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**Annual Report by the Public Utilities Commission
To the Utilities and Energy Committee
On Electric Incentive Ratemaking and Actions Taken by the Commission
Pursuant to 35-A M.R.S.A. § 3195**

December 31, 2008

Title 35-A M.R.S.A. § 3195 authorizes the Public Utilities Commission (Commission) to adopt rate mechanisms that promote electric utility efficiency. Subsection 5 of § 3195 states:

Annual Report. The commission shall submit to the joint standing committee of the Legislature having jurisdiction over utilities matters an annual report detailing any actions taken or proposed to be taken by the commission under this section, including actions on mechanisms for protecting ratepayers from the transfer of risks associated with rate-adjustment mechanisms. The report must be submitted by December 31st of each year.

This report provides background information about the use of alternative rate mechanisms in Maine and describes Commission actions taken during 2008 regarding mechanisms that promote electric efficiency through incentive rate plans.

I. BACKGROUND

Since 1995, several Maine utilities have operated under Alternative Rate Plans (ARPs). These plans replace traditional rate of return regulation¹ with a multi-year price cap approach that places an upper limit on the utility's rate increases, while allowing the utility to retain savings it accomplishes through improved efficiencies. ARPs, as a general matter, create rate predictability and stability, reduce regulatory costs, and provide stronger incentives for utilities to minimize their costs. However, if not properly structured, ARPs can disincentivize investment and maintenance activities by utilities and undermine other goals of public policy, such as energy efficiency.

On November 16, 2000, the Commission approved a second Alternative Rate Plan (ARP 2000) for CMP. CMP's ARP 2000 was a seven-year plan, which commenced on January 1, 2000 and expired on December 31, 2007. The plan provided for annual rate changes on July 1 of each year, which were based on a well-established formula of inflation minus a productivity offset, adjusted for mandated costs, earnings sharing and service quality index penalties.

¹Rate of return regulation is a regulatory approach in which the Commission examines all reasonable expenses a utility is likely to incur and establishes rates that will allow the utility, if operated efficiently, to recover those expenses and earn a reasonable return on its investments.

On April 29, 2004, the Commission initiated an Inquiry² for the purpose of conducting a study of the impact of incentive ratemaking plans on grid reliability as requested by the Utilities and Energy Committee (Committee). On June 17, 2005, the Commission provided its Final Report to the Committee in response to our Inquiry (June 17, 2005 Report). As discussed in the June 17, 2005 Report, the Commission found that, in most respects, the utilities were adequately operating and maintaining the grid. In certain respects, however, the Commission's examination revealed signs of potential shortcomings that warranted further and more in-depth review. In particular, the Commission concluded that certain aspects of CMP's distribution system and operation and maintenance practices should be examined.

On December 13, 2005, the Commission initiated an Inquiry³ to serve as the vehicle for conducting the further review and retained the services of Williams Consulting, Inc. (WCI) as the independent entity to conduct the review. On February 26, 2007, WCI submitted its "CMP Distribution Plant Evaluation – Final Report" to the Commission. Based on its study, WCI found that:

- CMP has achieved a high level of information system integration and development of support tools;
- CMP's stated approach to reliability performance was to "manage to the ARP targets." While this may be understandable from a cost perspective, it virtually assures that CMP's reliability performance will not improve;
- The current ARP targets for Customer Average Interruption Duration Index (CAIDI) and System Average Interruption Frequency Index (SAIFI)⁴ appear to be a protective minimum or floor intended to assure reliability performance does not deteriorate;
- Although within ARP reliability targets, CMP's reliability performance falls into the third quartile (i.e., poorer than average performance) for CAIDI, as compared to the Institute of Electrical and Electronic Engineers (IEEE) survey of U.S. utilities. Furthermore, CMP's SAIFI falls within the fourth quartile (i.e., worst performers), and has been increasing (getting worse) during the period 2001-2005;
- CMP has significantly reduced the percentage of outages caused by animal contact through its pro-active program of installing animal guards on distribution transformers. However, CMP's tree related outages were among the highest in the industry;

² *Inquiry Into the Status of the Reliability and Security of the Electric Grid in Maine*, Docket No. 2004-248.

³ *Review of CMP's Distribution System and Distribution Practice and Procedures*, Docket No. 2005-705.

⁴ CAIDI is intended to measure, on average, the duration of service interruptions. SAIFI is intended to measure, on average, the frequency of service interruptions.

