BEFORE THE

MAINE PUBLIC UTILITIES COMMISSION

CENTRAL MAINE POWER: Re: Request for Approval of an Alternative Rate Plan (Arp 2014) Pertaining to Central Maine Power Company.	Docket No. 2013-168

DIRECT TESTIMONY

OF

TIM WOOLF

ON BEHALF OF THE

MAINE PUBLIC ADVOCATE OFFIC

December 12, 2013

Office of the Public Advocate

112 State House Station

Augusta, Me 04333-0112

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1. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name, title, and employer.

A. My name is Tim Woolf. I am Vice President at Synapse Energy Economics, located at 485 Massachusetts Avenue, Cambridge, MA 02139.

Q. Please describe Synapse Energy Economics.

A. Synapse Energy Economics is a research and consulting firm specializing in electricity and gas industry regulation, planning and analysis. Our work covers a range of issues, including integrated resource planning; economic and technical assessments of energy resources; electricity market modeling and assessment; energy efficiency policies and programs; renewable resource technologies and policies; and climate change strategies. Synapse works for a wide range of clients, including attorneys general; consumer advocates; public utility commissions; environmental groups; federal agencies including the Environmental Protection Agency, Department of Energy, Department of Justice, and Federal Trade Commission; and the National Association of Regulatory Utility Commissioners. Synapse has over 20 professional staff with extensive experience in the electricity industry.

Q. Please summarize your professional and educational experience.

A. I have worked on a variety of electricity industry planning and regulatory issues for over 30 years. As Vice President of Synapse, I am responsible for providing expert testimony, preparing reports, conducting technical analyses, managing and participating in stakeholder working groups, and providing technical support to a range of clients.

From 2007 through 2011, I was a commissioner at the Massachusetts Department of Public Utilities (DPU). In that capacity I was responsible for overseeing a significant expansion of clean energy policies, including significantly increased ratepayer-funded energy efficiency programs; an update of the DPU energy efficiency guidelines; the implementation of decoupled rates for electric and gas companies; the promulgation of net metering regulations; review of smart grid pilot programs; and review and approval of long-term contracts for renewable power. I was also responsible for overseeing a variety of other dockets before the commission, including several electric and gas rate cases.

Prior to being a commissioner at the Massachusetts DPU, I was employed as the Vice President at Synapse Energy Economics; a Manager at Tellus Institute; the Research Director of the Association for the Conservation of Energy; a Staff Economist at the Massachusetts Department of Public Utilities; and a Policy Analyst at the Massachusetts Executive Office of Energy Resources.

I hold a Master's degree in Business Administration from Boston University, a Diploma in Economics from the London School of Economics, a BS in Mechanical Engineering and a BA in English from Tufts University.

Q. Please describe your professional experience as it relates to performance-based ratemaking, decoupling, and ratemaking in general.

A. In the 1990s, when the electricity industry was debating whether and how to introduce restructuring, I addressed performance-based ratemaking (PBR) for several of my clients, including the Delaware Public Service Commission Staff, the Mississippi Attorney General, the Kentucky Attorney General, the Colorado Office of Energy Conservation, and the Connecticut Office of Consumer Counsel. In 1997, I was the editor and co-author of a report prepared for the National Association of Regulatory Commissioners entitled "Performance-Based Ratemaking in a Restructured Electricity Industry." I have also published articles on PBR in *Public Utilities Fortnightly* and *The Electricity Journal*.

More recently, I addressed many issues related to PBR while I was a commissioner at the Massachusetts DPU. I oversaw several rate cases for electric utilities where PBR was the underlying structure of the rate-setting process. Furthermore, I was the lead commissioner on the Department's generic docket investigating revenue decoupling, where one of the key issues pertained to the adjustments that should be made between rate cases in the PBR mechanism, in light of the introduction of decoupling.

Even more recently, from August 2012 through June 2013, I was a co-leader of the Massachusetts Grid Modernization stakeholder working group process, as a consultant to the Massachusetts DPU. This working group debated in detail the various regulatory options for encouraging and incentivizing smart grid investments, and PBR emerged as one of the central options evaluated by the group.

Q. On whose behalf are you testifying in this case?

A. I am testifying on behalf of the Maine Office of the Public Advocate (OPA).

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address several of the policy issues raised by Central Maine Power Company's (CMP, or the Company) 2014 Alternative Rate Plan (ARP2014). I focus on the recovery of capital costs; the Revenue Index Mechanism (RIM) proposal; and the decoupling proposal. My testimony responds to the initial and supplemental testimony of the Policy Panel provided by Steven Adams, Eric Stinneford, and Laney Brown, as well as the initial and supplemental decoupling testimony provided by Mr. Lahtinen. My testimony builds off of the testimony of other witness for the OPA, particularly the testimonies of Charlie King, Tom Catlin, and David Dismukes.

2. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Q. Please summarize your primary conclusions.

A. My primary conclusions include the following:

- The Company's proposed ARP2014 is not consistent with the underlying principles of performance-based ratemaking, nor does it meet the original goals of the Commission when it established CMP's Alternative Rate Plan in 1994.
- The Company's proposed ARP2014 represents a fundamental shift in ratemaking policy relative to ARP2008, yet CMP has not provided justification for such a dramatic shift.
- The Company's proposed Rate Index Mechanism essentially provides CMP with pre-approval of its current capital expenditure plan and allows CMP to recover projected capital costs each year of the ARP2014 period, regardless of whether the costs are incurred.
- The Company's proposed Rate Index Mechanism significantly reduces the financial incentive for CMP to plan for and operate the company as efficiently as possible.

- The Company's proposal for recovery of the regulatory liability further reduces the financial incentive for CMP to plan for and operate the company as efficiently as possible.
- In total, the Company's proposal significantly reduces risk to the Company and its shareholders, and shifts an unacceptable amount of risk to the utility customers.
- The Company's decoupling proposal will mitigate the Company's desire to increase customer charges; reduce the pressure for recovery of increased costs through the Rate Index Mechanism; and eliminate the negative financial incentives that CMP faces with regard to demand-side resources.

Q. Please summarize your primary recommendations.

A. My primary recommendations include the following:

- The Commission should reject the Company's proposed ARP2014 on the basis of my findings above.
- The Commission should require the Company to ensure that its new Alternate Rate Plan meets the key objectives of performance-based ratemaking, as well as the objectives identified by the Commission.
- The Commission should make a distinction between the treatment of "baseline" capital expenditures (i.e., standard capital expenditures to maintain reliability and quality of service), and "major" capital expenditures (i.e., large, infrequent expenditures for distinct projects).
    - Baseline capital expenditures should be recovered through the ARP mechanism, as they have been to date.
    - Major capital expenditures should be recovered using traditional, cost-of-service ratemaking, i.e., outside of the ARP mechanism.
- The Commission should require that the X-factor used in the ARP2014 mechanism:
    - Reflects the potential productivity improvements from baseline capital expenditures, but not major capital expenditures.

- Be more clearly tied to relevant performance of peer utilities, and should not be designed to recover costs associated with the Company's projected capital plan.
- Be set to the factor proposed by Mr. King in his testimony for the OPA.

