January 30, 2006

Honorable Philip Bartlett, Senate Chair
Honorable Lawrence Bliss, House Chair
Joint Standing Committee on Utilities and Energy
Augusta, ME 04333

Re: Reexamination of Provisional Rules on Incorporating Renewable Resources into Standard Offer Supply

Dear Senator Bartlett and Representative Bliss:

By letter dated June 1, 2005 (a copy of the letter is attached), the Utilities and Energy Committee (Committee) asked the Commission to revisit major substantive rules that were submitted for legislative review during the 2005 session. The rules, which were provisionally adopted by the Commission, would have provided standards and procedures for incorporating new renewable resources into the standard offer supply mix. For reasons summarized below, the Commission recommended that the Committee not authorize the rule. The Legislative Resolve on the major substantive rule, Resolves 2005, ch. 65, did not authorize the rule, but did state that the Commission may submit rules on the same subject matter for review during the 2006 session (a copy of the Resolve is attached). The Committee's June 1st letter articulated some of the concerns it had with the major substantive rules and concluded:

> While the committee did not arrive at consensus on what direction to give the commission on the matter, it did decide it would be useful for the commission to revisit the rule and submit the results next session. This letter is to request the commission undertake this reexamination.

This letter provides the results of the Commission's reexamination of the issues raised by the submission of the major substantive rules.

Background

During its 2004 session, the Legislature enacted an Act To Promote Economic Development in the State by Encouraging the Production of Electricity from Renewable and Indigenous Resources. P.L. 2003, ch. 665 (Act). Section 2 of the Act (codified at 35-A M.R.S.A. § 3212(4-A)) required the Commission to promulgate major substantive rules establishing standards and procedures for incorporating renewable resources into the standard offer supply mix. The Act specified that the rules must provide for the incorporation of new renewable resources into the standard offer supply only if such action would reduce price volatility, offer an effective hedging strategy, and provide a competitively priced supply option.

As required by the Act, the Commission conducted a rulemaking proceeding to consider the best means to incorporate new renewable resources into the standard offer supply consistent with the Act's provisions. On February 23, 2005, the Commission provisionally adopted rules that would establish standards and procedures for the periodic solicitation by the Commission of long-term bids to supply portions of the standard offer load from new renewable resources. *Amendments to Incorporate Renewable Resources Into Standard Offer Supply (Chapter 301), Order Provisionally Adopting Rule,* Docket No. 2004-606 (Feb. 23, 2005). Consistent with major substantive rulemaking procedures, the Commission submitted the provisional rules to the Legislature for review.

Legislative Review

The Commission's provisional rules came before the Committee in the form of a Resolve that would authorize final adoption of the rules (L.D. 1392). During the hearings on the Resolve, the Commission presented testimony in opposition to the authorization of the provisional rules (a copy of the Commission's April 27, 2005 testimony is attached). As stated in the April 27th testimony, the Commission summarized its opposition to the rules as follows:

> The Commission opposes adopting the amendments because they would place the costs and risks of the State's policy of promoting the development of new renewable resources on standard offer customers, while the benefits of that policy affect the public more generally. Because the majority of smaller customers receive generation through the standard offer, the costs would fall disproportionately on Maine's smallest consumers.

The Commission went on to explain that it already had adequate authority to procure standard offer supply in a manner that reasonably hedges against price volatility and that it had recently implemented that authority through the adoption of a bid segmentation approach for the residential and small commercial classes. That segmentation approach reduces price volatility for these classes by the solicitation of supply for only one-third of the standard offer load each year. Because the Commission had already acted to reduce price volatility in a commercially reasonable manner, we testified that the new renewable resource supply requirement that would be established through the adoption of the provisional rules would only act to increase the cost of price hedging. Thus, the provisional rules would primarily be a means to promote new renewable power (rather than a least costly price hedging mechanism) that would be paid for only by standard offer customers. The Commission concluded that this result would simply be unfair.

As mentioned above, the Committee voted not to approve the provisional rules, but did authorize the Commission to submit revised provisional rules during the next legislative session. That legal authorization was accompanied by the June 1st

Committee letter formally requesting that the Commission undertake a reexamination of the matter.

