page 5, lines 23-26)

- Revenue requirements reflected in a gas company’s base rates include:
  - Depreciation expense
  - Operation and Maintenance (O&M) expenses
  - Cash Working Capital
- The gas company may end up with double recovery of costs from customers if these expenses remain unadjusted in base rates:
  - Depreciation expenses associated with plant that will be removed and replaced under the Plan
  - O&M expenses that should be reduced as a result of reduced leak activity in gas mains and services
  - Cash Working Capital used to balance out the differences between expenses and revenues over time
- Any actual reductions in financing costs may be matched or exceeded by additional costs due to an unadjusted return on equity (to reflect risk reductions) and unadjusted revenue requirements in base rates

7. The bill does not require the gas companies to include benchmarks and performance metrics to ensure that the surcharge monies achieve the objective of the Plan and surcharge – the reduction of leaks per mile of pipe.

- If the objective is to improve public safety and reliability by reducing leak rates, a baseline for leak rates, metrics for reductions in leak rates that result from the Plan and surcharge, and the actual results are needed as an incentive to control costs and prioritize repairs

8. The bill does not require a comprehensive audit and review process for the to enable the tracking of all relevant documents, expenses and revenues and ensure transparency

- The bill only requires the gas companies to file annual amendments to adjust the surcharge amounts
- Examples of the types of documents needed for proper review:
  - Requests to the Board of Directors for budget approval (including capital budgets)
  - Budget to actual comparison reports

- Segregated accounts for surcharge expenses and revenues
  - Identification of all expenses by Commission or FERC plant account numbers for proper tracking
  - Detailed project cost reports
  - Construction authorization orders
  - Construction variance reports (with explanations)
  - Detailed documentation for contingency allowances
  - Closing reports
9. The bill does not provide for evidentiary hearings prior to approval of the Plan and surcharge mechanism
- The surcharge increase to distribution rates can exceed increases approved in a base rate case
    - Fiscal Note, p. 8 states that a maximum monthly surcharge can generate about \$14.7 million from BGE residential customers and \$9.9 million from WGL residential customers
  - The Commission Technical Staff and stakeholders, including OPC, should have a full opportunity to scrutinize the company proposals and any Plan or tariff amendments
10. The bill permits but does not require a public hearing on the Plan or annual amendments
11. The bill does not permit the Commission, in its discretion, to terminate the surcharge or deny any amendments in full if it determines that the Company's overall performance does not satisfy the intended goals of improving public safety and service reliability.

A gas utility's 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.

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.

OPC therefore respectfully requests an unfavorable report on Senate Bill 8.