- The Commission should reject the Company's proposal to use $29.5 million of the regulatory liability to enable it to recover its allowed return on equity.
- The Commission should approve the Company's proposal to decouple revenue from sales, and require specific measures to protect consumers in light of this significant ratemaking development. These measures include: reducing the Company's allowed return on equity (ROE) to reflect the reduced risk resulting from the RDM; installing a cap of one percent of total revenues on the annual decoupling adjustment; and modifying the ROE threshold for the Company's earnings sharing mechanism so that it is commensurate with the new ROE allowed by the Commission in this docket.

3. OBJECTIVES OF THE ALTERNATE RATE PLAN

Q. Is the Alternate Rate Plan currently in place a form of performance-based ratemaking?

A. Yes. The Company's current Alternate Rate Plan (ARP2008) is a form of performance-based ratemaking. It was first established in Maine at a time when regulators in New England and elsewhere were investigating options for introducing greater competition into the electricity industry. Several states adopted various forms of PBR at that time, with the goal of creating more market-like incentives for an electric utility to increase its operational efficiency and maintain high-quality service to customers.

Q. Please provide a brief description of performance-based ratemaking.

A. Performance-based ratemaking can take a variety of forms. However, it typically includes several key elements.

- The initial (first year) rates are set in a rate case, based upon the revenue requirements in a historical test year, using traditional cost-of-service principles.

- The utility is not allowed to apply for a rate case for a fixed period of time, e.g., five years or more.
- Because of the presumably longer period of time between rate cases, the utility is allowed to increase the first-year rates by a predetermined amount at regular intervals between rate cases.
- The amount by which rates can be increased between rate cases is set in such a way as to provide the utility with the flexibility and the incentive to manage its expenditures so as to reduce costs, increase operational efficiency and increase profits. This is often achieved by allowing the utility to increase rates by inflation minus a productivity factor, where the productivity factor is an indication of how the utility can improve its operational efficiency relative to a group of peer utilities.
- Customer service and reliability standards are established to ensure that a utility's incentive to reduce costs does not lead to reduced quality of service to customers.
- Earnings sharing mechanisms are sometimes established to protect consumers from utilities earning especially high returns on equity (ROE), or to protect utilities from earning especially low ROEs.

Note that the description above pertains to a price-cap form of PBR. It is also possible to apply the same elements using a revenue-cap form of PBR, where the utility is allowed a fixed amount of revenue requirements, and the allowed revenues are adjusted between rate cases instead of the prices. With a revenue-cap PBR, a utility's revenues are decoupled from its sales levels, which eliminates the utility's financial incentive to increase sales or to oppose activities that reduce sales.

Q. What are the key objectives of performance-based ratemaking in general?

A. Performance-based ratemaking has several objectives, including the following:

1. To provide the utility with the flexibility and proper financial incentives to make sound management decisions to reduce costs and improve operational efficiency.

2. To strike the appropriate balance between the risks to the utility versus the risks to customers, by tying the utility's risk more closely to its managerial decisions regarding expenditures and operational efficiency.

3. To establish a target set of rates (or revenues) that gives the regulators some confidence that revenues recovered by a utility between rate cases will be limited, reasonable and appropriate.

4. To reduce the time and resources necessary for a commission and other stakeholders to review a utility's costs in rate cases. Less time should be required to review a utility's costs because there is a presumption that such costs are reasonable as long as they are consistent with inflation and the productivity trends of their peer utilities.

Q. Has the Commission articulated its objectives for the Company's Alternative Rate Plan?

Yes. In the Commission's Order of Partial Dismissal on August 2, 2013, the Commission noted that it had previously approved price-cap rate plans "to encourage efficiencies and cost effectiveness." The Commission quoted its order approving CMP's first ARP to reiterate that the benefits and objectives of an ARP include:

> (1) Electricity prices continue to be regulated in a comprehensible and predictable way;
>
> (2) Rate predictability and stability are more likely;
>
> (3) Regulatory "administration" costs can be reduced, thereby allowing for the conduct of other important regulatory activities and for CMP to expend more time and resources in managing its operations;
>
> (4) Risks can be shifted to shareholders and away from ratepayers (in a way that is manageable from the utility's financial perspective); and
>
> (5) Because exceptional cost management can lead to enhanced profitability for shareholders, stronger incentives for cost minimization are created.[1]

[1] Order of Partial Dismissal, pp. 5-6, citing Central Maine Power Company, Proposed Increase in Rates, Docket No.92-345, Order at 130 (December 14, 1993).

Q. Have the Company's Alternative Rate Plans to date achieved these objectives?

While I have not had the opportunity to review the historical performance of the Company in detail, it appears as though the current Alternate Rate Plan (ARP2008) has been successful. The Company has apparently maintained its distribution system sufficiently to provide safe, reliable service. CMP characterizes its distribution system as being "in good to very good condition based on the findings of the recent comprehensive asset health studies,"[2] and notes that it has met its System Average Interruption Frequency Indicator (SAIFI) and Customer Average Interruption Duration Indicator (CAIDI) service quality indicators in all but one instance over the last 13 years.[3] Furthermore, the Company has earned a reasonable rate of return on equity, ranging from a low of 9.62 percent to a high of 12.59 percent.[4]

Q. Does the Company's proposal for ARP2014 achieve the objectives of performance-based ratemaking or the objectives of ARP outlined by the Commission?

A. No. The Company's ARP2014 proposal includes two provisions that will result in a significant deviation from performance-based ratemaking, and that will make the ARP2014 inconsistent with the key objectives of PBR and the key objectives outlined by the Commission.

First, the Company's ARP2014 proposal essentially provides the Company with pre-approval and automatic recovery for its projected capital expenditures plan. I explain why this is so in Section 4. Pre-approval and automatic recovery of expenditures is not consistent with PBR practices in general, nor is it consistent with the Alternative Rate Plan objectives identified by the Commission.

Second, the Company's proposal includes a provision to use the regulatory liability depreciation schedule to ensure that it will earn its allowed ROE. This is a significant deviation from PBR because it essentially guarantees the Company its allowed ROE, regardless of how well the Company performs. I discuss this issue below in Section 5.

[2] Reynolds, Kruppenbacher, Montanye, Conroy, Wacker. Supplemental Testimony of the Capital Investment Panel, September 20, 2013. SUP-CAP-1 to SUP-CAP-2

[3] Reynolds, Kruppenbacher, Montanye, Conroy, Wacker. Supplemental Testimony of the Capital Investment Panel, September 20, 2013, SUP-CAP-2

[4] Response to Examiner 019-004.

Q. Why is it so important to acknowledge that the Company's proposal is a significant deviation from performance-based ratemaking?

A. In establishing any rate plan, it is important to identify the rationale and the objectives of the ratemaking framework, so that a proposed rate plan can be evaluated relative to that framework. Performance-based ratemaking is a useful framework for reviewing the Company's ARP2014 proposal.

