

# MAINE STATE LEGISLATURE

The following document is provided by the  
**LAW AND LEGISLATIVE DIGITAL LIBRARY**  
at the Maine State Law and Legislative Reference Library  
<http://legislature.maine.gov/lawlib>



Reproduced from electronic originals  
(may include minor formatting differences from printed original)

August 11, 2005

The Honorable Philip Bartlett II, Senate Chair  
The Honorable Lawrence Bliss, House Chair  
115 State House Station  
Augusta, Maine 04333

Re: Long-Term Contracting Program

Dear Senator Bartlett and Representative Bliss:

As you have requested, this letter presents the Commission's views on various aspects of a long-term electricity contracting program. By presenting this letter, the Commission expresses no position on whether the Legislature should adopt a long-term contracting program. However, we do believe that such a program should receive legislative consideration.

For purposes of this letter, we assume that the primary goals and objectives are to create a hedge for all Maine's ratepayers against volatile and rising electricity prices. We have endeavored to provide a mechanism with an open architecture; it is fuel neutral so the benefit can be achieved through any generation source or through energy efficiency. This letter provides an outline of the possible components of a long-term contracting program, potential alternatives, and various factors or issues that should be considered by policy makers. The Legislature could choose to augment a long-term contract with other attributes, such as increasing diversity through the use of renewable resources.

#### Benefits and Risks

There are several potential benefits to and risks inherent in any long-term contracting program. Some mitigation of volatile and increasing fossil fuel prices can be achieved by supplier contractual commitments to provide energy over a long-term at fixed prices or at prices that are tied to overall inflation, not the costs of an individual fossil fuel. In an environment of rising fossil fuel prices, and consequently increasing wholesale electricity prices, the value of the energy from the long-term contracts would increase. This value would be flowed back to ratepayers through the proceeds from periodic auctions of the contracted electricity, thus dampening the impact of market

price increases. The amount of the dampening impact would depend on the amount of energy under contract, an issue that is discussed further below.

The impact of long-term contracts on capacity costs is less certain, if only because the rules surrounding capacity costs, e.g. LICAP, remain unsettled. However, a potential benefit is that the capacity from long-term contracts should reduce net capacity costs in the Maine zone to benefit of all ratepayers. As with the energy hedging benefit, the benefit with respect to LICAP would depend on the amount of capacity under contract.

A long-term contracting program in Maine could contribute to resource diversity and could help promote price stability in the Maine zone. Some developers have stated that long-term power contracts are necessary or desirable in obtaining project financing on reasonable terms (although it does appear that some projects may be able to be financed without long-term contracts). A properly designed long-term contracting program could enhance resource diversity by aiding the development of new generating facilities.

The primary risk to any long-term contracting program is the potential for the creation of stranded costs. The State's restructuring law was enacted, to a large degree, to avoid the creation of new stranded cost by transferring certain risks away from ratepayers and onto market participants. Thus, any long-term contracting program could be considered contrary to this basic objective of electric restructuring. However, because of the dominance of expensive and volatile fossil fuel in the regional supply mix, the risk of new stranded costs may be justified. As a result, a long-term contracting program could be considered appropriate if the Legislature views the restructured market as failing to provide a reasonable level of price stability. However, because we are currently experiencing relatively high prices, there is a substantial risk of entering long-term contracts in the near-term that would later become uneconomic (i.e. QF contracts).

### Qualifying Resources

The Commission recommends that there be no explicit restriction on the type of resources that would qualify for long-term contracts (such as a requirement that contracts only be with new renewable resources). Allowing any type of generation or efficiency resource to qualify would prevent the cost to ratepayers of obtaining a price hedge from being any higher than necessary and would allow the Commission to promote resource diversity. However, this approach is still reasonably likely to benefit certain types of resources (i.e.

those without fuel costs) in that such resources may be in a better position to offer long-term contracts at fixed prices.

### Contract Term

The Commission recommends that the term of the contracts be flexible with a minimum term of five years and a maximum term of 15 years. This flexibility would allow for a portfolio of contracts with varying terms, start dates, and termination dates, thereby reducing the risk of locking in large amounts of high priced contracted power for long periods of time. It also precludes locking into contracts for terms of more than 15 years, thereby limiting stranded cost exposure compared to QF contracting in the past (i.e. most QF contract were either 15 or 30 years). In addition, the flexible contract term approach should allow for greater supplier participation and may result in greater diversity in that certain types of suppliers (e.g. those with fuel costs) may not want to accept a commitment for more than five years, while others (e.g. new wind projects) may require a 15-year contractual commitment. Finally, the use of flexible contract terms would allow for consideration of the current remaining terms of existing QF contracts in developing a reasonably diverse portfolio of contracts.

### Contract Type

To provide the desired hedge against volatile and rising fuel prices, the contracts should be fixed-price or indexed to a broad measure of inflation such as the consumer price index. The contracts can be unit specific or system contracts. Capacity-only contracts would also be considered.