Commission Reexamination

The Commission has carefully reexamined the matter and has decided not to submit revised provisional rules for consideration during this session. The Commission's concern that caused it to oppose the provisional rules submitted during the last session is based on a fundamental flaw with the implementing statute. That statute, 35-A M.R.S.A. § 3212(4-A), authorizes the Commission to procure long-term arrangements with renewable generators only to provide supply for standard offer service. This results in the basic fairness issue described above. Because the fairness issue is inherent in the implementing statute, the problem cannot be addressed through a revision of the provisional rules. As stated in the Commission's April 27th testimony, if the Legislature wants to use the standard offer procurement process as the means to promote new renewable resources, the provisional rules submitted last session represent the best approach within the limits of the implementing statute. The Commission continues to recommend against such action.

The Commission, however, has been working with some members of the Committee and as a participant in the Renewable Resources Stakeholder Group to develop the aspects of a long-term contracting program that would promote the development of renewable resources and provide a price hedge to a wider range of electricity customers. The program would be developed so that the benefits, costs and risks are spread through the population of electricity ratepayers, rather than just standard offer customers. The Commission's efforts in this regard are described in an August 11, 2005 letter to the Committee Chairs (a copy of the letter is attached) and in a November 30, 2005 report by a sub-group on long-term contracts to the Renewable Resources Stakeholder Group (a copy of the report is attached). The Commission understands that the Renewable Resources Stakeholder Group submitted its final report to the Committee earlier this month.

The Commission looks forward to continuing the dialogue with the Committee on the issues surrounding the promotion of renewable resources, long-term contracting, and the hedging of price volatility.

Sincerely,

Public Utilities Commission
Kurt Adams, Chairman
Stephen L. Diamond, Commissioner
Sharon M. Reishus, Commissioner

Attachments

cc: Members of the Utilities and Energy Committee
Lucia Nixon, OPLA

SENATE

PHILIP L. BARTLETT II, DISTRICT 6, CHAIR
SCOTT W. COWGER, DISTRICT 21
CAROL WESTON, DISTRICT 23

I C. CLARK, SENIOR ANALYST
.ISTEN GOTTLIEB, COMMITTEE CLERK

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STATE OF MAINE

ONE HUNDRED AND TWENTY-SECOND LEGISLATURE

COMMITTEE ON UTILITIES AND ENERGY

June 1, 2005

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RECEIVED

Sharon M. Reishus, Acting Chair
Maine Public Utilities Commission
State House Station 18
Augusta, ME 04333-0018

Dear Commissioner Reishus:

As you know, this committee has voted to recommend against approval of the "hedging" provisions of the commission's standard offer rule, Chapter 301. The committee's amendment to LD 1392, the resolve concerning the rule, authorizes the commission to submit revised or new rules on the same subject matter for review in the Second Regular Session of the 122nd Legislature.

The committee had concerns about the rule, in particular the limitation of any cost impacts of long-term hedging contracts to residential and small commercial standard offer customers. Committee members also expressed concerns about directing transmission and distribution utilities to enter into hedging contracts as a means of spreading costs among all T&D ratepayers. While the committee did not arrive at consensus on what direction to give the commission on the matter, it did decide it would be useful for the commission to revisit the rule and submit the results next session. This is letter is to request the commission undertake this reexamination.

Thank you for your attention to this matter. We look forward to reviewing next year the results of the commission's work.

Sincerely,

Philip Bartlett II
Senate Chair

Lawrence Bliss
House Chair

cc: Members, Joint Standing Committee on Utilities and Energy

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APPROVED MAY 31 '05 BY GOVERNOR | CHAPTER 65 RESOLVES

STATE OF MAINE

IN THE YEAR OF OUR LORD TWO THOUSAND AND FIVE

H.P. 969 - L.D. 1392

Resolve, Regarding Legislative Review of Portions of Chapter 301: Standard Offer Service, a Major Substantive Rule of the Public Utilities Commission

Emergency preamble. Whereas, acts and resolves of the Legislature do not become effective until 90 days after adjournment unless enacted as emergencies; and

Whereas, the Maine Revised Statutes, Title 5, chapter 375, subchapter 2-A requires legislative authorization before major substantive agency rules may be finally adopted by the agency; and

Whereas, the above-named major substantive rule has been submitted to the Legislature for review; and

Whereas, immediate enactment of this resolve is necessary to record the Legislature's position on final adoption of the rule; and