It is important to note that PBR can be applied in a variety of forms. There is no one single formula that must be used in all applications. When I refer to a "deviation" from PBR, I am referring to a modification that is inconsistent with the fundamental principles and objectives of PBR.

Q. Are there any instances where it may be appropriate to deviate from the performance-based ratemaking framework?

A. Possibly. There may be good reasons why it would be appropriate to deviate from a PBR framework because of lessons learned over time or significant changes to the electric utility or to the electricity industry in general. However, if the Company wishes to deviate from a PBR framework in designing its ARP, it should be allowed to do so only if it meets three important criteria. First, the proposal must be appropriate (i.e., it must meet the overall ratemaking goals of the Commission). Second, the proposal must be justified (i.e., the Company must demonstrate why there is a need to deviate from PBR). Third, the proposal must be transparent (i.e., it must be clear to the Commission and other stakeholders how the proposal works relative to the PBR framework).

Q. Are there other ratemaking frameworks that the Commission should bear in mind while reviewing the Company's ARP2014 proposal?

A. Yes. I am not suggesting that the PBR framework is the only option available or appropriate. Traditional cost-of-service ratemaking is still in use in many states and is still a viable framework for utility ratemaking. My main point is that CMP's ARP was originally established as a PBR framework, and that framework should be used to evaluate the Company's ARP2014 proposal. If the Company wishes to deviate from that framework—whether it is relying upon traditional cost-of-service ratemaking or some other framework—it should only be allowed to do so if the proposal is appropriate, justified and transparent.

Q. Is the Company's ARP2014 proposal appropriate, justified and transparent?

A. No. The Company's proposal for the treatment of capital costs represents a significant deviation from PBR, but it is not appropriate, it has not been justified by CMP, and it is not transparent. I explain why this is so in the following section.

Q. What are the implications of the Company's proposal to deviate from PBR practices?

A. The Company's ARP2014 proposal will not achieve any of the four PBR objectives that I identify above. First, the Company will not have the financial incentive to improve operational efficiency, because its current capital expenditure plan will essentially be pre-approved by the Commission and because CMP will be guaranteed its allowed ROE as a result of its proposal regarding the regulatory liability depreciation schedule.

Second, the ARP2014 proposal does not strike an appropriate balance of risks between the utility and the customers, because pre-approval of the capital expenditure plan shifts a significant amount of risk from the utility to the customers.

Third, the ARP2014 proposal does not provide any confidence, at least for the OPA, that the Company's expenditures during the term of the ARP will be appropriate relative to peer utilities. The productivity factor proposed by CMP is apparently designed to allow the Company to recover the costs of its projected capital plan and is not sufficiently tied to productivity or to the performance of peer utilities.

Fourth, the ARP2014 proposal does not reduce the need for regulatory oversight, because the Commission is essentially asked to pre-approve the Company's proposed capital expenditure plan. In order to make a determination as to whether the proposed plan is reasonable, the Commission and other intervenors would have to spend a considerable amount of effort to review the details of the plan.

Q. What do you recommend with regard to these issues?

A. I recommend that in evaluating the various elements of the Company's proposal for ARP2014, the Commission be mindful of how likely it is that the proposal will achieve the overall goals of PBR and the specific objectives identified by the Commission. Those elements that are not consistent with these goals and objectives should be rejected. I provide more specific recommendations in the following sections.

4. TREATMENT OF CAPITAL COSTS

Q. Please summarize the Company's proposal for the recovery of capital costs in its initial filing in this docket.

A. In its May 1, 2013 initial filing, CMP proposed to deviate significantly from both ARP2008 capital spending levels and the manner in which capital costs are recovered. CMP's proposed capital investment plan was projected to "average nearly $90 million per year, which is approximately one-third greater than the level of distribution capital investment during ARP2008…" (not adjusted for inflation).[5] CMP's capital investment plan included annual investments in base distribution capital programs, as well as significant investments in "distribution system modernization" projects, "distribution asset condition improvement projects," and a new IT system: the Customer Relationship Management & Billing System (CRM&B).

Figure 1 shows CMP's proposed capital investment levels relative to recent historical amounts, adjusted for inflation.[6] As indicated, the Company's average capital investment expenditure levels for 2014 (upper dashed line) exceed average ARP2008 expenditure levels (lower dashed line). However, this increase is due almost entirely to the CRM&B system, described by CMP as representing "a large, once in a generation" replacement of CMP's customer relations and billing system with an estimated cost of approximately $55 million.[7] When this major capital project is removed, the inflation-adjusted average ARP2014 capital expenditures (dotted black line) are essentially identical to the inflation-adjusted average ARP2008 capital expenditures (dashed red line).

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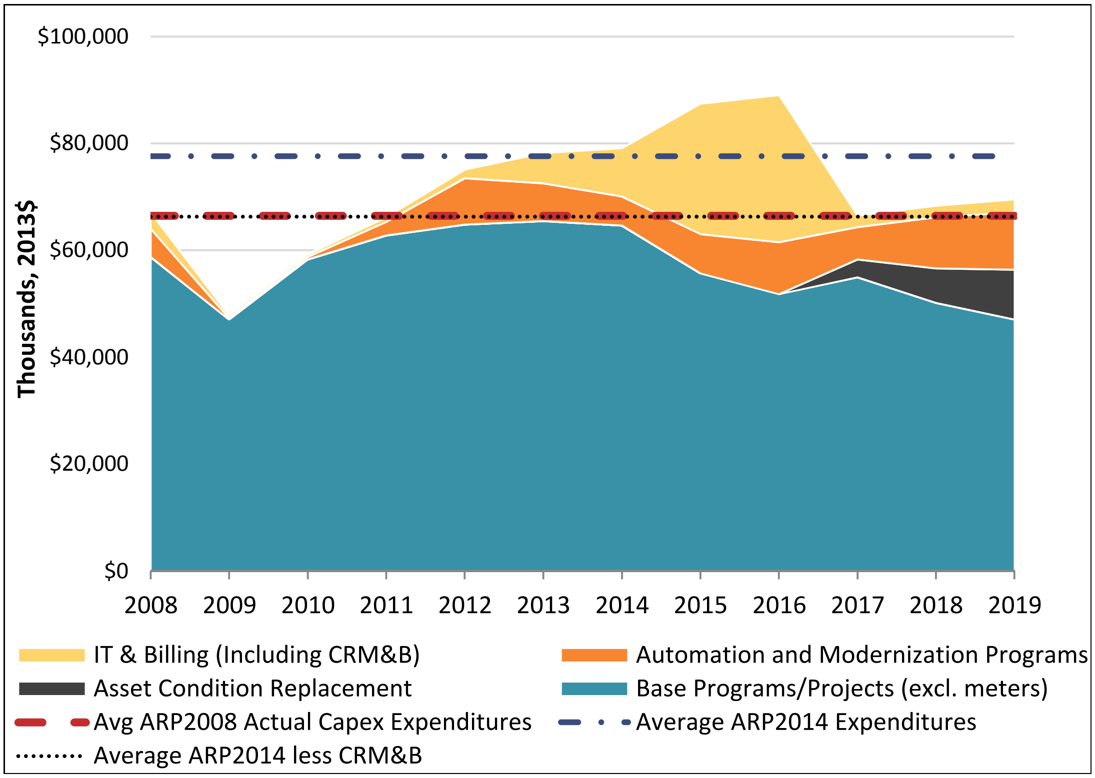
[5] Stinneford. CMP Filing Letter, Docket No. 2013-168, May 1, 2013, Page 2.

