Office of the Public Advocate
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An Overview of the Public Power Initiative

The following is an overview of some of the more significant issues and questions related to the upcoming Public Power Referendum. Please do not hesitate to contact the Office at (207) 624-3687 if you have any questions or concerns.

Ballot Question

The initiative will be presented to voters on Election Day, November 7, 2023 as Ballot Question 3. The proposal provides that a new power company will be created to acquire the assets of Central Maine Power Co. (CMP) and Versant Power and become a Maine regulated utility.

The precise ballot question will read as follows:

Do you want to create a new power company governed by an elected board to acquire and operate existing for-profit electricity transmission and distribution facilities in Maine?

If passed, the effective date of the legislation would be January 1, 2025. More information about the ballot question can be found on the Maine Secretary of State's website: https://www.maine.gov/sos/news/2023/2023ReferendumElectionBallotOrderAnnounced.html

What is the OPA's Position?

The OPA has not taken a position on the proposal. Our Office aims to provide accurate information to help voters make an informed decision about the proposal when they vote in November.

Structure of the Pine Tree Power Company

If the ballot question is approved, the new power company would be known as Pine Tree Power Company (PTP), would be governed by a Board of 13 voting members, seven of whom are elected in statewide public elections, and the remaining six of whom are appointed by the elected members. Board members serve staggered terms of six years.

PTP is obligated to conduct a competitive solicitation to contract with one or more private companies to operate the utility. The third-party operator hired by PTP is required to hire most non-

Disclaimer: The facts and opinions stated herein are based on our good faith judgment of how the proposal will be interpreted and implemented based on our understanding of the proposal and Maine utility law. Given the novelty and complexity of the proposal, however, we cannot guarantee that all our conclusions are correct.

executive CMP and Versant employees. The Act requires the payment of retention bonuses to incentivize employees to stay with the new operator.

FINANCES

Financing Acquisition

Under the Act, PTP is authorized to issue debt, which may be secured by a mortgage on its property, pursuant to Commission approval process currently applicable to all utilities. The debt of PTP would not be an obligation of, or guaranteed by, the State of Maine. The debt incurred to acquire the assets will not be tax exempt under IRS rules. The debt will be repaid through rates – see below.

Acquisition Price

Under the Constitution, the government is required to pay fair market value when it takes private property. Because utility assets are infrequently bought and sold, there is likely to be a dispute over the fair market value of CMP and Versant's assets. For ratemaking purposes, the Maine Public Utilities Commission (MPUC) values utility assets at net book value (what each asset originally cost the utility minus depreciation). However, the utilities will likely argue that they are entitled to receive compensation higher than net book value. If no agreement can be reached, Maine's state courts will determine the fair market value of the assets. Under this process, a court-appointed referee will establish the price and that decision may be appealed.

Financing Future Replacements and Improvements

Once the acquisition is complete, PTP can finance any future replacements or improvements by issuing tax exempt debt (the interest payments are not taxable income to the debt holder). Typically, this will be at a much lower cost than what CMP or Versant pay for issuing equity shares or taxable debt to finance replacements or improvements.

IRS Tax Benefits

Under IRS rules governing certain corporate tax benefits such as accumulated deferred income taxes (ADIT) and investment tax credits (ITC), CMP and Versant routinely collect from current ratepayers, funds that they are not required to pay to the IRS until many years in the future. Currently, the utilities are holding approximately $850 million of these tax benefit funds. Essentially, these funds belong to ratepayers and are reflected in rates every time the utilities propose a rate change. Because PTP would be exempt from state and federal income tax liability, it will have no need for these tax benefits. In the event of a takeover, it is not clear whether these funds currently held by CMP and Versant will be transferred to PTP so they can be returned to ratepayers or, alternatively, retained by CMP and Versant.

Taxes

Pine Tree Power's income would be exempt from federal and state corporate income taxes. Currently the two utilities pay approximate $13 million in federal income taxes and $3.4 million in state income taxes. PTP would still be required to pay municipal property taxes in the same manner as CMP and Versant.

