Detailed Summary of Standard Offer Bid Processes and Results

1. Bids for Service Beginning March 2000 (Year 1)

In the first year, the bid processes for the CMP and BHE classes were marked by few participants who met our financial security requirements and bid prices that, when compared to then-current market prices, were unacceptably high. As a result, retail arrangements were not implemented for the medium and large non-residential classes in CMP's territory or for any of the three classes in BHE's territory.

The Commission did accept a bid from Energy Atlantic to serve the CMP residential and small non-residential class for a two-year period. This bid was contingent on Engage Energy U.S., L.P. winning the output from CMP's non-divested contractually-held power (power entitlements).[1] Because the Engage bid for the entitlements was very close to the highest stand-alone bid for the entitlements, we were able to satisfy Energy Atlantic's contingency.

For MPS's service territory, we received two adequate bids, and designated the lower priced bidder as the standard offer provider for all but 20% of the medium non-residential class. The next-to-lowest bidder was designated the provider for 20% of the medium class to satisfy the statutory preference for choosing more than one provider.

[1] These entitlements consist primarily of long-term qualifying facility (QF) contracts that predate industry restructuring.

We directed CMP (for its medium and large non-residential classes) and BHE (for all three of its standard offer classes) to procure power supply in the wholesale market and provide the standard offer service needed. We monitored the utilities' procurement decisions and ensured that standard offer prices reflected the underlying power supply costs throughout the year. The power supply strategies used by CMP and BHE were different. CMP's strategy was to lock in most components of its supply and price up-front by securing a fixed price, full requirements contract with a wholesale supplier. BHE used a portfolio approach whereby standard offer supply was provided with a blend of wholesale contracts and spot market purchases.

Although CMP preferred a full requirements supply approach, it was not able to secure one component of supply, Installed Capability (ICAP). CMP did enter into a wholesale supply contract that provided all other supply requirements. BHE entered into a wholesale power contract that would serve approximately 60% of the standard offer load, leaving 40% to be served by the ISO-NE regional spot market.

The standard offer prices we set for these classes were necessarily based on some estimates. Because ICAP prices were higher than estimated (and quite volatile due to FERC actions) as were spot market energy prices (with an extraordinarily high market price spike in May), our estimates were low. Accordingly, we raised standard offer prices for CMP once during the first standard offer year and twice for BHE. The increases ensured that standard offer prices remained reflective of the market and that no large undercollected balances accumulated on the utilities' books for future recovery from ratepayers.

2. Bids for Service Beginning March 2001 (Year 2)

In October, 2000, the Commission issued an RFP for retail standard offer service beginning March 1, 2001 for CMP, BHE and MPS customers. As residential and small non-residential CMP customers were served under a two-year arrangement, the RFP did not include them. Price bids were due in December, which coincided with two events that had a dramatic and upward effect on electricity markets and, as a result, on the bids we received. First, prices in the natural gas commodity market rose dramatically, causing electricity prices to spike in response. In addition, the FERC issued a decision that set the cost of ICAP at a level much higher than anticipated. Not only were the standard offer bids we received considerably higher as a result, but the volatility in the natural gas and wholesale electricity markets was such that bidders in the CMP and BHE territories would hold firm bids open for only a few hours.

We judged the price spike to be transitory and were optimistic that FERC's ICAP decision would be modified or reversed; thus we rejected all bids received for CMP and BHE customers. We continued to receive retail bids and directed CMP and BHE to explore wholesale power supply arrangements, both with and without ICAP, that would allow the utilities to provide standard offer service. As the events in the ISO-NE market did not affect the MPS market, we received reasonable bids for the MPS service territory. On December 11, 2000, we accepted the bid of the low bidder for a three-year term ending February 28, 2004 for all three of MPS's standard offer rate classes.

The wholesale power supply proposals received by CMP and BHE proved more beneficial than the retail proposals received by the Commission. In February 2001, the Commission again designated CMP and BHE as standard offer providers and approved the related wholesale power arrangements. For its medium class, CMP entered into a wholesale all-requirements contract. CMP's wholesale contract for its large class was a requirements-type contract except for ICAP. These wholesale contracts formed the basis for the standard offer prices established by the Commission.

BHE's wholesale power supply approach for its small and medium classes was again to manage a portfolio rather than enter into requirements-type contracts. For the year beginning March 1, 2001, BHE entered into some firm energy contracts, leaving approximately 20% of the required energy as well as all the ICAP and ancillary electric products to be purchased during the year.