[6] Inflation adjustments made using Handy-Whitman Index for prior year through 2011. For 2012 – 2019, the adjustments use a projected Handy-Whitman Index increasing at 3.8 percent based upon the average percent increase from 2008 to 2011.

[7] Reynolds, Kruppenbacher, Montanye, Conroy, Wacker. Supplemental Testimony of the Capital Investment Panel, September 20, 2013, SUP-CAP-2.

Figure 1. CMP's proposed capital investments[8]



Q. How did CMP propose to recover the costs associated with its capital investment plan in its initial filing?

In its initial filing, CMP proposed to alter the previous ARP mechanism to allow separate treatment of capital costs. CMP proposed to maintain the (Inflation – X) formula for O&M expenses, while applying a capital recovery mechanism (CRM) with pre-established annual revenue requirements for capital cost recovery. The capital recovery mechanism would also enable net plant reconciliation and allow the company to retain net plant savings within a 10 percent bandwidth, provided System Average Interruption Frequency Indicator (SAIFI) or Customer Average Interruption Duration Indicator (CAIDI) performance targets were met. This net plant reconciliation mechanism would apply to plant investments other than the CRM&B.

[8] Graph created from CMP's response to OPA-023-007, with metering costs omitted due to separate treatment of AMI costs.

Q. What was the OPA's response to the Company's original proposal?

A. On June 19, 2013, the OPA filed a Motion and Brief seeking dismissal of CMP's cost recovery mechanism, arguing in part that the Company's proposal inappropriately shifts the risks and burdens from the Company to ratepayers.

Q. How did the Commission rule on the OPA's petition?

The Commission granted OPA's motion, citing a number of factors, including that the CRM removes one of the core objectives of an ARP (the elimination of the incentive to over-capitalize), and shifts the risk of overestimation and uncertainty to ratepayers. The Commission declined to pre-approve CMP's capital plan, stating:

> We are also not persuaded by CMP's arguments that its 6-year capital distribution plan should be fully vetted and blessed by the Commission in this proceeding. Detailed long-term capital planning is an activity that, at least in detail, should be left to management subject to prudency review. In addition, as a practical matter, by requiring that the parties and the Commission pre-approved specific capital programs years in advance, whenever CMP acknowledges that there is uncertainty relating to the timing, cost and even the ultimate need for the projects, the CRM introduces a level of predictive uncertainty into the ratemaking process that we find to be unacceptable.[9]

In essence, the Commission refused to allow the Company to collect revenues through its CRM for capital investments that are uncertain in their timing, cost, and need, and declined to engage in pre-approval of capital expenditures, reasoning that such decisions should be left to management subject to prudency review.

Q. Please describe the Company's current proposal.

A. CMP submitted supplemental testimony on September 20, 2013 that responded to the Commission's Order of Partial Dismissal. In this testimony, CMP reiterated its intention to move forward with its capital investment plan as laid out in its May 1, 2013 filing, but with a different cost recovery mechanism. The Company's testimony states that "CMP continues to believe that the investments and programs included within the Plan are appropriate for implementation during ARP2014. As such, CMP continues to offer the

[9] Order of Partial Dismissal, p.7

May 1 testimony of the Capital Investment Panel, with the exception of the capital investment delivery metrics…."[10]

Q. How does the Company propose to recover these capital costs?

A. To support this capital investment plan, the Company proposed to employ a Revenue Index Mechanism (RIM) equal to (Inflation – X).

Q. Do you have any concerns about the Company's Revenue Index Mechanism?

A. Yes, my general concern is that CMP has designed the Revenue Index Mechanism, particularly the X-factor, so that the Company will be able to recover those revenues needed to pay for its projected capital expenditure plan. This approach has several flaws: it is a significant deviation from PBR; it will essentially result in pre-approval of the Company's capital expenditure plan; it will reduce the Company's incentive to optimize its capital expenditures and O&M costs; and it will shift risk from the utility to its customers.

Q. How does the Company's proposed Revenue Index Mechanism differ from previous ARPs, and how does it deviate from PBR?

A. As in ARP2008, the Company's proposed RIM is equal to (Inflation – X). However, the X-factor proposed by the Company for ARP2014 was intentionally designed to allow the Company to recover enough revenue to undertake the same capital expenditures that it proposed in its initial filing. In previous ARPs, rates were allowed to increase between rate cases by inflation minus a productivity factor, where the productivity factor was designed to provide CMP with financial incentives to improve operational efficiency relative to comparable peer utilities.

The RIM proposed for ARP2014 bears superficial resemblance to the mechanism used in previous ARPs, but differs in several key ways. In particular, the X-factor now includes a "K" factor in order to allow CMP to recover revenue to support its capital expenditure plan. Company Witness Mark Lowry states this in several responses to discovery, including the following:

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[10] Reynolds, Kruppenbacher, Montanye, Conroy, Wacker. Supplemental Testimony of the Capital Investment Panel, September 20, 2013, SUP-CAP-3.

- "Dr. Lowry's approach to the calculation of the K factor is a sensible means of providing the Company with supplemental revenue to finance its capex program."[11]
- "[The K factor] will help the Company finance a program of higher capital spending that began in the expiring ARP."[12]
- "A K factor has been calculated only for the present proceeding, in which CMP has special capex needs but the Commission prefers not to rely heavily on company forecasts to establish compensation."[13]

Q. In what way does the Company's proposal essentially constitute pre-approval of its capital expenditure plan?

A. The Company has abandoned its originally proposed Capital Recovery Mechanism, but not its request to recover its proposed capital investment costs as set forth in its May filing. Rather, it appears that the Company has simply designed another mechanism—a RIM with a negative X-factor— "for the recovery of the Company's incremental capital investments and related costs."[14]

Table 1. May 1 Revenue Requirement and Supplemental Revenue Forecast

Rate Year	Revenue Requirement in May 1 Filing	Supplemental Revenue Forecast	Percent Difference
RY 1	$246,040	$241,792	-2%
RY 2	$263,770	$258,722	-2%
RY 3	$280,871	$275,542	-2%
RY 4	$297,736	$292,068	-2%
RY 5	$312,818	$305,059	-2%
Total for RY1-RY5	**$1,401,235**	**$1,373,183**	**-2%**

Sources:
May 1 Revenue Request from Exhibit RRP-2 of May 1 Revenue Requirements Testimony.
Supplemental Revenue Forecast from Exhibit SUP-RRP 2, p.3 of 32, of Supplemental Revenue Requirements Testimony.

