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PUBLIC UTILITIES COMMISSION

February 16, 1995

Senator David L. Carpenter, Chair
Representative Carol A. Kontos, Chair
Joint Standing Committee on Utilities
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. Carpenter and Rep. Kontos:

In 1991, the Legislature enacted P.L. 1991, c. 413, AN ACT to Encourage Electric Utility Efficiency and Economical Electric Rates (attached). 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

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

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

The purpose of this letter is to provide the Commission's report to the joint standing committee having jurisdiction over utility matters pursuant to subsection 3195(5) for the year 1994.⁴

I. CENTRAL MAINE POWER COMPANY

A. Alternative Rate Plan

In a recently completed Order in Docket No. 92-345, Phase II, dated January 10, 1995, the Commission adopted an Alternative Rate Plan (ARP) for CMP. This January 10 Order adopts the stipulated Alternative Rate Plan ("ARP" or "stipulated ARP") for CMP that was submitted by several parties in that case on October 14, 1994. The October 14 Stipulation ("the Stipulation") sets forth the terms and conditions relating to the form of rate regulation that will be used to regulate Central Maine Power Company ("CMP" or the "Company") for the next 5 years.⁵

²Under section 3195(5), 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.

⁴This report was due on January 3, 1995. The Commission's desire to provide the Committee with the most up-to-date information regarding Docket No. 92-345, Phase II (see Part I(A) below), Docket No. 94-125 (see Part II(A) below) and Docket No. 94-273 (see Part II(B) below) has delayed completion of this report.

⁵The October 14th Stipulation was signed by CMP, the Commission's Advocacy Staff (Staff), the Office of the Public Advocate (OPA), the Commercial Customer Utility Coalition (CCUC), the Department of the Navy (Navy) and the Maine State Legislative Committee, American Association of Retired Persons (AARP). The Alliance to Benefit Consumers (ABC) filed a Brief in which it opposed the stipulation. The only other parties to the case, the
(continued...)

By way of background, it should be noted that a year earlier, in its December 14, 1993 Order in the most recent previous CMP rate case (Docket No. 92-345, Phase I), the Commission determined that the "time was ripe" to thoroughly explore issues relating to alternative rate plans and urged the parties to develop a plan that would meet the needs of utility ratepayers by providing rate predictability and stability and other benefits. The Commission outlined the framework of that plan in the December 14 Order, but acknowledged that a number of details needed to be worked out before a plan could go into effect. In the December 14 Order, the Commission indicated that a Phase II proceeding would be opened to further explore an ARP for CMP.

In early 1994, the parties attempted to reach agreement on the terms of an ARP for CMP. However, the parties failed to reach consensus on such a plan and on April 20, 1994 the Commission formally opened Phase II of this case to develop an ARP for CMP. With its Phase II direct testimony, CMP filed a specific plan that became known as the CMP ARP. Several non-CMP parties supported an alternative rate plan that became known as the Public Party/Customer Proposal (PPCP) ARP.⁶

On October 14, CMP filed a Stipulation, which sought to resolve all remaining issues in the Phase II proceeding, on behalf of the Staff, CMP, the OPA, the CCUC and the Navy. The AARP eventually signed the Stipulation. The Stipulation includes three major components:

- **price-cap component.** Under the stipulated ARP, traditional modified cost-plus regulation of CMP's rates is replaced with a plan that adjusts CMP's revenues based on changes in inflation, productivity growth and other factors that are outside the control of CMP. This new regulatory approach can be expected to provide a positive or negative financial incentive to encourage efficient management of CMP's operations.
- **profit-sharing component.** This component would provide an explicit mechanism to share the risk of

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Industrial Energy Consumer Group (IECG) and the Bath Iron Works Corporation (BIW) did not file briefs and took no formal position with regard to the Stipulation.

⁶The Public Party/Customer Proposal (PPCP) was developed by many of the non-CMP parties in this proceeding, including the Staff, the CCUC, the OPA, AARP, and the Navy.

extreme outcomes between ratepayers and shareholders.

- **pricing flexibility component.** Under the pricing flexibility component, CMP gains increased pricing flexibility since the rates that the utility could charge to any customer become maximum prices or "caps." Marginal-cost price floors, based on either short- or long-term costs (depending upon the circumstances), are needed to assure that the utility does not price below cost. Pricing flexibility can be expected to be an improvement over rigid and inflexible traditional "command-and-control" regulation of a utility's rates and tariffs.

On November 22, CMP filed revised rate schedules and 5-year contracts to reduce rates for a number of the Company's large industrial customers. The 5-year, reduced-rate contracts are designed to retain at least a portion of these large industrial customers' contribution to the costs of maintaining the system. Large industrial customers typically have the greatest opportunity to "leave the system," thereby potentially shifting the responsibility for these costs to the remaining residential and commercial customers.