Whereas, in the judgment of the Legislature, these facts create an emergency within the meaning of the Constitution of Maine and require the following legislation as immediately necessary for the preservation of the public peace, health and safety; now, therefore, be it

Sec. 1. Adoption. Resolved: That final adoption of portions of Chapter 301: Standard Offer Service, a provisionally adopted major substantive rule of the Public Utilities Commission that has been submitted to the Legislature for review pursuant to the Maine Revised Statutes, Title 5, chapter 375, subchapter 2-A, is not authorized. The commission may submit revised or new rules on the same subject matter for review in the Second Regular Session of the 122nd Legislature.

Emergency clause. In view of the emergency cited in the preamble, this resolve takes effect when approved.

STATE OF MAINE
PUBLIC UTILITIES COMMISSION
242 STATE STREET
18 STATE HOUSE STATION
AUGUSTA, MAINE
04333-0018

THOMAS L. WELCH
CHAIRMAN

STEPHEN L. DIAMOND
SHARON M. REISHUS
COMMISSIONERS

April 27, 2005

Honorable Philip Bartlett, Senate Chair
Honorable Lawrence Bliss, House Chair
Joint Standing Committee on Utilities and Energy
Augusta, ME 04333

Re: LD 1392, Resolve Regarding Legislative Review of Portions of Chapter 301: Standard Offer Service, a Major Substantive Rule of the Public Utilities Commission

Dear Senator Bartlett and Representative Bliss:

The Commission will testify in opposition to LD 1392, a Resolve that authorizes final adoption of amendments to the Commission's standard offer rule (Chapter 301). However, we offer two alternative proposals that we would not oppose.

The amendments adopted by LD 1392 establish standards and procedures for incorporating new renewable resources into standard offer service supply, to hedge against price volatility. The Commission opposes adopting the amendments because they would place the costs and risks of the State's policy of promoting the development of new renewable resources on standard offer customers, while the benefits of that policy affect the public more generally. Because the majority of smaller customers receive generation through the standard offer, the costs would fall disproportionately on Maine's smallest consumers.

Background. The Commission provisionally adopted amendments to its standard offer rule as a result of P.L. 2003, ch 665, sec. 2, which directed the Commission to adopt rules to incorporate new renewable resources into standard offer supply if it found that such action would "reduce the risk of price volatility, offer an effective hedging strategy and provide a competitively priced supply option." This legislative direction (as well as directives for the Commission to conduct a wind power study and inform consumers of the benefit of renewable resources) resulted from bills introduced last session that would have substantially amended the State's renewable resource portfolio requirement. In our view, the rulemaking directive had two purposes: 1) promotion of new renewable resources; and 2) reduction of price volatility for standard offer customers.

Comments on LD 1392. As explained in our Order Provisionally Adopting Rule (pages 2-4), the Commission already has adequate authority to procure standard offer supply in a manner that reasonably hedges against price volatility and has recently implemented a bid segmentation approach to reduce price volatility for residential and

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small commercial standard offer customers.[1] The new renewable resource supply requirement established through the provisional rule could only act to increase the cost of a price hedging mechanism. The rule would, however, be a means to promote renewable power, but only standard offer customers would fund the promotion. The Commission views this result as unfair and suggests consideration of two alternative promotional mechanisms that would spread the cost of the State's policy among a broader group of consumers.[2]

The first alternative would be to revise Maine's Resource Portfolio Standard (RPS), an approach that is proposed in LD 1065 and LD 1434.

The second alternative would be to authorize long-term contracts for new renewable resource suppliers through some means other than the standard offer. This approach would address what is asserted to be a primary barrier to construction of new generating facilities, which is that suppliers have difficulty obtaining long-term contracts and therefore have difficulty obtaining financing.[3] Depending on future market conditions (which cannot be predicted with any accuracy), long-term contracts could come at a significant price to consumers in the form of new stranded costs. However, they may also act to stabilize or lower rates for all customers. If the Legislature decides to promote new renewable resource development through long term contracts that are paid for through electricity rates, the Commission recommends that the T&D utilities be authorized to enter into such contracts under Commission direction with the output sold into the market at regular intervals (as is currently done with the output of QF contracts). Placing a MW cap on the contracted amount would limit ratepayer exposure. Under this approach, the general body of electricity ratepayers would pay the costs, take the risk, and obtain any price stability benefits, while limiting ratepayer exposure to a known level.