As designed, this mechanism will allow the Company to recover essentially the same amount of revenue as previously proposed, thereby implicitly requesting pre-approval of

[11] Response to OPA-029-005.
[12] Response to OPA-029-001.
[13] Response to OPA-029-002.
[14] Reynolds, Kruppenbacher, Montanye, Conroy, Wacker. Supplemental Testimony of the Capital Investment Panel, September 20, 2013, SUP-CAP-1.

the CMP capital expenditure plan. In fact, the revenues that would be recovered from the Company's September Supplemental filing differ very little from the Company's revenue requirement set forth in its May 1 testimony.

Table 1 presents the revenue requirement included in the Company's initial filing in this docket, compared to the forecast of supplemental revenues that would be recovered by CMP under its current proposal for the Revenue Index Mechanism. As indicated the difference between these two revenue streams is very small, on the order of two percent.

Q. What is wrong with the Company essentially asking for pre-approval for its capital expenditure plan?

As noted above, in its Order of Partial Dismissal the Commission has rejected the concept of regulatory review of the Company's capital expenditure plan in this docket. The OPA agrees with the Commission's findings in that order. The purpose of the ARP mechanism is not to conduct an *a priori* regulatory review of the Company's projections and estimates of future expenditures—either capital or O&M expenditures. The purpose of the ARP mechanism is to set a reasonable cap on prices (or revenues) between rate cases, so that the Company has the flexibility and the incentive to make efficient and prudent decisions regarding expenditures and operational improvements.

In addition, pre-approval of capital expenditures is not consistent with PBR. It reduces the Company's financial incentive to optimize costs and increase operational efficiency between rate cases.

Pre-approval of capital expenditures is also inconsistent with PBR because it shifts risk from the Company to its customers. With pre-approval of expenditures, a utility has the incentive to overstate the estimated future capital costs. In order to prevent this, the Commission and other intervenors must spend a considerable amount of time and resources to review and assess the proposed capital expenditures. The OPA is not in a position to conduct such a review in this docket, nor does it need to conduct such a review given that it would not be consistent with PBR in general or the Alternative Rate Plan system established in Maine, or indeed with the Commission's Order of Partial

Dismissal in which it said it would not entertain preapproval.[15] In the absence of such a review, the Company's customers are subject to a significant risk that (a) the capital projects are not the optimal projects to undertake between rate cases, and (b) the costs associated with those capital projects are overstated.

Another risk results from the fact that the Company would recover the costs of the capital expenditures plan, regardless of whether it actually makes the capital investments. As stated by the Company, CMP "cannot commit definitively to complete each of the programs as set forth in the Capital Investment Plan."[16] Although this statement is made because CMP is not sure that the mechanism will generate funding sufficient to cover all of its proposed investments, it highlights the fact that the Company's proposed cost recovery mechanism will provide the Company with funds without commensurate incentives to ensure that the Company implements all of the programs that drove the development of its revenue index mechanism. To the contrary, Company could profit from not implementing its proposed capital expenditures plan, as long as it can continue to achieve its service quality index targets.

Q. What do you think is the underlying cause of the problems with the Company's proposed productivity factor?

A. I think that a big challenge facing the Company in this docket is caused by its plan to make the large capital investment in its CRM&B system before the next rate case. A typical "inflation minus productivity" adjustment may not provide the Company with sufficient revenues to recover the costs associated with such a large capital investment. Consequently, the Company has proposed a productivity factor that is essentially designed to make room for such large capital investments. This point was demonstrated by Mark Lowry in one of the Technical Conferences:

> MR. WOOLF: So if the company were to decide to invest in this [CRM&B] system, then it should have the right incentive and the right revenue recovery under the formula you've proposed?

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[15] Order of Partial Dismissal at 7.

[16] Reynolds, Kruppenbacher, Montanye, Conroy, Wacker. Supplemental Testimony of the Capital Investment Panel, September 20, 2013, SUP-CAP-3.

DR. LOWRY: Yes.[17]

The problem with this approach, as discussed above, is that it essentially amounts to pre-approval and it eliminates one of the central elements of PBR.

In fact, this issue points to one of the biggest challenges regarding the Alternate Rate Plan as designed for CMP to date. It may not provide the Company with sufficient revenues to recover the costs required to make reasonable, prudent major capital expenditures. This challenges exists because (a) the first-year revenue requirement for capital expenditures is based on the Company's historical expenditures, which might not be a good reflection of major capital expenditures needed in the future; and (b) the changes in allowed revenue requirements between rate cases are based on a productivity relative to peer utilities, which may not adequately capture the need for or the impact of major capital expenditures.

Q. What do you recommend with regard to the treatment of capital expenditures in ARP2014?

A. I recommend that major capital expenditures be treated separately from the ARP mechanism. This will prevent the problem facing the Company and the Commission in this case, where CMP wants some assurance that it will be able to recover the costs of major capital expenditures such as the CRM&B. Instead, the ARP mechanism should only apply to baseline capital expenditures that generally do not deviate significantly from previous levels of investment.

Q. If major capital expenditures are not recovered through the ARP mechanism, how should they be recovered?

A. I recommend that the Company have the opportunity to recover major capital expenditures using traditional, cost-of-service ratemaking practices. This would include the following elements:

- The Company would have the flexibility to undertake major capital projects based upon its own assessment of the need for the projects, either on the grounds of

[17] Transcript of Productivity Technical Conference, Nov. 1, 2013, p. 96.

maintaining customer service needs, improving operational efficiency, or achieving some other goal.

- The Commission would not review such capital projects in advance, and would not provide any sort of pre-approval for such capital projects.
- When the Company undertakes a major capital project, it would be allowed to place those expenditures into an account for ongoing recovery. The Company would be allowed to recover the depreciation expense, taxes and return associated with the capital investment through an automatic adjustment mechanism. The undepreciated portion of the investment would remain in the account, to be treated at the time of a subsequent rate case.
- In the rate case following the placement into service of the capital project, the Company would file a request to place the remaining undepreciated amounts into rate base.
- At that time, the Commission would conduct a retrospective analysis to determine whether the capital project is reasonable and prudent. Expenditures that are not found to be reasonable and prudent would be disallowed, including any refunds to customers of funds already collected.

Q. How should major capital expenditures be defined?

A. Major capital expenditures should include infrequent, large capital projects that are not included in the historical pattern of capital expenditures, and are designed to achieve specific improvements to the Company's system. The Company's proposal for the CRM&B system is an example of something that should be considered a major capital expenditure and should therefore be treated outside of the ARP mechanism.

Q. Is this treatment of major capital expenditures consistent with the goals of PBR and the objectives of the Commission regarding ARP?

A. Yes. Treating major capital expenditures this way is a significant deviation from the current ARP. However, I believe that this approach to capital expenditures is appropriate at this time, and is consistent with the goals and objectives of PBR and ARP. Allowing the Company to recover prudent investments in major capital projects outside of the ARP ensures that the company faces incentives to make sound management decisions to invest in necessary capital infrastructure without requiring that these costs be pre-approved and immediately recovered, thereby preventing the utility's managerial decision risk from being unduly shifted to ratepayers.