TRANSITION

Initial Process Following Approval

If the proposal is approved by voters, a statewide election will be held to select the Board members of PTP. The elected members of the Board will then choose the remaining Board members, hire staff, and begin the process of acquiring the assets of CMP and Versant.

Transition Timeline

If the Act is passed, the process of transitioning from an investor-owned utility to a consumer-owned utility may be lengthy. The acquiring consumer-owned utility must be formed and the Board selected by the voters. There may also be litigation over the constitutionality of using eminent domain to "take" CMP and Versant's private assets and also litigation over the acquisition price. The entire process could take approximately 5- 10 years.

Transition Financing

PTP is authorized to borrow money to fund its initial activities prior to the acquisition. This debt is presumed to be a prudent cost and may be recovered from CMP and Versant's ratepayers unless there is a showing of imprudence beyond a reasonable doubt. If such a showing of imprudence were made before the MPUC, it is not clear who would be responsible for paying the imprudent costs.

Regulatory Approvals

If the voters approve the acquisition, it still will be subject to a number of regulatory approvals, including by the MPUC and the Federal Energy Regulatory Commission (FERC). Each regulatory agency will conduct a potentially lengthy proceeding to determine whether, based on the specific terms, the acquisition is in the public interest. Such approvals may be subject to several conditions, designed to make sure that the transaction is in the public interest. These decisions may be appealed to the courts

SERVICE

Customer Service

It is not possible to predict with certainty whether the quality of utility service would improve or deteriorate following the acquisition. Although it has been suggested that PTP would be more responsive to ratepayer concerns, there is no clear evidence that a private third-party operator would provide better customer service compared to the existing utilities.

Reliability

It is not possible to predict with certainty whether reliability would improve or deteriorate following the acquisition. The priorities of low-cost and reliability are often in tension. It is possible that PTP would feel political pressure to keep rates as low as possible, which may negatively impact the reliability of its operations.

Climate Goals

It is not possible to predict with certainty whether PTP would be more or less responsive to meeting the State's climate goals compared to the investor-owned utilities. A stated purpose of PTP is to help the State meet or exceed its climate action plan goals and it is conceivable that PTP would be more aggressive in pursuing climate-related policies. On the other hand, it is possible that PTP will face political pressure to keep rates low and therefore will feel constrained to make new investments to facilitate beneficial electrification or the integration of renewable energy.

It is important to note that Maine's transmission and distribution utilities are generally prohibited from owning generation and this same prohibition would apply to PTP. Thus, any impact on climate goals would be related to measures such as facilitating the transition to electric vehicles or integrating renewable energy resources into the grid.

RATES

Under the Act, the rates of PTP must be approved by the MPUC or FERC and must be sufficient to pay the Company's full cost of providing service, including the cost of debt.

As explained below, FERC would likely not permit any recovery of an acquisition premium above book value and would likely continue to set rates to achieve a return based on a hypothetical capital structure typical of an investor-owned utility.

Independent Analysis of Proposal and Rate Impact

In 2020, the Public Utilities Commission hired a respected utility consultant, London Economics International (LEI) to evaluate a very similar but different piece of legislation that would have created a consumer-owned utility. The full analysis is a public document and can be found online at https://legislature.maine.gov/doc/4350.

The key conclusions from the LEI analysis were:

- The proposal was likely to raise rates in the short-term due to the cost of financing the acquisition
- The proposal was likely lower rates over the long-term due to future lower financing costs and tax savings
- The proposal could increase taxes and/or result in a reduction in government services due to lower state tax revenues collected from CMP and Versant
- There is significant uncertainty related to the acquisition price, the operator's management fee, the actual financing costs of PTP, and the future rate of growth in utility capital assets. These factors make it difficult to predict with certainty whether the acquisition will result in net savings to ratepayers

Economies of Scale

Currently, ratepayers may be benefitting from the fact the CMP and Versant are formally affiliated with other out-of-state utilities which may have created beneficial economies of scale through joint purchasing and sharing of expertise. However, under the proposal, it is anticipated that the CMP and Versant operations will be consolidated for the first time under one organization which will create new efficiencies and economies of scale that should offset any losses from lost corporate affiliations.

