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December 15, 1997

Hon. Richard J. Carey, Senate
Hon. Kyle W. 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:

I. 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 1997. 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.

During the 1997 legislative session, the Maine legislature passed and Governor King signed P.L. 1997, Ch. 316, which is codified as 35-A M.R.S.A. Chapter 32. This legislation, among other things, requires that all consumers of electricity shall have the right to purchase generation services directly from competitive electricity providers beginning on March 1, 2000. The beginning of retail access will approximately match the end of the plans that we have developed, pursuant to Section 3195, for the three investor-owned electric utilities.

During the summer of 1997, the Maine Yankee Atomic Power Company (Maine Yankee) Board of Directors effected the permanent shutdown of the nuclear generating station owned by Maine Yankee. The shutdown of Maine Yankee has significant



ratemaking implications for the Maine-based, investor-owned utilities that own Maine Yankee.¹ The current BHE rate case is, in part, a result of the financial impact of Maine Yankee's closure. MPS has requested an additional rate increase, in its current annual review case, to reflect sharing of the cost of replacement power resulting from Maine Yankee's closure.

B. Background

In 1991, the Legislature enacted P.L. 1991, ch. 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, provides the Commission's authority regarding incentive ratemaking and the promotion of electric utility efficiency.²

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

¹ CMP owns 38 percent, BHE owns 7 percent, and MPS owns 5 percent, with the balance owned by other electric utilities.

² Section 3195 is entitled "Commission authority to promote electric utility efficiency."

transfer of risks associated with rate-adjustment mechanisms.³

In 1994, the Legislature added a subsection to section 3195 entitled "Rate flexibility."⁴ 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]."

This letter provides the Commission's report to the Utilities and Energy Committee for 1997.⁵

II. 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 1997 regarding CMP can be grouped into four categories, as described below.

A. Mid-Period Review of the ARP.

On June 27, 1997, the Commission approved a partial Stipulation that resolved certain issues in the annual⁶ and

³ Under section 3195 (4), the Commission is required to consider the transfer of risks associated with the effect of the economy of the economy and the weather on the utility's sales.

⁴ P.L. 1993, Ch. 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.

⁵ This Report is due on December 31, 1997.

⁶ Each 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 flow through 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.

mid-period⁷ reviews of the CMP ARP (Docket Nos. 97-016 and 97-599), including a negotiated return on equity for the purposes of earning sharing, a greater degree of pricing flexibility, and a reduction in the administrative burden of the pricing rules. The Commission found that the stipulation is in the public interest, represents a sufficiently broad range of interests, and provides a reasonable resolution of the issues in the case.

The Stipulation was supported by CMP, the Commission's Advocacy Staff, and the Public Advocate, and was opposed by the IECG, the Coalition for Sensible Energy, and Renewable Energy Assistance Project. Several matters were not resolved by the Partial Stipulation. First, the parties deferred issues related to CMP's entering contracts that extend beyond the date of retail competition. Second, the parties agreed to establish a collaborative effort to develop revisions to the customer service index by December 31, 1997; this collaborative effort has ended with no proposed changes to the index.

B. Annual Price Change Proceeding.

The June 27, 1997 Order approving the Partial Stipulation authorized a 1.10% increase on July 1, 1997 in the rate caps for all customer classes, the third such annual increase since the ARP's adoption. The Partial Stipulation settled two issues for the remainder of the ARP that were first raised in last year's annual review: the so-called "denominator" issue (relating to the manner of calculating the percentage rate change) and the treatment of Houlton Water Company revenues.

C. Pricing Flexibility

CMP's ARP allows considerable flexibility in how it may price its electric service. The Commission established criteria and an expedited process under CMP's ARP to review and evaluate filings.⁸ In the first 11 months of 1997, CMP filed 33 flexible pricing petitions that became effective automatically upon 30

⁷ Paragraph 21 of the ARP Stipulation provides for a mid-period review in 1997 to "assess the overall operation and results of the ARP's performance," and to allow for modifications that may be necessary or desirable.

⁸ 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.

days notice, pursuant to its ARP criteria. CMP filed 11 additional filings that were approved by Commission orders. About 70% of CMP's filings were for approval of special rate contracts intended to retain existing electric load or induce incremental growth in electric sales. Its other filings introduced or revised optional service rates that are intended to improve customer satisfaction with regard to pricing structure, promote incremental sales, or to aid economic development.

