Maine Public Utilities Commission

Report Regarding Deferred Costs Pursuant to Public Law 2023, chapter 121 (LD 923)

Submitted to the Joint Standing Committee on Energy, Utilities and Technology

January 2, 2024

I. Introduction

In 2023, the Legislature enacted Public Law 2023, chapter 121 (Act), which requires the Commission to (1) determine a method to communicate to electric transmission and distribution utility ratepayers the anticipated impacts of all deferred costs approved by the Commission on residential electric rates, (2) publish that information on the Commission's website, and (3) provide the information to the Legislature with any recommended legislation:

> **Sec. 2.** Deferred costs. The Public Utilities Commission shall determine the method necessary to convey to residential ratepayers of a transmission and distribution utility the anticipated effects of all deferred costs approved by the commission on residential transmission and distribution utility rates. The commission shall publish this information on its publicly accessible website by November 1, 2023. By January 1, 2024, the commission shall provide this information along with any recommended legislation to the Joint Standing Committee on Energy, Utilities and Technology, which may report out legislation to the Second Regular Session of the 131st Legislature.

This report addresses that directive and provides the requested information to the Legislature. However, given the complexity associated with deferred accounting, the Commission believes detailed information may be difficult for ratepayers to navigate and understand; for the same reason, providing summary information would not be helpful to ratepayers because it would be overly simplified and potentially misleading. Thus, the Commission respectfully recommends that the Legislature take no further action at this time.

II. What is a Deferred Accounting and Why is it Used?

Deferred Accounting Generally

Deferred accounting is an important regulatory tool that may be used to provide rate stability or rate smoothing and minimize rate fluctuation over time. Regulatory commissions across the United States have employed deferred accounting for utilities (both consumer and investor owned) for many decades. Deferred accounting involves either (1) delaying the recovery of costs that the utility has incurred (either partially or entirely) or (2) delaying the return to ratepayers of amounts the utility has received or costs that have been reduced (either partially or entirely) until the costs or revenues are incorporated in rates. The first is referred to as a "regulatory asset" (i.e. when the utility has an enforceable present right to add an amount in determining the regulated rate to be charged to customers in future periods).[1] The second is referred to as a "regulatory liability"(i.e. when the utility has an enforceable present obligation to deduct an amount in determining the regulated rate to be charged to customers in future periods).[2] In lay terms, a regulatory asset is essentially a "loan" from the utility to ratepayers and a regulatory liability is "loan" from ratepayers to the utility (See Appendix A). In each instance, carrying costs (analogous to interest) accrue on the balance.[3]

[1] Regulatory assets fall under Federal Energy Regulatory Commission Account 182.3, Other Regulatory Assets.
[2] Regulatory liabilities fall under FERC Account 254, Other Regulatory Liabilities.
[3] Generally, carrying costs are applied to deferred costs to make the utility or the ratepayers "whole." In lay terms, carrying costs represent the "interest rate" applicable to the "loan." If the costs are deferred for rate recovery for a shorter period, the utility's short-term cost of capital may be applied. If the period for rate recovery is a longer, the carrying costs are usually the utility's weighted average cost of capital. Both short-term carrying costs and the long-term weighted average cost of capital are determined in the distribution rate case in which the utility seeks to begin recovering the cost of the deferral.

Types of Deferred Accounting in Maine

In Maine, deferred accounting has been used to smooth the impact on ratepayers of costs such as those associated with extraordinary storms, various public policy programs, and unusual litigation expenses. Maine has also used deferred accounting to return to ratepayers the benefit of reduced federal corporate taxes over time. There are essentially three “buckets” of deferred accounting commonly used in Maine.