If the Legislature decides to use the standard offer supply procurement process to promote new renewable resources, the Commission recommends authorization of the provisional rule with one addition. The provisional rule provides flexibility for new renewable resource suppliers to include terms in their proposals that would satisfy the goals of the rule. It establishes time frames for bid solicitations, confines the procedures

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[1] During each solicitation, the Commission will obtain 1/3 of the standard offer requirements. The Commission carried out the first solicitation under this arrangement in Fall 2004.

[2] In addition, because the law requires that the renewable power must be competitively priced, there is some likelihood that the rule will result in no viable long-term contracts.

[3] As discussed in our testimony on LD 1065, the causal relationships among market activities and government and regulatory support mechanisms are subject to considerable disagreement.

It is interesting to note that, to deal with complaints that financing for new generation is difficult to obtain, ISO-NE, at the direction of the FERC, is developing a new installed capacity requirement that intends to incent new generation by providing generators with higher capacity payments. If adopted, the proposal, which is currently the subject of litigation, would put upward pressure on electricity prices in New England. Since all forms of generation would be entitled to the payments, the requirement may also increase the amount of renewable power.

to residential and small commercial solicitations, and defines what resources may be considered new.

The Commission would request that the Legislature make a change to the implementing statute and the rule to grant the Commission the authority to require utilities to enter into contracts with new renewable resource suppliers. Current law only allows the Commission itself or a standard offer provider to enter into such contracts. This is problematic because the Commission is not a market participant and individual standard offer providers typically have only short-term obligations, making long term supply contract requirements impractical.

Requirements of Title 5. 5 M.R.S.A. § 8072 requires that the Committee consider eight requirements in its review of a major substantive rule. We discuss each:

- *Whether the agency has exceeded the scope of its statutory authority in approving the rule.* The Commission has provisionally adopted Chapter 301 pursuant to P.L. 2003 ch. 665.
- *Whether the rule is in conformity with the legislative intent of the statute the rule is intended to implement.* The revisions to the rule carry out the intent of the directing statute by directly adopting the requirement to make the three findings required in statute as the condition for incorporating renewable resources into standard offer service.
- *Whether the rule conflicts with any other provision of law or rule.* No such conflict exists.
- *Whether the rule is necessary to fully accomplish the objectives of the statute.* While the revisions to the rule are required to guarantee that the law's requirements are carried out, as we have discussed in our testimony, the law's goals may be met through current Commission authority and are being furthered by current practice.
- *Whether the rule is reasonable, especially as it affects the convenience of the general public or of persons particularly affected by it.* The revisions to the rule do not conflict with this requirement.
- *Whether the rule could be made less complex or more readily understandable for the general public.* The revisions to the rule will be understandable to suppliers who bid on standard offer service.
- *Whether the rule was proposed in compliance with the requirements of this chapter and with requirements imposed by any other provision of law.* As described in the Commission's order, the rulemaking was conducted in compliance with the requirements in Title 5.
- *For a rule that is reasonably expected to result in significant reduction in property values, certain requirements exist.* The rule will not result in a reduction in property values.

Sincerely,

Marjorie R. McLaughlin

Marjorie R. McLaughlin
Legislative Liaison

cc. Members of the Utilities and Energy Committee
Jon Clark, Committee Analyst

STATE OF MAINE
PUBLIC UTILITIES COMMISSION
242 STATE STREET
18 STATE HOUSE STATION
AUGUSTA, MAINE
04333-0018

RT ADAMS
CHAIRMAN

STEPHEN L. DIAMOND
SHARON M. REISHUS
COMMISSIONERS

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 a 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 (JD)

Kurt Adams
Chairman

Long-Term Contracts Sub-Group
Report[1]
Nov. 30, 2005

Participants

There were two meetings of the sub-group. The following participated in one or both of the meetings:

Kurt Adams, Rep. Stacey Fitts, Beth Nagusky, Steve Ward, Sharon Statz, Chris Hall, Bill Short, Dave Wilby, Dain Trafton, Newell Augur, Jeff Jones, David Allen, Tony Buxton, Dan Sosland, Ed Howard, Mitch Tannenabum

General Outcome

The sub-group came to a general consensus on many aspects of two variants of a long-term contracting program, which are not mutually exclusive. The general consensus does not mean that participants believe that a long-term contracting program should be adopted by the legislature; rather, the consensus means that, if a program is adopted by the Legislature, it should have the aspects described in this report. Additionally, general consensus does not mean that every participant necessarily agrees with all aspects of a program as outlined in this report.