Further, removing large capital investments from the revenue index mechanism enables target revenues to be established in a manner that is more clearly tied to the performance of peer utilities facing similar baseline capital investment costs. This provides regulators with some assurance that the Company's expenditures will be reasonable and appropriate, enhances incentives for the Company to control costs, and reduces the amount of time and resources required to review the Company's proposal.

Finally, review of major capital expenditures after they have been made ensures that the investments will be used and useful and reduces information asymmetry between the Company and interveners inherent in evaluating cost forecasts.

Q. Does this treatment of capital expenditures provide the Company with the proper incentives for balancing capital expenditures with O&M costs?

A. Yes, it does. In its Order of Partial Dismissal, the Commission expressed concern that the Company's original CRM mechanism would create a mismatch of costs and savings by not reflecting productivity improvements from capital investments.[18] I agree that the Company's CRM proposal would create such a mismatch, which would be inconsistent with the ARP objectives.

However, this concern is mitigated in my proposal in two ways. First, the baseline capital costs are kept within the ARP mechanism, therefore the connection between baseline capital costs and O&M costs will be maintained throughout the ARP period. Second, for major capital projects that are treated outside of the ARP mechanism, the costs will be recovered only after the project has been completed and is operational. As long as the major capital project is operational prior to the test year for the next rate case, the operational efficiencies resulting from the project will flow through to consumers.

[18] Order of Partial Dismissal, p. 7.

Q. What do you recommend with regard to setting the productivity factor?

A. The Commission should require that the productivity factor be more clearly tied to relevant performance of peer utilities, and should not be designed to recover costs associated with the Company's projected capital plan. With regard to the productivity factor for ARP2014, I recommend that the Commission adopt the productivity factor proposed by Mr. King in his testimony for the OPA.

5. TREATMENT OF THE REGULATORY LIABILITY

Q. Please describe briefly how the Company proposes to use the accelerated amortization of the cost of removal regulatory liability.

A. The Company is proposing to modify the current cost of removal regulatory liability amortization schedule for two reasons. In its supplemental policy testimony, the company first proposes to mitigate rate increases by modifying the amortization schedule over the ARP2014 period. Second, the Company proposes to modify the amortization schedule by an additional $19.5 million "to allow the Company to earn its requested return."[19] This second amount of $19.5 million was subsequently increased by an additional $10.0 million in the Company's November 25 Revenue Requirement Update testimony, for a total of $29.5 million of "base" shaping "in order for the Company to achieve its requested return."[20]

Q. Do you have concerns regarding the Company's proposal for the regulatory liability?

A. I do not have any concerns with the Company's proposal to mitigate rate increases by amortizing a portion of the regulatory liability over the ARP2014 period. The Company's proposal essentially results in an accelerated schedule for returning the regulatory liability to customers. Over the long term, customers will experience the same cumulative impact from either schedule.

However, I am concerned with the Company's proposal to amortize an additional $29.5 million to allow the Company to earn its allowed return, i.e., the ROE shaping

[19] Adams, Stinneford, Brown. Supplemental Policy Panel Testimony, Sept. 20, 2013, p. SUP-POL-9.
[20] Adams, Stinneford, Cohen, Pelletier, Fitzgerald. Revenue Requirement Update Testimony, Nov. 25, 2013, p. RRP-Update-8.

mechanism. First, the ROE shaping mechanism will reduce the amount of regulatory liability that will eventually flow to customers. Unlike the rate mitigation mechanism, which holds customers harmless over the long term, the ROE shaping mechanism will result in increased rates to customers over the long-term.

Second, the ROE shaping mechanism will reduce the Company's incentive to plan for and operate the Company as efficiently as possible, because it would provide the Company with its allowed ROE, regardless of how well it performs. Such an outcome would be inconsistent with the goals and objectives of PBR and ARP, would likely lead to higher costs incurred by the Company and passed on to customers, and would significantly shift risk from the utility to its customers.

Q. What do you recommend with regard to the Company's proposal to use a portion of its regulatory liability to allow it to earn its requested return on equity?

A. I recommend that the Commission reject the Company's proposed ROE shaping mechanism. Instead, I recommend that the Commission adopt the OPA's proposal, as described in the testimony of Tom Catlin, which applies an inflation adjustment to enable the Company to collect sufficient revenues during the course of ARP2014. This adjustment is more closely tied to the underlying cause of the Company's revenue requirement needs, and therefore helps to retain the logic and the objectives of PBR. It is also more transparent than the Company's proposal to use the amortization of the regulatory liability to make up for revenues that it would not otherwise recover.

Q. Are there other options available to address this issue?

A. Yes. The underlying issue here is that the Company is concerned that if it undertakes its proposed capital expenditure plan, then the Revenue Index Mechanism will not provide it with enough revenues to cover those costs and earn its allowed ROE. The PBR framework offers a mechanism to address concerns that a specific price-cap (or revenue-cap) formula will not result in a company earning its allowed ROE: the earnings sharing mechanism. Instead of adopting the Company's proposed ROE shaping mechanism, the Commission could establish a shared savings mechanism designed to provide the Company with revenues in the event that its ROE falls significantly below it's allowed ROE. These mechanisms are sometimes used in the context of PBR to (a) ensure that a utility's ROE is not subject to extreme fluctuations, and (b) provide the utility with the incentive to optimize its investments and seek cost savings where possible.

Q. **Does the Company's proposal include an earnings sharing mechanism?**

A. Similar to ARP2008, the Company's proposal for ARP2014 includes a high-end earnings sharing mechanism. Specifically, the Company's proposal provides that returns exceeding 135 basis points of the Company's allowed ROE be apportioned 50 percent to Customers and 50 percent to CMP shareholders.[21]

If the Commission decides that a low-end sharing approach is preferable to the OPA's proposal to apply an inflation adjustment, then it should establish a low-end earnings sharing mechanism to protect the Company from significant losses outside a certain bandwidth. The bandwidth could be, for example, ±350 basis points. An earnings sharing mechanism of this form was incorporated in the Stipulation that established the CMP's first ARP in 1994.[22]

6. THE REVENUE DECOUPLING MECHANISM

Q. Please summarize the Company's Revenue Decoupling Mechanism proposal.

A. The Company's Revenue Decoupling Mechanism (RDM) proposal is a new feature for its Alternate Rate Plan that would fully decouple the amount of distribution revenues recovered from the volume of sales to customers, regardless of whether the sales are caused by energy efficiency investments, weather, changes in the wider economy, or other reasons. The Company claims that the RDM is appropriate at this time, because there is a high level of uncertainty regarding future energy efficiency investments.

Q. Please summarize the key features of the Company's RDM proposal.

A. The Company's proposal includes the following features:

- Establishment of target annual revenues for the classes covered by the RDM;

[21] Adams, Stinneford, Brown. Supplemental Policy Panel Testimony, Sept. 20, 2013, Exhibit SUP-POL-5. The Company's supplemental testimony contains an earnings sharing mechanism in which an ROE in excess of 11.5 percent (135 basis points above Stewart's recommended ROE of 10.15 percent) is shared 50/50 between customers and shareholders.