CMP's flexible pricing criteria were reviewed in detail as part of its mid-term ARP review in Docket No. 97-016. The ARP criteria remain largely unchanged, but some revisions were made. First, CMP's notification requirements to customers receiving special rates and to the competitors of customers receiving special rates were revised. Second, the restriction that CMP must set prices for optional targeted service rates or special rate contracts below rate caps was eliminated. Finally, CMP may demonstrate the revenue test criteria by submitting a "worst case scenario" analysis.

The Commission approved these changes to CMP's flexible pricing criteria on June 27, 1997. The order did not resolve issues associated with long-term contracts that extend beyond the beginning of retail choice in Maine. Policy governing these long-term contracts is influenced significantly by electric utility restructuring, and the parties continue to discuss resolution of these issues.⁹

D. DSM Performance Target Proceeding.

The November 15, 1996 Order (Docket No. 96-598) that adopted a DSM performance target of 34 million kilowatt-hours (kWh) for 1997 was modified by the Commission on February 7, 1997 in response to a motion for reconsideration and a Stipulation signed by all parties. That stipulation requires CMP to issue RFPs to obtain cost-effective residential and commercial energy savings from outside sources, and by doing so, removed the need for the cost-recovery limitation of \$3.5 million previously imposed by the Commission. On May 5, 1997, CMP notified parties that it decided not to contract with outside contractors, but instead to develop its own programs. Should the Company fail to meet at least 90% of its target, Attachment H of the ARP prescribes monetary penalties.

⁹ On November 27, 1997, the Commission's Advocacy Staff and CMP asked that the parties be given an additional month, to January 5, 1998, to submit either a settlement agreement on this issue or a litigation schedule.

By Stipulation approved on March 19, 1997, DSM kWh targets for 1998 and 1999 were set in Docket No. 97-016 for 30 million kWh in each year, by agreement of CMP, Advocacy Staff, Public Advocate, Coalition for Sensible Energy and the Renewable Energy Assistance Project. The Stipulation requires CMP to obtain at least 8.25 million kWh of savings from each customer class: residential, commercial, and industrial.

III. BANGOR ELECTRIC-ELECTRIC COMPANY

The Commission's February 14, 1995 Order established BHE's Alternative Marketing Plan (AMP), which provided BHE with significant pricing flexibility, and sought the development of a comprehensive rate cap plan for BHE. 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 the continuation of traditional regulation. The Commission's decision was based, in part, on BHE's public commitment that it would not seek rate increases for a 5-year period.

A. Rate Increase Case.

On April 1, 1997, BHE filed a petition for a temporary rate increase pursuant to 35-A.M.R.S.A. § 1322. BHE asked for an increase of \$10 million (on an annual basis) to take effect as soon as possible. BHE stated that, without the temporary rate increase, injury would result to both the Company and its customers because of the precarious financial condition of the Company.

On May 9, 1997, BHE filed for a general increase in rates of about \$5.0 million upon completion of the case in early 1998 and an additional rate increase of \$4.5 million on January 1, 1999. This request also proposed a Maine Yankee adjustment clause whereby the Company would be allowed to defer costs related to the Maine Yankee nuclear power plant for future collection in rates.

In an Order dated June 25, 1997, the Commission granted BHE a temporary rate increase of \$5,098,561. The Commission also required BHE to increase, by an annual rate of \$5 million, the amortization of its regulatory asset associated with the buyout of the Beaverwood Qualifying Facility contract; this acceleration means that BHE's earnings, as distinct from its cash flow, were

not affected by the rate increase.¹⁰ The Commission found that a temporary rate increase of \$5.0 million in rates is needed to help to avert a more serious financial situation for BHE.

On July 2, 1997, BHE notified the Commission of its intent to revise its request to eliminate the two-step nature of its rate increase proposal, to eliminate the proposed Maine Yankee adjustment mechanism, and to revise its overall request upward to a one-time increase in rates of \$20.6 million (about 15.6 percent), effective upon completion of the case. In September, 1997, the Company filed rebuttal testimony in which the requested rate increase was further increased to \$22.1 million. The Company stated that its financial circumstances, taken together with the outcome of the electric restructuring legislation, made it necessary to fully recover its revenue deficiency. The Commission held public witness hearings in Bangor and Machias to receive input from the public on BHE's rate increase request.