For the large class, BHE entered into a power supply contract that included energy, ICAP and ancillary electric products but not energy uplift, up to a cap of 65 MW. Standard offer prices were set using the contract costs and estimates for power supply products that were not contracted for. For both CMP and BHE, the estimates were higher than the costs actually incurred, and the standard offer prices for that we set in February 2001 remained in effect for the entire period and resulting overcollections were subsequently flowed back to customers.

Even though this second bid process did not result in acceptance of any retail standard offer bids by this time, suppliers were becoming accustomed to bidding in Maine in both the retail and wholesale auctions. Moreover, when the wholesale electricity dropped significantly in the first half of 2001, competitive suppliers were able to contract with substantial numbers of medium and large customers.

3. <u>Standard Offer Solicitations for Service Beginning March 2002 (Year 3)</u>

During 2001, wholesale market electricity prices had dropped substantially, and, in the summer, the Commission decided to move forward with a bid process for the CMP and BHE residential and small non-residential classes, for service beginning March 2002. Because of the sizable number of medium and large customers who were switching from standard offer to competitive suppliers, the Commission decided to wait to solicit supply for the medium and large classes. We also directed CMP and BHE to conduct wholesale bid solicitations concurrently with our retail process. Due to the success of the contingent or “linked” bid in the first standard offer solicitation, we allowed both retail and wholesale bids that were contingent on the purchase of the utility power entitlements.

In the third solicitation, the retail solicitation was far more competitive than before. The Commission received adequate retail bids, and because the Act prefers retail, we designated the supplier with the best bid, Constellation Power Source Maine (CPS Maine), as the standard offer provider for both the CMP and BHE residential and small non-residential classes. The CPS Maine bid was contingent upon its affiliate acquiring the CMP and BHE power entitlements at prices that were consistent with then-current electricity forward prices. The Commission chose the CPS Maine bid for a three-year period to ensure reasonable and stable prices for residential and small non-residential customers.

In November 2001, we solicited bids for the CMP and BHE medium and large non-residential classes. Again, we directed CMP and BHE to concurrently solicit wholesale bids. Our retail solicitation was quite competitive and we directed CMP and

BHE to forego further processing of wholesale bids until the Commission processed the retail bids. On January 14, 2002, the Commission selected the best retail bid (from Select Energy, Inc.) for both classes for both utilities. Select's bid reflected the considerable decrease in wholesale electricity prices since the prior year, and standard offer prices would drop substantially on March 1, 2002. Although the Commission solicited multi-year bids, we decided to accept a bid for one year only so that standard offer prices and market prices would not diverge for such a lengthy period of time in the event market prices changed. Unlike the residential and small non-residential classes, the recent performance of competitive suppliers in serving medium and large customers indicated that these customers should be able to obtain two or three year contracts for competitive suppliers if customers seek price certainty for more than one year.

Lessons Learned from Our Experience

1. Suppliers are risk averse

Even before the financial problems that now plague the industry, our experience taught us that suppliers in the electricity market tend to be risk averse. This has been evident since our first solicitation in suppliers' bidding strategies as well as in discussions and negotiations about contractual and legal issues. In the current economic and post-Enron financial climate, supplier concerns are likely to be heightened.

Because of market volatility bidders typically will not hold firm prices open for more than one day. This has required the Commission to move quickly to lock in beneficial prices. With respect to contractual and legal issues, many bidders require that their rights and obligations be well-defined, as they would be in a typical wholesale power supply contract. For example, many bidders sought legal guarantees that the Maine Legislature or the Commission would not impair their rights or change their obligations in any material way during the standard offer term. Because under Maine's retail model there is no supply contract, we have developed alternative mechanisms to deal with these concerns. For example, many concerns have been satisfied through a Commission order regarding bidder conditions and through contractual provisions with the T&D utilities. While bidders' concerns over contractual and legal issues have significantly increased the length and complexity of the procurement process, we expect this will diminish as responses to bidders' issues are developed and bidders become more accustomed to Maine's retail standard offer model.