[22] *Central Maine Power Company, Proposed Increase in Rates,* Docket No. 92-345 (Phase II), Detailed Opinion and Subsidiary Findings, page 9 (January 10, 1995).

- Reconciliations for differences between the RDM target revenues and actuals, generally on an annual basis unless the difference between targeted revenues and actual revenues exceeds 5 percent;[23]

- Two reconciliation groups:

    - Residential (A/R, A/R-TOU, A-TOU_OPTS, A-LM)

    - Commercial/Industrial (SGS, SGS-TOU, MGS-S, MGS-S-TOU, MGS-P, MGS-P-TOU, IGS-S, IGS-P, LGS-S, LGS-P, and targeted programs that track changes in core rate, e.g., Easy Hours for Business)

- Interest would be computed using CMP's short-term borrowing rate for period between the end of the calendar and the beginning of the next rate year, with additional interest calculated over the term of the recovery period using CMP's proposed average cost of capital.[24]

Q. Do you support the application of a revenue decoupling mechanism for the Company at this time?

A. Yes. I support a revenue decoupling mechanism for CMP at this time for several reasons. First and foremost, a decoupling mechanism will result in the actual revenues collected by the Company being more closely matched to its allowed revenues. In the absence of a revenue decoupling mechanism, the actual revenues can deviate from the allowed revenues as a result of changes in sales volumes. These changes in sales volumes can be a result of the Company's actions, or they can be completely beyond the control of the Company (e.g., as a result of weather conditions or economic swings). With a revenue decoupling mechanism in place, the actual revenues collected by the Company will be more closely tied to the revenues allowed by the Commission, because they are no longer affected by the changes in sales volumes between rate cases. In my view, this is a more

[23] As explained in Lahtinen's Revenue Decoupling Mechanism testimony dated May 1, 2013, p. JAL-14, reconciliations would be based on the difference between actual and target revenues at the end of each calendar year, with the exception of the first reconciliation, which would be done over 18 months, ending December 2015, unless, after 6 months, the difference between target and actual revenues is 5 percent or more.

[24] Lahtinen. Revenue Decoupling Mechanism Testimony, May 1, 2013, p. JAL-14.

accurate way of providing a utility with the revenues that it is allowed in a rate case, relative to a system where the prices are guaranteed but the revenues are not.

Q. What are the other reasons why you support a revenue decoupling mechanism for CMP at this time?

A. A revenue decoupling mechanism will reduce the pressure for the Company to request increased revenues through the ARP mechanism. In the past, when sales were typically increasing each year, the Company could rely upon increased sales to lead to increased revenues. However, the Company is currently expecting sales to decline slightly during the ARP2014 period. In the absence of decoupling, the Company's actual revenues are likely to decline slightly as well, all else being equal. Consequently, the Company may seek a higher amount of revenues in its ARP to offset the declining revenues due to declining sales. A revenue decoupling mechanism should reduce the pressure for the Company to seek higher revenues in anticipation of declining sales.

Q. Will a revenue decoupling mechanism help reduce the Company's interest in increasing its customer charges?

Yes. CMP has proposed significant increases to its customer charges, as a means of recovering more of the distribution costs through fixed charges, and less through variable charges. A revenue decoupling mechanism can help meet one of the key goals of increasing customer charges: to ensure a more predictable and stable collection of revenues.[25]

A revenue decoupling mechanism is a far superior way to address revenue uncertainty than increasing fixed customer charges. Increasing fixed customer charges can result in significant negative impacts on some customers, and will reduce customers' financial incentive to reduce their bills through energy efficiency or other means. In fact, the Company compares its proposed RDM to the alternative of increasing customer charges, and notes that moving to a system with no RDM and a fully fixed charge rate redesign

[25] Lahtinen. Revenue Decoupling Mechanism Testimony, May 1, 2013, p. JAL-6; and Lahtinen. Revenue Decoupling Mechanism (Phase II) Testimony, August 1, 2013, p. JAL-2.

would lead to "significantly higher rate impacts than lower use customers would see under the proposed rate design" in combination with its proposed RDM.[26]

The problems with increasing fixed customer charges are addressed in more detail in the testimony of David Dismukes on behalf of the OPA. My main point is that adopting a revenue decoupling mechanism for CMP at this time will significantly reduce the pressure on the Company to increase customer charges.[27]

Q. Are there any other reasons why you support a revenue decoupling mechanism for CMP at this time?

Yes. A revenue decoupling mechanism will remove the financial disincentive that the Company currently experiences regarding demand-side resources. Currently, as customers implement demand-side resources (including energy efficiency, demand response, and behind-the-meter generation), the Company's sales are reduced, leading to reduced revenues and reduced profits. A revenue decoupling mechanism would eliminate this significant financial disincentive by enabling the Company to earn its allowed revenues regardless of sales levels.

A revenue decoupling mechanism can lead to a significant shift in the mindset of utility management, where it becomes much more likely to support (and less likely to oppose) demand-side resources. This shift can help enable a much broader implementation of demand-side resources, potentially leading to significantly reduced electric costs for many customers. Furthermore, as state, regional, and federal climate change requirements become increasingly stringent over time, it will be even more important for utilities to support demand-side recourse as low-cost options for reducing carbon emissions.

Q. In Maine the ratepayer-funded efficiency programs are implemented by Efficiency Maine, not by CMP. Does this arrangement eliminate the need for decoupling?

A. No. As I describe above, there are several reasons why a revenue decoupling mechanism is appropriate for CMP at this time, regardless of the financial disincentives related to demand-side resources. In addition, it is important to remove CMP's financial

[26] Lahtinen. Revenue Decoupling Mechanism Testimony, May 1, 2013, p. JAL-5.
[27] Adams, Stinneford, Brown. Policy Testimony, May 1, 2013, p. Policy Panel-27.

disincentive to demand-side resources, as well as its financial incentive to increase sales, regardless of which entity implements the ratepayer-funded efficiency programs.

First, there may be ways that the Company can cooperate with and support the efforts of Efficiency Maine. Ideally, a utility should have the financial incentive to make the ratepayer-funded programs as effective and as successful as possible, and should not have the incentive to limit or undermine those programs. Decoupling helps align a utility's goals with the goals of the independent energy efficiency program administrator.

Second, there are a variety of demand-side measures and resources that Efficiency Maine might not influence, but that might be influenced by the Company. Such measures include, for example: the installation of combined heat and power, rooftop photovoltaics, and other behind-the-meter generation resources; the development and enforcement of appliance efficiency standards and building codes; the implementation of evolving demand response or smart grid technologies; and the establishment of new legislation to support any of these measures. A revenue decoupling mechanism should provide the Company with the proper financial incentive to support such measures and thereby be more consistent with Maine's energy goals.