The Commission's Advocacy Staff, the Public Advocate, and other parties dispute the level of rate relief that BHE has requested and have presented evidence indicating that a smaller rate increase would be appropriate.

Both the Advocacy Staff and the Public Advocate filed proposals for limited versions of rate cap plans, pursuant to 35-A M.R.S.A. § 3195, for the period between the end of the rate case and March 2000, the onset of retail access. Those parties contend that as a condition of the Commission's establishment of pricing flexibility for BHE in 1995, BHE agreed to voluntarily refrain from rate increases for 5 years. BHE disputes this interpretation of the Commission's Order and opposes the imposition of a price cap plan for 1998-2000. The Commission's final order on the rate request is due by February 9, 1998.

B. Pricing Flexibility Requests.

BHE's AMP allows considerable flexibility in the way it may price its electric service. In the first 11 months of 1997, BHE filed eight cases for review pursuant to its AMP criteria.

¹⁰On December 12, 1997, in response to a request by BHE that the Commission grant an additional rate increase to the Company, pursuant to 35-A M.R.S.A § 312, the Commission decided to end the accelerated amortization of the Beaverwood contract. This decision does not change the rates paid by ratepayers but does improve BHE's earnings during the 2-month period until BHE's rate case request is decided.

Seven of these filings became effective automatically upon 30-days notice, and one was approved by Commission order. All of these filings were requests for special rate contracts with individual customers, which were intended to retain existing electric load or induce incremental growth in electric sales. In the current BHE rate case, the Commission's Advocacy Staff recommends that the Commission require that ratepayers and shareholders share the risks associated with special rate contracts.

IV. MAINE PUBLIC SERVICE COMPANY

On November 13, 1995, the Commission approved a stipulation that set forth the major components of MPS'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 each subsequent February 1, MPS is permitted to increase retail rates by specified percentages.

A. Rate Stability Plan.

On February 1, 1997, MPS received its second annual retail rate increase of 2.9% pursuant to the RSP stipulation. On November 13, 1997, in Docket No. 97-830, MPS requested a retail rate increase totaling 7.59%. This request comprises MPS's annual increase of 2.75%, pursuant to the RSP stipulation, plus additional amounts reflecting price cap mechanisms that provide protection to the company in the event of poor earnings (2.62%) and Maine Yankee replacement cost sharing (2.22%).¹¹ MPS requests an effective date of February 1, 1998 for this rate increase.

B. Pricing Flexibility Program.

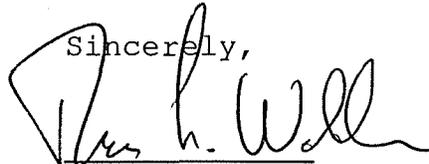
MPS's Flexible Pricing criteria are essentially the same as CMP's ARP provisions. During 1997, MPS filed four petitions that became effective automatically upon 30 days notice pursuant to its flexible pricing criteria. MPS filed two additional flexible pricing petitions that became effective by Commission orders. Four of MPS's filings were for approval of special rate contracts intended to retain existing electric load. The remaining two filings introduced discounts for optional

¹¹Under the MPS RSP, if Maine Yankee is shut down for longer than 6 months, then beginning with the seventh month of the outage, MPS is permitted a price cap increase equal to 50% of the net purchased power cost incurred to replace its Maine Yankee entitlement. The remaining 50% of these net costs accrue to shareholders and will be recognized in the computation of earnings for calculation of profit sharing.

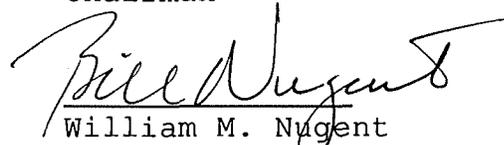
service rates intended to retain existing electric load or promote incremental electric sales.

Please contact any of us if you would like further information on any of these matters.

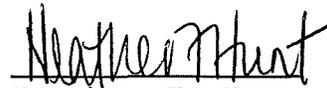
Sincerely,



Thomas L. Welch
Chairman



William M. Nugent
Commissioner



Heather F. Hunt
Commissioner