First, utilities may request and receive “accounting orders” for extraordinary costs. An accounting order gives the utility an enforceable right to incorporate certain costs in distribution rates in the future. However, the accounting order does not necessarily establish the precise amount that will be incorporated in rates, the period over which the amounts will be recovered, or the amount of any carrying costs applied. Thus, there may be significant time between when costs are first incurred and when they are incorporated in distribution rates.[4]

Second, there are deferred costs or revenues that are incorporated in distribution rates without necessarily issuing an accounting order.[5] A common example is storm costs. At times, a utility may seek an accounting order related to certain storm costs. However, if a rate case is imminent the utility may simply seek to include those costs as part of its rate case without first seeking an accounting order. Regardless, because the costs of responding to a single storm may be tens of millions of dollars, it may be desirable to spread the cost recovery from ratepayers over multiple years, rather than recover all of the costs in a single year. Moreover, the Commission will also consider other components of ratepayers’ electric bills when determining an appropriate time period for recovery. Because at any point in time, some previously deferred costs may be fully collected, and “rolling off” the utilities books, while others may be incorporated in rates for the first time, the cumulative impact of all deferrals on ratepayers can be complicated and, in some instances, may result in no change in

[4] For example, in 2005 the Commission issued an accounting order that authorized Bangor Hydro-Electric Company to defer on its accounting books its external litigation costs related to defending a claim brought by the Bankruptcy Trustee for Great Northern Paper, Inc. against Bangor-Hydro for “headwater benefits” associated with certain dams that Bangor Hydro had owned prior to electric restructuring. *Bangor Hydro-Elec. Co.*, 2004-735, Accounting Order (M.P.U.C. Mar. 24, 2005). The litigation associated with the bankruptcy claim took more than 10 years to resolve. When the Commission issued the accounting order in 2005, the litigation had been on-going for approximately 2 years and the total amount of the external litigation costs was unknown. In 2016, once the headwater benefits claim was finally resolved and the total litigation costs (of $1.5 million) were known, Bangor Hydro sought to recover those costs through its stranded cost rates. *See Emera Me. Request for Approval of Rate Change (Stranded Costs)*, No. 2016-00270, Order Approving Stipulation at 1 (MPUC June 15, 2017).

The Commission does not generally determine whether a cost is prudently incurred when issuing an accounting order. Rather, it reviews the prudence of the costs (or investments) at the time the utility seeks to recover the costs in rates, as was the case here. The prudence of Bangor Hydro’s headwater benefits external litigation costs was reviewed. Ultimately, the Commission approved a settlement (a “stipulation”) that allowed Bangor Hydro to recover those expenses (without any carrying costs) over a multi-year period, thereby smoothing the impact on ratepayers. Note that when the Commission issued the accounting order, it could not have determined the estimated impact on ratepayers because the total litigation expenses were not known and were still subject to a prudence determination.

[5] Accounting standards allow a utility to record a regulatory asset/liability without a specific accounting order if past practices of the regulatory body show that it is probable that the accounting order and recovery would be granted. However, to the extent that a deferred amount is determined to be imprudently incurred or an agreement is reached to recover only a portion of the deferred amount, accounting principles require that the deferred amount be written off the utility’s books as it no longer represents a future recovery and is not an asset.

the rate.

For example, the Commission has authorized the recovery in distribution rates of certain costs associated with Central Maine Power Company's response to particular storms. The recovery of those costs was smoothed over time to avoid "rate shock." Chart 1 below illustrates the impact on CMP's distribution rates of CMP's storm costs for the years 2019-2022 if the recovery of those storm costs had not been smoothed and were incorporated in rates in each year in which they were incurred. In contrast, Chart 2 illustrates how the Commission has incorporated storm costs into rates over time. As one can see, in Chart 2, 2019 and 2020 storm costs were each recovered over three years; 2021 storm costs were recovered in one year; and 2022 storm costs will be recovered over two years.