STATE REGUALTION OF PTP

Role of the MPUC and the OPA During and After the Transition

MPUC approval would be required for the following:

- The contract between PTP and the outside operator
- Debt issuances
- Proposed rate changes
- Construction of major new transmission lines

The OPA:

- May provide assistance and counsel to the PTP Board
- Would participate in all Commission proceedings related to the acquisition
- Would continue to participate in Commission proceedings involving PTP following the acquisition

Prudence Doctrine

The prudence doctrine is a well-established principle of utility ratemaking that applies to all utility expenditures. It requires utility spending decisions to be reasonable under the circumstances, that were known or should have been known, to the utility at the time they were made. The Commission has the authority to review spending decisions and if it finds that a utility acted imprudently, it can order that shareholders absorb the costs of such imprudence and deny any request by a utility to recover them from ratepayers.

It does not appear that the prudence doctrine could be applied to PTP following the acquisition. Because there would be no shareholders of the PTP, all costs must be recovered from ratepayers. Similarly, without shareholders, any fines or penalties imposed on the Company, would have to be borne by utility customers.

Proponents argue that PTP will have no financial incentive to act imprudently because PTP will not earn a higher return based on its capital spending. While it is true that PTP would have no financial incentive to overbuild its system, it is also true that without the threat of an imprudence finding there is no clear regulatory mechanism to discourage wasteful or unnecessary spending.

One possibility to maintain the prudence doctrine is that any imprudently incurred costs could be charged to the third-party Operator, rather than ratepayers. The contract between PTP and the

Operator could include a provision that the amount of any imprudence found by the MPUC would be deducted from the amounts owed to the Operator.

REGIONAL AND FEDERAL ISSUES

Participation in ISO-NE

Under the Act, PTP will remain in ISO-NE unless and until the Board votes to withdraw.

Regulation by Federal Energy Regulatory Commission (FERC)

Because PTP would remain in ISO-NE, it is likely that its transmission assets and rates would continue to be regulated by FERC.

In some circumstances FERC allows hypothetical capital structures for consumer owned entities. This means that regardless of the actual financial structure of the utility, FERC will assume that it is financed by a combination of shareholder equity and long-term debt typical of an investor-owned utility. It is therefore likely that for purposes of setting New England regional transmission rates, PTP would earn a return comparable to that of CMP or Versant.

Regardless of the rates established by FERC, under the proposal the MPUC is obligated to set rates to ensure PTP has sufficient revenues to satisfy its debt obligations. Accordingly, presumably the MPUC would take into account any shortfall or windfall received by PTP through transmission rates and adjust state-regulated rates accordingly.

MISCELLANEOUS

Fitness to Serve Provision

A provision of the proposed PTP legislation would require the MPUC to find that a utility is "unfit to serve" if at least four of eight enumerated conditions are met. The conditions include well established measurements of adequate service quality. Upon such a finding, the Commission is obligated to order the utility be sold to another entity within 24 months. Under this provision, it is possible that CMP or Versant would be required to sell their assets to another privately owned company, even if the acquisition fails.

Freedom of Access Act (FoAA) Requirements

PTP would be subject to Maine's FoAA law. This means that the records of the company would generally be public records and meetings would have to comply with Maine's open meeting requirements. A process is set forth in the law that would allow PTP to designate certain records as confidential, including customer records.

Impact of Debt Referendum

Opponents of the PTP proposal have advanced a separate initiative that would require voter approval of borrowing of more than $1 billion by certain public entities, including consumer-owned utilities. The question will be presented to voters at the same time as the PTP question and read as follows:

Do you want to bar some quasi-governmental entities and all consumer-owned electric utilities from taking on more than $1 billion in debt unless they get statewide voter approval?

If this question is approved by voters, it would likely require PTP to obtain additional voter approval before issuing debt needed to finance the acquisition of CMP's and Versant's assets.