- Tree related outages appear to be more frequent in areas with lower customer density. This implies that the Company focuses its vegetation management and overhead lines maintenance resources on its more heavily populated service areas;
- CMP's overhead distribution plant appears to be in good mechanical and electrical condition. CMP has undertaken a number of pro-active programs to improve the performance of the system, such as the focused animal guard program;
- CMP does not employ a cycle trim program. CMP sets an informal goal of trimming 15% to 20% of its 3-phase circuits annually. However, these circuits only comprise 20% of the system. The remaining 80% are planned for trim on a reactive basis;
- Annual distribution vegetation management program budgets and actual expenditures have remained relatively flat over the past five years, while tree-related outages have increased each year; and
- Based on its physical condition inspection results, WCI found that CMP faced a significant risk of outages due to vegetation encroachment on the overhead primary distribution system.

Pursuant to the terms of the ARP 2000 Stipulation, CMP submitted revenue requirement information on May 1, 2007 in the following Commission proceeding, *Request for Approval of an Alternative Rate Plan, Transmission and Distribution Utility Revenue Requirements and Rate Design*, Docket No. 2007-215, to be used by the Commission to decide what rate actions, if any, should be taken at the end of the ARP. In its May 1 filing, CMP recommended that no rate change occur at the expiration of the current ARP and that the Commission adopt a new ARP, ARP 2008. CMP also responded to the findings and recommendations contained in the WCI Report and proposed a Reliability Improvement Program as part of its ARP proposal. The Office of the Public Advocate (OPA) submitted testimony and Commission Staff submitted a Bench Analysis in response to CMP's proposal. Additional activities which took place in 2008 are described below.

II. ACTIVITIES IN 2008

A. Annual Price Change Filing (Docket No. 2008-111)

On March 17, 2008, CMP filed a request to increase its distribution rates by 2.49% for mandated costs which occurred during 2007. On March 21, 2008 the OPA filed a Motion to Dismiss CMP's petition on the grounds that ARP 2000 had expired and there was no provision in the ARP 2000 Stipulation which authorized such a change. On April 11, 2008, the Hearing Examiner in this matter issued an Examiner's Report recommending that the OPA's Motion to Dismiss be granted.

B. ARP/Rate Case (Docket No. 2007-215)⁵

Hearings in the ARP 2008/Rate Case were held in February 2008. On June 6, 2008, after more than a year of litigation, the Commission received a Stipulation entered by CMP, the OPA, the Industrial Energy Consumer Group and the International Brotherhood of Electrical Workers and supported by the Commission's Staff, which resolved all issues in both Docket No. 2008-111 and in Docket No. 2007-215. On July 1, 2008, the Commission issued an Order Approving Stipulation. The Stipulation approved by the Commission contains the following provisions:

- a \$20.3 million decrease in CMP distribution rates effective July 1, 2008;
- a new five-year ARP (ARP 2008) to take effect in January 2009;
- a formula by which CMP's distribution rates will be adjusted annually based on inflation less a productivity offset of 1%;
- an upper-end earnings sharing provision in the event CMP's Return on Equity (ROE) exceeds 11% in any calendar year during ARP 2008;
- a Reliability Improvement Program to address distribution system reliability issues raised in the WCI Report;
- a set of service quality provisions intended to ensure CMP's reliability and customer service performance, including seven performance metrics and penalties of up to \$5 million.

As part of the ARP 2008 Reliability Improvement Program, CMP agreed to implement a five year Cycle Vegetation Management Trim Program (Trim Program). Under this program, CMP will trim 110,000 spans per year so that by the end of 2013, CMP will have trimmed its entire distribution system. In addition to its Trim Program, CMP agreed to implement a Trees in Contact Program to address the vegetation encroachment issues identified in the WCI report. Under this program, CMP agreed to spend \$1 million in 2008, \$2 million in 2009 and \$1 million in 2010. This \$4 million level of spending was not included in CMP's revenue requirement in developing the rates approved in the case.

As part of the Reliability Improvement Program, CMP also agreed to enhance its Distribution Inspection Program to a five year cycle program compared to its current ten year program. Finally, as part of ARP 2008, the service quality mechanism would become more rigorous during the ARP 2008 and would go from a baseline level of 2.10 in 2009 to 1.89 in 2013.

⁵ All filings in this case and in Docket No. 2008-111 can be found under this docket number on the Commission's Virtual Case File on the Commission's website at www.maine.gov/mpuc by clicking the "Online Documents and Services" icon and then the "Virtual Case File" icon and entering "2007215" in the "Case ID" box.