Chart 1 – Impact of Incremental Storm Costs – No Deferral

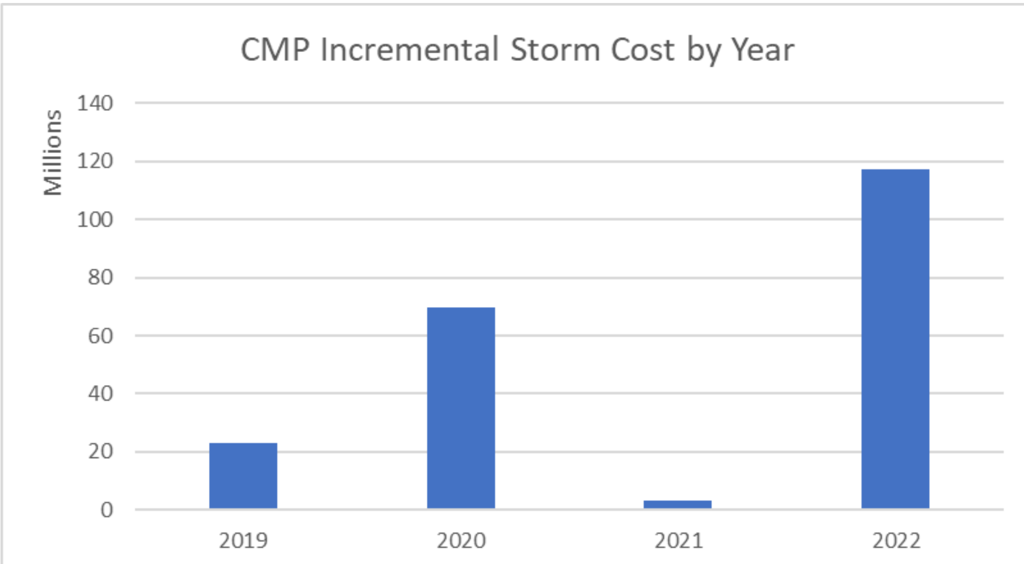
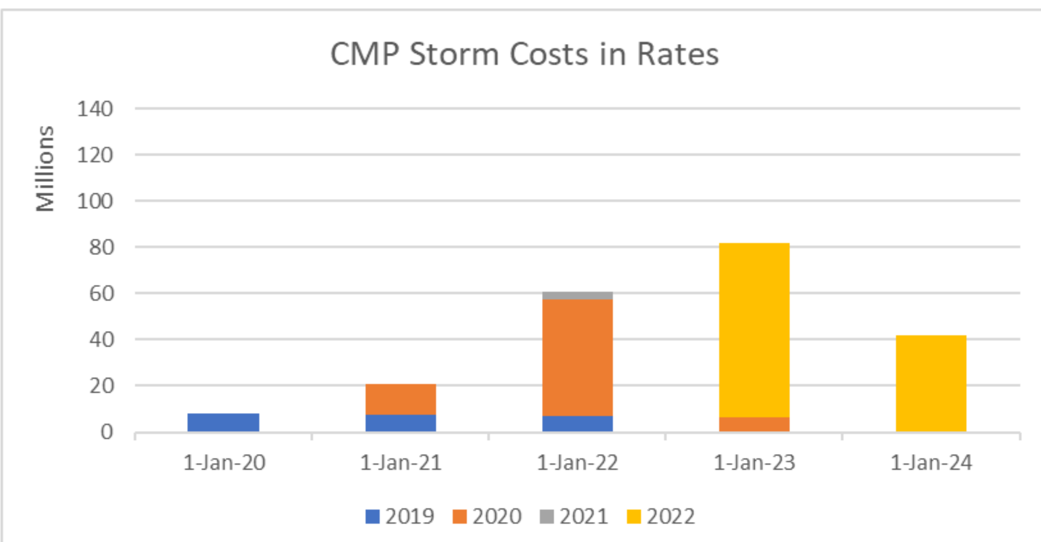


Chart 2 – Impact of Incremental Storm Costs with Deferral



Third, there are deferred costs and revenues associated with relatively short timing delays associated with "regulatory lag" (the time between when a cost is incurred, or revenue received and the final regulatory decision to include those costs in rates).

For example, transmission and distribution utilities are entitled to recover the costs and pass through to ratepayers the revenues associated with various public policy initiatives. For example, the costs and revenues associated with power purchase agreements that the utility has been directed to execute following a competitive procurement for renewable generation are reconciled through stranded cost rates. Typically, a three-year revenue stranded cost requirement is established, and those costs and revenues may be "levelized" over the three-year period. Thus, there is a period of regulatory lag between when the cost is incurred and when it is approved by the Commission to be incorporated rates, which is a deferral, and the levelization of costs over three years, is also a form of deferral. Further to minimize the frequency of rate changes during the calendar year, the Commission used a March through February rate year for stranded costs, but implements the stranded cost rate changes on July 1, at a time when other rate changes occur. This period of regulatory lag is also a deferral.