### Contract Amounts

A firm cap should be placed on the quantity of power supply to be procured by long-term contracts so that there is a limit to ratepayer exposure to new stranded costs. However, the cap must be high enough to allow for an effective hedge against volatile and rising fuel prices and the impact of LICAP. A quantity in the range of 20% of the annual energy usage within each utility service territory (determined over a historic period) appears to reasonably balance these objectives. Existing QF contracts, which currently serve as a fuel price hedge, should be included in determining whether the cap has been reached. A 20% hedge on energy, assuming a 60% average capacity factor of the portfolio of contracts, would be approximately 440 MW of contracted capacity. CMP, BHE and MPS have about 280 MW of QF

capacity remaining under contract as of the beginning of 2006 (individual QF contracts expire gradually over the next ten years).

The Legislature could decide to establish a higher or lower cap depending on a weighing of the importance of an effective hedge and resource diversity against the risks of substantial new stranded costs.

### Contract Price

The contract prices would be based on the competitiveness of the proposals and an evaluation of market prices over the term of the contract proposals. No contract proposal should be accepted if the price is above the prevailing market for electricity (determined using either spot or forward market prices) in the applicable zone.

An alternative would be to specify an actual price cap (e.g. 6 cents/kWh). If the price cap is sufficiently low, this approach could provide some comfort to stakeholders that substantial new stranded costs will not be created as a result of the program. However, if there is an explicit price cap, all or most of the contract proposals might be at or close to the cap (this situation occurred in the past when avoided costs were published in the context of QF bidding). Concerns that all or most bids may be at the explicit price cap would be addressed to a large degree by the authority to reject all bids in any solicitation.

### Solicitation Process

The Commission recommends that it be charged with the responsibility of periodically conducting a solicitation process for long-term contract proposals. The solicitation process should be a competitive bid process that is conducted no less than every three years until the maximum contracts amount are obtained. The contract amount in any one solicitation should be limited so that no more than one-third of the maximum amount is obtained. This approach should help to avoid a situation in which most of the contracts under the program are entered into at a time that, in retrospect, turns out to a high point in market prices. The solicitations should occur concurrently for all participating utilities so that individual projects can be selected for more than one utility at the same time.

Another option is to require the transmission and distribution (T&D) utilities to conduct the solicitation processes subject to Commission approval of the

outcomes. This would not appear to be the preferred approach because utilities may not agree with a long-term contracting program, their corporate objectives may differ from the objectives of the program, and there may be conflicts of interest if utilities have an affiliate in the electric generation business.

### Consumer-Owned Utilities

Because consumer-owned utilities are relatively small and owned or controlled by their customers, the Commission recommends that participation by these utilities in a long-term contracting program be voluntary.

### Evaluation Criteria

The Commission would evaluate and select bids so as to achieve the objectives of the long-term contracting program. Bids would be evaluated based primarily on cost to ratepayers, feasibility of projects, and diversity benefits of resources.

### Disposition of Power

Power from long-term contracts should be periodically auctioned into the wholesale market through a competitive auction (as currently occurs with QF entitlement). It is in this manner that the contracts will act as hedge against volatile and rising fuel prices in that the auction will result in higher prices for the benefit of ratepayers at the same time that retail electricity prices are rising.

Another approach is for the contracted power to be used as supply for the standard offer. The Commission has consistently raised concerns with such an approach. Use of the electricity contracts to supply standard offer service would result in the hedging benefit and the costs and risks of the contracting program being placed only on standard offer customers. It is the Commission's position that the benefits, costs and risks of a long-term contracting program that has been implemented for the general public good (e.g. environmental benefits) should go to the general body of ratepayers, rather than just standard offer customers. However, if the goal of the program is to hedge electricity prices (as opposed to the promotion of renewable power), the Legislature may want to consider if the larger classes of customers should be exempted on the rationale that such customers can make their own energy hedging decisions. The Legislature may want to seek

input from larger customers on whether they should be included in a price hedging program.

#### Ratemaking

Assuming that the goal of the program is to provide a price hedge to all customers, the costs of the long-term contracts would be recovered by the general body of ratepayers through T&D utility rates. Similarly, the price volatility hedging benefit and any lower costs benefit from the long-term contracts would go to the general body of ratepayers through T&D rates. If the Legislature decides that a hedging program should be implemented only for the smaller classes, then the benefits, costs and risks should be allocated to the applicable classes through the ratemaking process.

#### Legislation

Legislation would be needed to implement a long-term contracting program. At a minimum, legislation would be necessary to authorize the Commission to conduct a competitive bid process for long-term contracts. The Legislature should also consider placing other aspects of a long-term contracting program into statute.

#### Rulemaking

The Commission would need to adopt rules to implement a long-term contracting program.

We look forward to future discussions on issues involving long-term contracts.

Sincerely

Kurt Adams  
Chairman