Long-Term Contracting Program

The sub-group discussed two variants of a long-term contracting program. The first would use the contracted power to provide a price volatility hedge to the general body of ratepayers and is generally based on the PUC's August 11, 2005 letter to the Committee Chairs. The second, referred to as "targeted aggregation," would provide a ratepayer credit "backstop" to commercial and industrial customers who enter into long-term power contracts. The following are the aspects of both variants discussed by the sub-group.[2]

Price Hedging Program

-Principal Goal: The group agreed that the goals of the program should include the provision of a hedge for the general body of ratepayers against price

[1] This report has been prepared by PUC staff; it has not been reviewed by participants in the sub-group.
[2] One participant expressed concern regarding the resource implications involved in administering a long-term contract program.

volatility and to promote the development of new renewable resources. The group did not come to a consensus as to the principal goal of the program.

-Qualifying Resources: The group generally agreed that qualifying resources should be limited new resources,[3] but not necessarily to new renewable resources. Renewable resources would be given some preference in the evaluation process through the objective of increasing resource diversity. The definition of a "new" resource requires further discussion. There was some discussion regarding the inclusion of efficiency resources, but the group came to no conclusion on the matter.

-Contract Term: The group agreed that contracts should be between 3 and 20 years.[4]

-Amount Cap: The group agreed that there should be a firm cap on the amount of energy under contract of 20% of annual usage on a service territory basis. The 20% includes energy from existing QF contracts.

-Price Cap: The group agreed that there should not be a firm cents/kWh cap on contracts, but that contracts should not exceed current market price at the time of contracting.

-Solicitation Process: The group agreed that the PUC would conduct the solicitation process and determine the winning contracts. The Commission would conduct solicitations periodically.

-Evaluation Criteria: The group agreed that contracts should be evaluated based on price, diversity of resources, and diversity of contract type (e.g. contract length).

-Renewable Energy Credits: The group agreed that there would be no requirement that RECs be sold with the power. The matter would be determined through the bid evaluation process.

-Disposition of Power: The group agreed that that the power from the contracts would be periodically sold into the market in a similar manner as current utility QF entitlements.

-Contracting Entity: The group generally agreed that the utility is in the best position to be the contracting party. However, the group agreed that significant further work would be required to ensure proper risk protection for the utilities.

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[3] Ed Howard could not agree to restrict qualifying resources to new resources.
[4] One participant expressed interest in the exploration of 30-year arrangements based on the cost of service.

-Large Customer Opt-Out: There was insufficient time to discuss the issue of whether large customers should be able to "opt-out" of the benefits and costs of a long-term contracting program.

-COU Opt-Out: The group agreed that COUs should be able to opt-out of the requirements under a long-term contract program.

Targeted Aggregation Program

-Concept: The group discussed an alternative concept offered by Chairman Adams referred to as "targeted aggregation" and generally agreed that the concept deserved further exploration. The general concept is for a ratepayer backstop of commercial and industrial load obligations to support new generation project development. Essentially, C&I customers would receive ratepayer backstop benefits in the event they default on a long-term contract used to secure generator financing. The state or utility providing the backstop would have recourse against the customer or its estate in the event of default. There should be an inherent LMP benefit as a trade-off for ratepayer risk.

-Program Attributes: The program would limit the circumstances in which ratepayers might be responsible for new stranded costs, would be less disruptive to the goals of industry restructuring, and could provide a benefit to credit distressed industries in the State. The program would not provide the price volatility hedge for general body of ratepayers.

-Qualifying Resources: The group generally agreed that qualifying resources should be limited to new resources, but not necessarily new renewable resources. Renewable resources might, however, be given some type of preference.

-Utility Credit Backstop: The group agreed that further discussion is required regarding how the backstop would work and the possible risks and appropriate protections for the utilities.

-PUC Involvement: The group agreed that the program would be subject to PUC oversight.