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PUBLIC SERVICE COMMISSION

February 16, 2021

Chair Delores G. Kelley
Senate Finance Committee
3 East, Miller Senate Office Building
Annapolis, MD 21401

RE: SB 506 - INFORMATION – Public Utilities - Regulatory Assets - Prohibition

Dear Chair Kelley and Committee Members:

Senate Bill 506 would prohibit a public service company from collecting a rate of return on a regulatory asset associated with a declared state of emergency. A regulatory asset is an accounting treatment that allows a utility to defer certain costs on its balance sheet so that they can eventually be capitalized and recovered over time. In general, a regulatory asset is used for extraordinary and unanticipated costs. This treatment recognizes that a utility has expended capital for the benefit of customers and is likely to be allowed to recover those costs in the future. The Commission has concerns with this bill for two reasons, as it will: (1) create a disincentive for spending on emergency recovery; and (2) likely result in higher costs to ratepayers.

The best, and most likely, example of how SB 506 would function in practice is a large scale weather event such as a derecho or hurricane. The 2012 derecho resulted in over 400,000 outages in the Pepco service territory and cost over \$40 million in restoration costs. In two separate rate cases, the Commission reviewed Pepco's spending for prudence and required an independent audit to verify all costs. Ultimately Pepco was able to recover those costs, with an authorized return, over several years to minimize the impact on ratepayers. This bill would prohibit a public service company in a similar situation from earning a return on that expenditure while awaiting recovery.

The Commission also has concerns with SB 506 because it would treat costs associated with declared states of emergency differently than every other dollar spent for the benefit of utility customers. The core of the Commission's duty as an economic regulator is an agreement that a public service company has an obligation to provide an essential service to everyone within its franchise and in exchange, the Commission will provide the company with sufficient revenues to recover the monies spent for the benefit of customers, as well as a reasonable return on that invested capital. This is what is known as the regulatory compact. Under this bill, a public service company would have a financial disincentive to spend on disaster recovery.

Finally, while this bill intends to reduce the amounts that ratepayers will pay for the identified regulatory assets -- it is more likely to have the opposite effect. Maryland's public service companies must raise significant amounts of capital from investors and through debt offerings. Ratings agencies closely watch legislative activity and will view SB 506 as an indication that Maryland does not intend to allow its utilities to earn a return on all monies spent to benefit customers. As a result, the ratings agencies may downgrade Maryland's utilities to indicate they are higher risk. If that happens, any reasonable investor will demand a higher rate of return on the company's entire investment. To use the example above, this bill may allow ratepayers to save some interest, over 5 years, on \$40 million in storm-related costs but could easily cause them to pay a higher rate, indefinitely, on over \$3.5 billion in rate base.

The Commission appreciates the opportunity to provide this information on SB0506. Please contact the Commission's Director of Legislative Affairs, Lisa Smith, if you have any questions.

Thank you for your consideration.

Sincerely,



Jason M. Stanek
Chairman