On January 10, the Commission adopted the October 14 Stipulation and allowed the proposed rate schedules and 5-year contracts for 14 of CMP's largest industrial customers to take effect. In the January 10 Order, the Commission reviewed the discrete components of the stipulated ARP and found them to be appropriate. The Commission also reviewed the Stipulation on an integrated basis, from three different perspectives, and found that the Stipulation constituted a reasonable plan for regulating CMP for the next 5 years. First, from a financial perspective, the Commission found that the stipulated ARP was sufficiently robust and flexible. Second, from a qualitative perspective, the Commission found that the stipulated ARP satisfied the goals, and was reasonably likely to produce a substantial portion of the benefits that the Commission had articulated in their Phase I Order. Finally, from a legal perspective, the Commission found that it has the authority to implement the stipulated ARP under section 3195 and that doing so was not contrary to other provisions of Title 35-A. For all of these reasons, the Commission adopted the stipulated Alternative Rate Plan for CMP.

In its January 10 Order, the Commission found that section 3195 supports the Commission's authority to adopt rate adjustment mechanisms, such as the ones contained in the stipulated ARP. The Commission determined that its decision to implement an ARP is fully consistent with section 3195 because the plan can be expected to provide positive or negative

financial incentives for efficient operations (section 3195(1)(D)). The Commission found that a particular potential advantage of an ARP is that it can be expected to protect ratepayers by shifting certain risks, such as the effects of the economy and the weather on the utility's sales, from ratepayers to shareholders (section 3195(4)). Further, the Commission found that: (1) the record in this case provides substantial evidence that the rates anticipated under the stipulated ARP are just and reasonable (subsection 3195(2)); and (2) the stipulated ARP provides substantial safeguards in the event that foreseen or unforeseen circumstances jeopardize the justness and reasonableness of rates during the term of the ARP. The Commission also found that the stipulated ARP is not inconsistent with any other provision in Title 35-A, including, but not limited to, the Commission's general ratemaking authority in Chapter 3, the provisions governing the regulation and control of public utilities under Chapter 7, State energy policy codified in the Electric Rate Reform Act (section 3152 et seq.) the Maine Energy Policy Act (section 3191), and with recently enacted provisions such as section 3156 (certificates of approval for electric rate stabilization agreements) and Chapter 44 (Maine Surplus Energy Auction Program).

B. Fuel Clause Adjustment

In 1994, the Legislature added subsection 6 to section 3195 entitled "rate flexibility" that allows the Commission to waive the requirements of the fuel adjustment clause (section 3101) if it implements a pricing flexibility component.

Prior to enactment of subsection 3195(6), the Commission's lack of discretion regarding the design of the fuel adjustment clause had been a substantial obstacle to the potential implementation of an ARP. Since the Fuel Adjustment Clause, codified at 35-A M.R.S.A. § 3101, does not provide for Commission discretion, it had previously been unclear whether the Commission had the discretion to design a comprehensive alternative rate plan that could provide improved efficiency incentives and other potential benefits.

Because of the authority provided in §3195(6), the Commission was able to adopt the Stipulated ARP, which suspends the annual rate changes associated with the operation of the fuel adjustment clause.

II. BANGOR HYDRO-ELECTRIC COMPANY (BHE)

A. Alternative Marketing Plan

Pursuant to 35-A M.R.S.A. subsection 3195(6), the Commission issued its Notice of Investigation on April 27, 1994

in Docket No. 94-125. The purpose of this proceeding was to consider the adoption of general standards and procedures governing pricing flexibility for BHE. A Commission decision in this proceeding is expected on or before January 31, 1995.

The Commission recently approved a pricing flexibility plan for BHE, eliminated the BHE's FCA and made a number of other rulings. BHE's had proposed an Alternative Marketing Plan that the Commission considered in Docket No. 94-125. BHE's proposed plan would (1) grant BHE substantial marketing flexibility, including the right to selectively lower its rates to customers; (2) eliminate the fuel clause adjustment and freeze rates at current levels; (3) make a "good faith" commitment to maintain rates at current levels for a period of 5 years; (4) eliminate the seasonal differential in its rates; and (5) allow BHE to amortize the cost of additional NUG buyouts over a period not to exceed 10 years.

The Staff, the OPA and the CCUC have participated in this proceeding. Both Staff and OPA proposed a set of pricing flexibility principles and guidelines that would provide additional safeguards to ensure that Maine's energy policy, as set by the Legislature, is complied with and to ensure that other important policy goals are met. All parties agreed that the fuel adjustment clause should be eliminated, but there were differences of opinion regarding the appropriate fuel clause rate level.

