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January 2, 1997

Hon. Richard Carey, Senate
 Hon. Kyle Jones, House
 Joint Standing Committee on Utilities and Energy
 State House Station No. 115
 Augusta, ME 04333-0115

Re: P.L. 1991, c. 413, AN ACT to Encourage Electric
 Utility Efficiency and Economical Electric Rates

Dear Sen. Carey and Rep. Jones:

1. INTRODUCTION

a. Summary

The purpose of this report is to inform the Legislature of activities that the Public Utilities Commission (Commission) has undertaken pursuant to 35-A M.R.S.A. § 3195 during 1996. During the past year, the Commission has been involved in a variety of activities for Central Maine Power Company (CMP), Bangor Hydro-Electric Company (BHE) and Maine Public Service Company (MPS), relating to the implementation of incentive ratemaking and pricing flexibility plans. During 1995, we developed plans, pursuant to § 3195, for each of these companies.

b. Background

In 1991, the Legislature enacted P.L. 1991, c. 413, AN ACT to Encourage Electric Utility Efficiency and Economical Electric Rates. The Act creates subchapter VII of Title 35-A entitled "Incentive Ratemaking." This legislation, codified at 35-A M.R.S.A. § 3195, clarifies the Commission's authority regarding incentive ratemaking and



the promotion of electric utility efficiency.¹

Subsection 3195(1) makes explicit the Commission's authority to establish or authorize "any reasonable rate-adjustment mechanisms to promote efficiency in electric utility operations and least-cost planning" and lists four types of permissible mechanisms. These mechanisms include: (1) "decoupling of utility profits from utility sales;" (2) "reconciliation of actual revenues or costs with projected revenues or costs;" 3) "adjustment of revenues based on reconciled, indexed or forecasted costs;" and 4) "positive or negative financial incentives for efficient operations."

Subsection 3195(2) requires that rates resulting from the implementation of such rate adjustment mechanisms must be "just and reasonable." Subsection 3195(5) of the Act requires the Commission to submit to the joint standing committee having jurisdiction over utility matters an annual report:

detailing any actions taken or proposed to be taken by the commission under this section, including actions or proposed actions on mechanisms for protecting ratepayers from the transfer of risks associated with rate-adjustment mechanisms.²

In 1994, the Legislature added a subsection to section 3195 entitled "Rate flexibility."³ Subsection 3195(6) clarifies that the Commission may authorize an electric utility to implement a pricing flexibility program that includes changing rate schedules and entering into special rate contracts with limited notice and approval. Subsection 3195(6) further provides that "[a]s part of a program adopted under this subsection, the commission may

¹Section 3195 is entitled "Commission authority to promote electric utility efficiency."

²Under section 3195(4), the Commission is required to consider the transfer of risks associated with the effect of the economy and the weather on the utility's sales.

³P.L. 1993, c. 614 developed out of L.D. 1666 entitled AN ACT to Permit Electric Utilities Greater Flexibility in Adjusting Electric Utility Prices to Meet Changing Market Conditions.

waive the requirements of section 3101 [the fuel adjustment clause]."

This letter provides the Commission's report to the Utilities and Energy Committee for 1996.⁴

2. CENTRAL MAINE POWER COMPANY

Since the Commission's approval of the CMP Alternative Rate Plan (ARP) stipulation in the Order dated January 10, 1995, there have been several filings and proceedings that relate to the implementation of that Order. The Commission's activities during 1996 regarding CMP can be grouped into three categories:

- Pricing flexibility requests. CMP's ARP allows considerable flexibility in the way it may price its electric service. A set of criteria and an expedited process were established under CMP's ARP by which to review and evaluate filings.⁵ In the first 11 months of 1996, CMP filed 32 petitions for review under the criteria of its ARP. Of these 32 filings, the Commission staff determined that 21 were reasonably in conformance with CMP's ARP criteria and these were allowed to go into effect by operation of law. The remaining 11 filings were approved by Commission orders. About two-thirds of CMP's ARP filings were requests for special rate contracts with individual customers that were intended to retain existing electric load or induce incremental growth in electric sales. Other filings were for targeted optional service rates designed to improve customer satisfaction with regard to pricing structures, promote incremental electric sales, and to aid economic development. CMP's pricing flexibility activities will be reviewed in detail during the 1997 mid-term review of the ARP.
- ARP Annual Review Proceeding. On June 28, 1996, the Commission issued an Order approving the second annual

⁴This report is due on December 31, 1996.

⁵ Filings that meet the ARP criteria may go into effect by operation of law after 30-days notice. Filings that do not strictly meet the ARP criteria and long-term contracts require Commission approval within 4 months.

price change under the CMP ARP (Docket No. 96-599).⁶ That Order authorized a 1.26% increase in the rate caps for all customer classes, and also required CMP to reduce the balance of its regulatory asset account by \$1.011 million, representing a flow back to ratepayers from certain QF contract restructurings. Several issues raised during the annual review proceeding will be explored further in the mid-period ARP review in 1997, including consideration of an external funding mechanism for post-retirement benefit costs (Statement of Financial Accounting Standards No. 106) and possible changes to the demand-side management (DSM) target setting mechanism, including the use of a bidding process.