Time Period

Because the time period over which a deferred amount may be recovered or returned to customers in rates is flexible (e.g. from a few months to several years), when the Commission ultimately incorporates deferred amounts in rates, as noted above, the Commission often considers other elements of the distribution rate change, or changes in other components of the electric rates (e.g. standard offer supply rates, transmission, or stranded cost rates) that may be occurring simultaneously to wholistically balance rate impacts.

III. Process

In response to the Act, on September 12, 2023, the Commission issued a Notice of Inquiry. The notice requested the following detailed information from transmission and distribution utilities:

1. A list of items deferred as regulatory assets/liabilities, including the original amount of the deferral, the balance as of December 31, 2022, and the current balance.
2. For each item in 1, please indicate whether the recovery is through transmission, distribution, or stranded costs rates.
3. For each item in 1, please indicate whether carrying charges are accrued and if so, at what rate, and provide the carrying costs accrued to date and expected through the recovery period.
    a. For each item in 1, please indicate the approved period for deferral/recovery.
4. For each item in 1, please provide authority for the deferral. Specifically
    a. For deferrals that originate from an accounting order, the docket number and date of each accounting order issued by the Commission approving the deferral.
    b. For deferrals that do not originate from an accounting order, the docket number and order, with page reference, if possible.
    c. For deferred costs authorized by Commission Rule, the chapter number and section of the Rule.
    d. For all other deferrals, a specific reference to the Commission approval thereof.
5. The current rate impact, in dollars per month, for a typical residential customer of:
    a. The net total regulatory assets/liabilities
    b. the total regulatory assets
    c. The total regulatory liabilities
    d. Each deferral that individually exceeds 10% of the net total regulatory

assets/liabilities

7. The anticipated future annual rate impact, in dollars per month, for a typical residential customer of:
    a. The net total regulatory assets/liabilities
    b. the total regulatory assets
    c. The total regulatory liabilities
    d. Each deferral that individually exceeds 10% of the net total regulatory assets/liabilities

All of the utilities' filings (filed from October 13 to November 6, 2023) are available in the Commission's Case Management System under Docket No. 2023-00238[6]. The Commission received filings from Central Maine Power Company, Versant Power, Fox Island Electric Cooperative, Inc., Kennebunk Light & Power District, Eastern Maine Electric Company, Isle Au Haut Electric Power Company, Houlton Water Company, and Van Buren Light & Power. Brunswick Landing, Monhegan Plantation Power District, Madison Electric Works, and Matinicus Plantation Electric did not submit filings. All filings are publicly accessible.

Commission Staff then met several times to work through how best to address the Legislative directives.

IV. Website Information

As discussed above and as a review of the detailed utility filings reveals, deferral accounting is applied in a wide variety of contexts to both investor and consumer owned utilities. It is not easy to calculate the combined rate impact of in any one year for Maine's largest utilities.[7] In particular, if the Commission has issued an accounting order regarding a deferral but that cost/revenue has not yet been the subject of, for example, a rate case, then the impact on ratepayers is not known, and cannot be accurately calculated. Further, for deferrals associated with public policy initiatives, such as Net Energy Billing costs, those costs are not subject to accounting orders but are reconciled annually with some months of regulatory lag. These costs may vary significantly from year to year and may be challenging to predict. Thus, is difficult to provide ratepayers with accurate information about the precise impact of the costs of all deferrals in a given year.

Based on Commission's Staff's brief, informal survey of other states, summary information about the impact of deferrals on residential electricity rates does not generally appear to be published in the form that is contemplated by the Act.[8]

The Commission has published an explanation of deferral accounting, including the CMP storm cost example discussed above to provide residential customers with more information about the potential

[6] This very detailed deferral information is publicly available on the Commission's website under Docket No. 2023-00238. Thus, it is "a method to communicate to . . . ratepayers the anticipated impacts of all deferred costs approved by the Commission on residential electric rates." Moreover, the Commission will publish a copy on this report on its webpage. However, the Commission does not consider this an ideal method of communicating to ratepayers the anticipated impacts of deferred costs because some of the utility filings are very complex.

[7] Smaller utilities tend to have fewer deferrals and in those situations the calculation may be easier.