In its Decision and Order, dated February 14, 1995, the Commission allowed BHE substantial pricing flexibility in order to give BHE an improved opportunity to compete successfully. The Commission evaluated the need for safeguards to protect the interests of BHE's customers and included those safeguards needed to protect customers from risks relating to pricing flexibility.

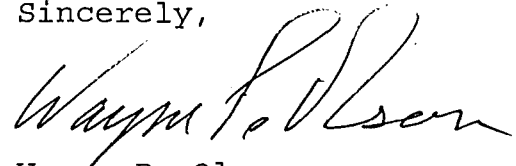
The Commission also made a number of other decisions in their Order. These include:

- . rejecting of Staff's proposed "risk sharing" mechanism because it was overly complicated and unnecessary;
- . approving a 10% "revenue delta" cap, which limits the potential revenue losses from negotiated price reductions;
- . beginning a proceeding to develop a "rate cap" or "stayout" for BHE;
- . waiving of the requirement of a FCA without requiring a change in rates; and

- permitting BHE to create a "regulatory asset" for the costs of any buyout or buydown of a contract with a Qualifying Facility and to begin the amortization of those costs over the shorter of the remaining life of the contract or ten years.

The Commission is persuaded that BHE faces significant competitive risk and that BHE's management and not the Commission is better able to develop, within the parameters set forth in the Commission's Order, the best pricing strategy to stem the revenue erosion due to such competition.

Sincerely,



Wayne P. Olson
Director of Finance

WPO/jf

cc: Evan Ricker, Director, State Planning Office
Jon Clark, OPLA Analyst (16 copies)

B. Upon receipt of proper notification, the code enforcement officer shall issue a stop-work order to the person or entity responsible for the activity that threatens to disturb the burial site.

C. Before the construction activity may continue, the excavator or person who owns the land shall notify the Director of the Maine Historic Preservation Commission and the president of any local historical society of the probable location of the burial site. The excavator or the person who owns the land shall also arrange, at that person's own expense, for appropriate investigation to determine the existence and location of graves.

D. When the investigation is complete, if no human remains are discovered, the person responsible for the investigation shall notify the code enforcement officer of the results and the code enforcement officer shall revoke the stop-work order if satisfied that the investigation is complete and accurate.

E. If a burial site is discovered, excavation or construction may not continue except in accordance with subsection 1 and other applicable provisions of state law.

3. Application. This section applies only to burial sites and graveyards containing the bodies of humans.

See title page for effective date.

CHAPTER 413

S.P. 196 - L.D. 505

An Act to Encourage Electric Utility Efficiency and Economical Electric Rates

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 35-A MRSA c. 31, sub-c. VII is enacted to read:

SUBCHAPTER VII

INCENTIVE RATEMAKING

§3195. Commission authority to promote electric utility efficiency

1. Rate-adjustment mechanisms. This Title may not be construed to prohibit the commission from or to restrict the commission in establishing or authorizing any reasonable rate-adjustment mechanisms to promote effi-

ciency in electric utility operations and least-cost planning. Rate-adjustment mechanisms may include, but are not limited to:

A. Decoupling of utility profits from utility sales through revenue reconciliation;

B. Reconciliation of actual revenues or costs with projected revenues or costs, either on a total or per customer basis;

C. Adjustment of revenues based on reconciled, indexed or forecasted costs; and

D. Positive or negative financial incentives for efficient operations.

2. Just and reasonable rates. In determining the reasonableness of any rate-adjustment mechanism established under this subchapter, the commission shall apply the standards of section 301 to assure that the rates resulting from the implementation of the mechanism are just and reasonable.

3. Value of utility property. Notwithstanding section 303, rate-adjustment mechanisms established under this section may be used to establish the value of the electric utility's property.

4. Ratepayer protection. In determining the reasonableness of any rate-adjustment mechanisms, the commission shall consider the transfer of risks associated with the effect of the economy and the weather on the utility's sales. To the extent these risks are transferred from the utility to its customers, the commission shall consider in a rate proceeding the effect of the transfer of risk in determining a utility's allowed rate of return.

5. 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 or proposed 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.

Sec. 2. Retroactivity. This Act applies retroactively to March 1, 1991.

Sec. 3. Public Utilities Commission Docket 90-085. The Public Utilities Commission shall consider and adopt a mechanism that limits the rate impact of the per customer electric rate-adjustment mechanism approved for Central Maine Power Company in Commission Docket No. 90-085.

See title page for effective date.