- DSM Performance Target Proceeding. The Commission's Order in this proceeding (Docket No. 96-598, dated November 15, 1996) adopted a DSM performance target for CMP of 34 million kilowatt-hours (kWh) for 1997, with a requirement that CMP attempt to provide a minimum of 6.25 million kWh in DSM savings to each of the residential, commercial and industrial classes.⁷ The Order also limited the amount of DSM expense incurred in 1997 that could be recovered in rates to a maximum of \$3.5 million. A request for reconsideration of that Order, specifically regarding the \$3.5 million cap, is pending.

⁶Each July 1, beginning on July 1, 1995, the cap on each of CMP's rates for retail electric service will change by a percentage equal to the total of the following four items: (1) inflation index; (2) less productivity offset and QF factor; (3) plus or minus sharing mechanism; and (4) plus or minus flowthrough items and mandated costs. Paragraph 20 of the CMP ARP Stipulation (approved by the Commission in the CMP ARP Order dated January 10, 1995) requires CMP to file information on a number of matters relating to this rate change on each March 15 during the term of the ARP.

⁷The CMP ARP stipulation, which was incorporated into the Commission Order dated January 10, 1995, requires that CMP file on April 1st of each year a proposed DSM performance target for the next year.

3. BANGOR HYDRO-ELECTRIC COMPANY

In last year's report under this statute, the Commission reported on the BHE's pricing flexibility requests and progress in the development of a comprehensive rate cap plan. The 1996 activity relating to BHE's Alternative Marketing Plan (AMP) is described below.

- Pricing Flexibility Requests. BHE's AMP allows considerable flexibility in the way it may price its electric service.⁸ In the first 11 months of 1996, BHE filed seven cases for review under the criteria of its AMP. Each of these filings was determined by the Commission staff to be reasonably in conformance with BHE's AMP criteria and were allowed to go into effect. All except one of these filings were requests for special rate contracts with individual customers that were intended to retain existing electric load or induce incremental growth in electric sales. In at least two cases, these special rate contracts were part of a larger effort to promote regional economic development by offering electric rates designed to be competitive with rates in other regions of the country where competing products are manufactured. On December 12, 1996, BHE and its large industrial customer, HoltraChem Manufacturing, resolved a prolonged dispute by executing a new rate agreement, establishing a special rate contract through the end of 1999.
- Rate Cap Proceeding. The Commission's February 14, 1995 BHE AMP Order established pricing flexibility and sought the development of a comprehensive rate cap plan for BHE. Because negotiations among the parties during 1995 were unsuccessful, in the first half of 1996 the parties presented and litigated various rate plans in what became known as Phase II of the AMP proceeding. On July 10, 1996, the Commission issued its Order in Phase II, concluding that no formal price cap plan for BHE be adopted at that time, and instead, ordered that traditional regulation be continued. The Commission's conclusion was based largely on BHE's public commitment to its customers that it will not seek rate increases, and on the Commission's assessment that, given BHE's

⁸While the terms of the BHE AMP are different in some technical respects from the CMP ARP, the two processes operate in a similar way and have similar objectives.

financial condition, the Company would be unlikely to seek a general rate hike through the end of the decade.

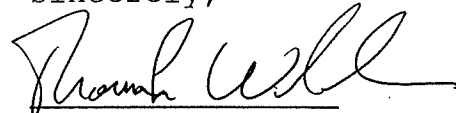
4. MAINE PUBLIC SERVICE COMPANY

On November 13, 1995, the Commission approved a stipulation which set forth the major components of Maine Public Service's Rate Stability Plan (RSP), effective during the period January 1, 1996 to January 31, 2000. Subject to the provisions of the Stipulation, beginning on January 1, 1996 and on each February 1, MPS will be permitted to increase retail rates by a specified percentage.

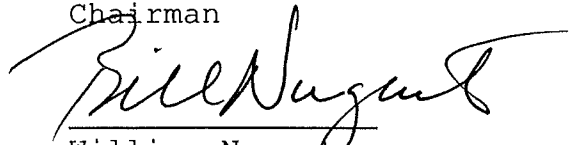
- Pricing Flexibility Program. MPS's Flexible Pricing criteria are essentially the same as CMP's ARP provisions. During 1996, MPS filed two petitions for review under the criteria of flexible pricing. Each filing requested approval of a special rate contract with an industrial customer engaged in the business of food processing. The Commission staff determined that each filing met MPS's flexible pricing criteria and both were approved by Commission order.
- Rate Stability Plan. In accordance with the RSP stipulation, MPS raised its rates by 4.4% on January 1, 1996. On November 14, 1996 (Docket No. 96-719), MPS requested its second annual rate change of 2.9%, pursuant to the MPS's Rate Stability plan, to be effective February 1, 1997. Under the stipulation, rate increases effective in 1998 and 1999 will be limited to 2.75% in each year.
- Rate Design Proceeding. The approval of the RSP did not resolve certain rate design issues for MPS, and thus, during 1996, parties presented and litigated their positions. The Commission issued its Order on June 10, 1996, approving rate design changes that were based to a degree upon marginal cost results, but tempered to comport with its judgment on fair allocations to classes. The rate design changes resulted in slightly higher rates for the Company's residential and commercial customers and slightly lower rates for certain large industrial customers.

Please contact us for further information or clarification.

Sincerely,



Thomas Welch
Chairman



William Nugent
Commissioner



Heather Hunt
Commissioner