2. Flexibility is essential

Since the first bid process in 1999, bidders have proposed standard offer arrangements that are complex and varied. Thus, to operate effectively in the supply market, we have learned that it is essential to maintain flexibility. Our solicitation processes have evolved over time to allow flexibility and to encourage such creative bids. For example, we have allowed bids for standard offer service to be structured with contingencies, such as the acquisition of utilities' purchased power contract entitlements. In our recent solicitation for the CMP and BHE large classes, we allowed bidders to propose indexed, or formula, bids. Although flexibility can make bid evaluation more difficult, it allows suppliers to put their best offers on the table and generally to mirror the creative arrangements found in competitive markets. Because electricity markets continue to change in ways we cannot foresee, it is essential that the Commission retain flexibility to respond to market circumstances as they develop.

3. Contractual protections and financial security are critical

We have also learned that contractual protections and adequate financial security are crucial to protect Maine's interests. This lesson was soundly reinforced during 2001 when a contract dispute between Energy Atlantic (EA), the CMP small class standard offer provider, and EA's wholesale supplier, Engage Energy America LLC (Engage), threatened the sustainability of EA's standard offer price. Although EA had provided financial security in form of a $33 million bond, that alone would not have fully covered the cost of replacement standard offer supply. Because of an unexpected, dramatic increase in wholesale electricity markets, the dispute exposed CMP's residential and small commercial customers to potential cost increases of as much as $150 million.

The Commission facilitated a settlement of the dispute. The settlement included payments to Engage by EA and the bond company and a reduction in Engage's entitlement costs, of which $4.5 million was funded by ratepayers, but also secured the provision of favorably priced standard offer service for the remainder of the term. The experience underscored the importance of obtaining sufficient financial security and adequate legal protections from standard offer suppliers as well as ensuring that contingent entitlement agreements cannot be unraveled by contract disputes to the ratepayers' detriment. The Commission has acted on this experience by engaging outside counsel experienced in commercial transactions and insisting on adequate financial security and legal protections. The Commission will continue to retain outside legal counsel with the necessary expertise in transactions to ensure that proper protections are included in our standard offer transactions.

4. <u>Wholesale markets must be functioning properly</u>

When wholesale prices are volatile, or wholesale market rules are unsettled, the retail standard offer bid process will suffer the consequences. By the same token, when the wholesale market is operating smoothly, we receive more bids and reasonable prices. Since mid-2001, the operation and competitiveness of the regional wholesale market has notably improved. This improvement is reflected in the successful solicitations since that time.

5. Consistency and fairness in our laws, rules and processes is important

Suppliers are more willing to participate in Maine than other states because our laws, rules and processes are clear, consistent and fairly applied. Consistency does not require that there be no changes in the structure of standard offer in Maine or the processes by which standard offer service is acquired, but that any changes be deliberate, clearly articulated and fair to all affected parties.

6. Contingent bids can be beneficial

As mentioned above, the Commission has on two occasions accepted "contingent bids" in which the standard offer bid was contingent on the acceptance of a corresponding bid for the purchase of the output of utility power entitlements. Through its experience in conducting the standard offer bid processes, the Commission has found that contingent bidding can be a means to maximize the value of utility power entitlements to the benefit of the utility's ratepayers. This is because the business risk for a bidder can be reduced when load obligations and the resources to serve that load are simultaneously obtained. Reduced risk translates to lower costs and a higher value for the entitlements.

However, contingent bids can be problematic if they result in below market prices for standard offer service. This can occur if the accompanying bid for the power entitlements is below prevailing market prices, thus allowing the standard offer to be subsidized by the acquisition of below-market resources. Prices for standard offer service that are below market for this reason are not desirable because they could inhibit the development of competition by making it difficult to compete.

Cognizant of this potential problem, the Commission during its last solicitation informed bidders that it would not accept contingent bids structured such that below-market bids for power entitlements were used to reduce standard offer prices. Bidders were explicitly directed to present bids for entitlements that reflected their stand-alone value and the Commission evaluated these bids based on its own assessment of prevailing market prices for power resources.

Although contingent bids must be carefully reviewed to evaluate any potential impact on the development of the competitive market, the Commission continues to believe that the flexibility to consider such bids is important to maximize the value of utility power entitlements for the benefit of ratepayers. We note that in our last solicitation for residential standard offer service for the CMP and BHE service territories, we accepted a three-year contingent bid for service beginning March 2002, thus issues regarding contingent bids are essentially moot until 2005. Additionally, we note that issues surrounding contingent bids will become less important over time as utility entitlements expire according to their contract terms.