[8] Staff understands that the Public Service Commission of South Carolina has requested some annual reporting related to utility deferrals. However, either that information cannot be easily found, is not public, or does not yet appear on the Commission's website. *See* https://psc.sc.gov/

impact of deferral accounting.[9] Further, the "Residential Electricity Rates in Maine" chart that appears on the Commission's website now includes a column named "Deferrals," which refers the reader to the sometimes very detailed information filed by the utility in Docket No. 2023-00238.

V. Conclusion

The Commission recognizes that having general information on our website that explains what deferred costs are and how these costs may impact rates may be helpful to ratepayers; however, including this information as envisioned in the Act is not feasible as outlined in this report. To convey "anticipated effects of all deferred costs approved by the commission on residential transmission and distribution utility rates" could be misleading if the estimates are wrong or could create more confusion for ratepayers. Given the complexity of this information, the Commission suggests that the Legislature take no further action at this time. Thus, the Commission does not recommend any additional legislation.

[9] https://www.maine.gov/mpuc/regulated-utilities/electricity/delivery-rates

Appendix A

Deferred Accounting

S&P Global Market Intelligence describes deferred accounting as follows:

Deferrals are an interim ratemaking remedy designed to help reduce "regulatory lag." Allowing the utility to defer recovery of increases in specific costs until the commission can address them at a later date leaves the utility's earnings unaffected by the increased costs, as the increases are offset from an accounting perspective by the creation of a regulatory asset that would likely be recovered through customer rates in the future. Once a commission determines, typically in the company's next rate case, that the costs were prudently incurred and are "extraordinary" in nature, recovery will generally take place over a multiyear period and the commission may or may not permit the utility to earn a return on the unamortized balance during the recovery period. However, these deferrals do nothing to mitigate any cash flow constraints that might exist.

Some state utility commissions have approved the use of deferral techniques for various costs in recent years, perhaps most prominently for costs incurred to restore service after large storms. On a basic level, many utilities' fuel and gas commodity cost adjustment clauses account for differences in such costs, relative to base levels, in "balancing accounts," and these types of deferrals, although not necessarily for costs that are extraordinary in nature, are ultimately recovered through the next rate adjustment under the clause. Deferral treatment has also been accorded other types of costs, including those associated with pension plans, participation in a regional transmission organization, regulatory and compliance-related requirements, and distribution infrastructure maintenance.

Regulatory liabilities are created for amounts that are likely to be returned to ratepayers at a later date. Perhaps the most prominent regulatory liability utilities have recorded over the past couple years stems from federal tax reform. Accumulated deferred income taxes (ADIT), arise from the tax timing differences created by the alternate depreciation calculation methodologies. The utility is essentially collecting, at present, a portion of the tax liability it will owe at some point in the future, and these "cost-free" funds need to be accounted for. ADIT can be accounted for as a reduction to rate base, as is the case in most jurisdictions, or as a source of zero-cost capital in the rate-of-return calculation.

Following the 2018 reduction in the corporate income tax rate from 35% to 21%, utility financial statements were showing ADIT balances that were too high. In most circumstances, utilities have been required to establish regulatory liabilities for the "excess" balances, with these amounts to be returned to ratepayers over an extended period of time. The time period for recovery varies with certain types of excess ADIT balances required to be returned to ratepayers over the lives of the underlying assets per accounting standards and others returned to ratepayers over a shorter period of time determined by regulators.

Regulatory Research Associates, a group within S&P Global Market Intelligence, notes that deferrals also come into play for companies that have a revenue decoupling mechanism in place. A decoupling mechanism essentially allows the utility to defer fixed costs that it fails to recoup through volumetric charges due to customers' participation in conservation programs, weather fluctuations or altered economic conditions, changes in demographics or even the departure of a large customer. The utility is then allowed to recover the deferrals associated with the unrecovered fixed costs through a mechanism over a period of time, generally with carrying charges on the deferred balance. volumetric charges due to customers' participation in conservation programs, weather fluctuations or altered economic conditions, changes in demographics or even the departure of a large customer. The utility is then allowed to recover the deferrals associated with the unrecovered fixed costs through a mechanism over a period of time, generally with carrying charges on the deferred balance.[10]

[10] Ernst, Russell. S&P Global Market Intelligence, 10 Sept. 2020; "Postponing Review of Deferral Mechanics Hampers One's Grasp of Ratemaking Tools."