These points have already been recognized by the Commission. The 2008 *Report on Revenue Decoupling for Transmission and Distribution Utilities*, prepared for the Maine legislature by the Office of Energy Independence and Security (OEIS), the OPA and the Commission (the 2008 Maine Decoupling Report) noted that decoupling may be needed despite the role of Efficiency Maine in implementing efficiency programs. In particular, the study found that:

> Maine's utilities continue to have an incentive to promote sales and act in ways that can be viewed as contrary to State policies regarding energy efficiency and conservation. This continuing financial incentive has led to utility efforts to enhance sales (or reduce the erosion of sales) through such activities as use of bill inserts to encourage usage by promoting air conditioners, space heaters or increased lighting, opposing legislation that would increase efficiency spending through increases in electricity rates, and

> resisting the installation of on-site generation (generally on the grounds that purchases from the grid are more cost-effective).[28]

Q. Do you recommend any modifications to the Revenue Decoupling Mechanism proposed by the Company?

A. Yes. I recommend three important modifications to the Company's RDM proposal, to ensure that customers are not harmed by decoupling and to maintain the appropriate balance of risk between the Company and its customers. These include: (a) placing a cap (equal to one percent of revenues) on the amount of revenues that can be recovered from customers in any one RDM adjustment; (b) reducing the Company's allowed ROE to reflect the reduced risk associated with the RDM; and (c) the earnings sharing mechanism should include a lower ROE threshold, commensurate with the new allowed ROE set by the Commission in this docket. I elaborate on each of these modifications below.

Q. Please explain why you recommend a cap on the amount of revenues that can be recovered from customers in any one RDM adjustment.

A. In general, one of the disadvantages to customers of a revenue decoupling mechanism is that rates may be more volatile than they would have been otherwise. In the case of CMP's ARP2014 proposal, this volatility risk is mitigated by the fact that decoupling applies only to a portion of customers' rates (i.e., distribution rates). This volatility risk is also mitigated because under the Alternate Rate Plan, CMP historically reset rates each year using the previous year's sales levels, and therefore any decoupling adjustment would be smaller than would be the case for a utility that sets rates using the sales levels from the test year.

Nonetheless, customers may experience some rate volatility from the Company's proposed RDM, and it is difficult to predict how much volatility there may be over the course of the next five years. In order to prevent customers from experiencing significant rate increases as a result of the RDM, I recommend that the Commission require the Company to apply a cap to the annual RDM adjustments. The cap should be set at one percent of the total allowed revenues for CMP for the period covered by the annual

[28] Maine Public Utilities Commission, Maine Office of the Public Advocate, and Office of Energy Independence and Security. *Report on Revenue Decoupling for Transmission & Distribution Utilities.* Jan. 31, 2008, p.10.

adjustment. Applying this cap would guarantee that customers will not see their total bill go up by more than one percent between rate cases as a result of the RDM adjustments.

If the difference between allowed revenue and actual revenue turns out to be greater than one percent of total revenues in any one year (i.e., the difference exceeds the cap), the Company should be allowed to carry any unrecovered revenues into the next period, and these unrecovered revenues would be added to the allowed revenues for that next period. In other words, unrecovered revenues could be rolled over from one period to the next. This way, the Company can recover the unrecovered revenues from the previous year in the next year, as long as the one percent cap is not exceeded that next year. If there remains some unrecovered revenues at the end of the 2014 ARP period, then the Company would not be allowed to recover those remaining unrecovered revenues.

Q. Please explain why it is appropriate to reduce the Company's allowed ROE to reflect the reduced risk associated with the RDM.

A. There is no question that decoupling will reduce the risk to a utility's shareholders. By definition, decoupling will reduce the instability and uncertainty associated with revenue collection. This will, in turn, reduce the instability and uncertainty associated with a utility's profits. Reduced volatility of utility profits is the equivalent of reduced risk to shareholders. When a utility is exposed to reduced risk, its ROE should be reduced accordingly. Stated differently, when shareholders are exposed to reduced risk, they should be willing to earn a lower return on equity (ROE), all else being equal. The 2008 Maine Decoupling Report concluded that decoupling will reduce a utility's risk, and recommended that there should be a return on equity adjustment to account for reduced risk.[29] I recommend that the Commission reduce CMP's allowed ROE to reflect the reduced risk to the Company as a result of introducing the RDM. Charlie King addresses the issues involved in setting the allowed ROE in his testimony on behalf of the OPA.

[29] Maine Public Utilities Commission, Maine Office of the Public Advocate, and Office of Energy Independence and Security. *Report on Revenue Decoupling for Transmission & Distribution Utilities.* Jan. 31, 2008, pp. 11 and 16.

Q. Please explain why you recommend that the earnings sharing mechanism threshold ROE should be different from that proposed by the Company.

A. My colleague Charlie King, in his testimony on behalf of the OPA, is recommending an allowed ROE that is significantly lower than the ROE requested by the Company. If the Commission establishes an allowed ROE that is lower than that proposed by the Company, then the threshold ROE for the earnings sharing mechanism should be lowered commensurately. Specifically, the ARP2014 earnings sharing mechanism should have a threshold of 350 basis points above the allowed ROE.

Q. Please summarize the OPA's position with regard to the Company's RDM proposal.

A. The OPA supports the Company's RDM proposal, under the condition that the OPA's other recommendations in this docket are accepted. This includes the recommendations of all the OPA's witnesses in this case, as well as the recommendations in my testimony.

7. SUMMARY OF RECOMMENDATIONS

Q. Please provide your recommendations regarding the topics you cover above.

A. First, I recommend that the Commission reject the Company's proposed ARP2014, on the basis of my findings above.

Second, I recommend that the Commission require the Company to continue to use the basic structure of the ARP2008, and to ensure that its Alternate Rate Plan meets the key objectives of performance-based ratemaking in general, as well as the objectives identified by the Commission.

Third, I recommend that the Commission modify the Alternate Rate Plan by making a distinction between the treatment of baseline capital expenditures, and major capital expenditures. Baseline capital expenditures should be recovered through the ARP mechanism, as they have been to date. Major capital expenditures should be recovered using traditional, cost-of-service ratemaking, i.e., outside of the ARP mechanism.

Fourth, I recommend that the Commission clarify the purpose of the productivity factor and how it should be used in the ARP mechanism. In particular, the Commission should clarify that the productivity factor should reflect the potential productivity improvements from baseline capital expenditures, but not major capital expenditures. The Commission should require that the productivity factor be more clearly tied to relevant performance of peer utilities, and should not be designed to recover costs associated with the Company's projected capital plan. With regard to the productivity factor for ARP2014, I recommend that the Commission adopt the factor proposed by Mr. King in his testimony for the OPA.

Fifth, I recommend that the Commission reject the Company's proposal to use $29.5 million of the regulatory liability to enable it to recover its allowed return on equity.

Finally, I recommend that the Commission approve the Company's proposal to decouple revenues from sales. The Commission should also require specific measures to protect consumers in light of this significant ratemaking development. These measures include: (a) reducing the Company's allowed return on equity to reflect the reduced risk from decoupling; (b) installing a cap of one percent of total revenues on the annual decoupling adjustment; and (c) the Company's the earnings sharing mechanism should have an ROE threshold that is commensurate with the new ROE allowed by the Commission.

Q. Does this conclude your pre-filed testimony?

A. Yes, it does.