STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2008-104

October 8, 2009

MAINE PUBLIC UTILITIES COMMISSON
Resource Planning and
Long-Term Contracting

ORDER DIRECTING
UTILITIES TO ENTER
INTO LONG-TERM
CONTRACT

REISHUS, Chairman; VAFIADES and CASHMAN, Commissioners

I. SUMMARY

Through this Order, we direct Central Maine Power Company (CMP) and Bangor-Hydro-Electric Company (BHE) to enter into long-term contracts for capacity and energy with Evergreen Wind Power III, LLC (EWP), a subsidiary of First Wind Holdings, LLC (First Wind), for the output of the Rollins Wind Project. The Rollins Wind Project is a 60 MW wind facility to be constructed in Penobscot County, Maine. We direct CMP to enter into a contract for 80% of the output of the Project and BHE to enter into a contract for 20% of the output of the contract.

II. PROCEDURAL BACKGROUND

During its 2006 session, the Legislature enacted an Act to Enhance Maine's Energy Independence and Security (Act). P.L. 2005, ch. 677. Part C of the Act (codified at 35-A M.R.S.A § 3210-C) authorized the Commission to direct investor-owned transmission and distribution (T&D) utilities to enter long-term contracts for capacity resources and associated energy. As required by the Act, the Commission adopted rules to implement the Act (Chapter 316).

Chapter 316, § 5(B) provides that the Commission solicit bids for capacity resources through the issuance of a request for proposals (RFP) that contains all standards, procedures and requirements for the long-term contract solicitation process, as well as a standard form contract. On December 3, 2008, the Commission issued an order approving and issuing the first long-term contract RFP.

The RFP called for Stage 1 Proposals (Bidder Registration) to be submitted by January 7, 2009 and Stage 2 Proposals (Comprehensive Proposals and Indicative Pricing) to be submitted by April 7, 2009. Since the submission of Stage 2 proposals, Staff and the Commission's consultant, London Economic Inc. (LEI), have conducted economic analyses of the various proposals, and have been working with a short-list of bidders and the utilities to develop commercial and contractual terms for long-term contracts that would be beneficial to ratepayers. The Staff has also consulted on a regular basis with the Public Advocate and the Department of Environmental Protection on the details of potential contractual arrangements.

Over recent weeks, the Staff and EWP, with substantial input from the utilities, worked to finalize contracts that could be presented to the Commission for its consideration. CMP, BHE, EWP and the Public Advocate filed comments on the proposed contracts. On October 7, 2009, the Commission deliberated the matter.

II. CONTRACTING AUTHORITY

1. Overview

As stated above, section 3210-C of Title 35-A, provides the Commission with the authority to direct investor-own utilities to enter into long-term contracts for capacity and energy under certain circumstances. The underlying purpose of this authority, in the Commission's view, is to take advantage of opportunities to use long-term contracts for capacity and energy with utilities as a means to lower capacity and energy costs or otherwise benefit Maine ratepayers. A long-term contract with a creditworthy counterparty such as a utility can be very valuable to developers or owners of generation resources and may be necessary to obtain financing for new projects. This is especially the case in the current financial climate. Accordingly, project developers and owners may be willing to offer utilities contractual terms that would be beneficial to electricity ratepayers. For example, project developers or owners may be willing to sell capacity and energy at a discount off of expected future prices. Such contracts may also provide a low-cost hedge against rising electricity prices (resulting from increases in natural gas prices). Moreover, by allowing for financing of projects and subsequent development that might not otherwise occur, long-term contracts could facilitate the construction of generation facilities in Maine. Such new generation could serve to lower capacity costs in Maine, enhance reliability, and promote the State's renewable energy development policies. *See* 35-A M.R.S.A. §3210-C (2).

2. Statute

Section 3210-C specifies that the Commission may direct investor-owned T&D utilities to enter into long term-contracts for capacity resources and any available energy associated with the capacity resource to the extent that the purchase of the energy fulfills the State's renewable energy expansion policies, or will lower the cost of electricity for ratepayers. 35-A M.R.S.A § 3210-C (3). The statute specifies that the Commission select proposals that are competitive and the lowest cost relative to similar bids. Among such proposals, the statute provides a priority order that establishes new renewable resources as a high priority in the selection of proposals. 35-A M.R.S.A § 3210-C (4).

Section 3210-C also specifies that the long-term contracts should be no more than 10 years, unless the Commission finds that a longer term to be prudent. The section states that the Commission may not require utilities to enter into "contracts for differences" that are designed to buffer ratepayers from negative impacts from

transmission development, but does not otherwise restrict the Commission's authority to direct utilities to enter into financial transactions.[1] 35-A M.R.S.A § 3210-C (3). Finally, the section requires the Commission to ensure that long-term contracts be consistent with the State's goals for greenhouse gas reduction and the regional greenhouse gas initiative.

3. Implementing Rules

The Commission's long-term contracting implementing rules (Chapter 316) state that contracted for capacity resources may not exceed the amount necessary to ensure the reliability of Maine's grid or to lower customer costs. Specifically, the rules state that the Commission may authorize a contract for capacity if: 1) the contract is a least cost means to address a local grid reliability need; 2) the contract is necessary for the resource to be developed, the resource will significantly lower regional capacity costs, and the contract prices are not expected to be higher then market prices; or 3) the contract prices are significantly below expected market value. The rules further state that the Commission may authorize contracts for associated energy if: 1) the contract is necessary to fulfill the State's new renewable resource policy, is necessary for the resource to be developed, and the contract prices are not expected to be higher than market prices; or 2) the contract prices are significantly below expected market value. Ch. 316, § 5.

III. PROPOSED LONG-TERM CONTRACT

The proposal under consideration is for a long-term contract between EWP and CMP and BHE for the entire energy output and capacity value of the Rollins Wind Project. The Rollins Wind Project is a 60 MW wind generating facility proposed to be developed in the Penobscot County towns of Lincoln, Winn, Lee and Burlington, Maine. The project is expected to begin commercial operation at the end of 2011.

The contract is for a twenty year term. The term begins with the commercial operation of the facility.[2] The energy under the contract is priced at the hourly real time locational marginal price at the ISO-NE internal hub (hub LMP) minus $10/MWh when the hourly real time locational marginal price for energy for the applicable node (node LMP) is within 10% of the hub LMP, and hub LMP minus $15/MWh when the node LMP is more than 10% lower than the hub LMP. Because the value of the energy under the contract will reflect the node LMP applicable to the Rollins facility, the two-tiered formula structure is intended to mitigate the risk of divergence between the node LMP and the

[1] Financial transactions are agreements in which only money (rather than a physical delivery of the capacity and energy commodity) is exchanged among the contracting parties. Such transactions mirror exactly the financial consequences of a physical transaction, but can do so in a way that reduces transaction costs and risks for utilities.

[2] Either party may terminate the contract if the facility is not in commercial operation by December 31, 2013.

hub LMP. Due to congestion and line losses, the node LMP has tended to be lower than the hub LMP, creating a risk that the $10/MWh discount off the hub LMP will be higher than the value of the energy. It is for this reason that the discount off hub LMP drops to $15/MWh if the differential between the hub LMP and nodal LMP is greater than 10%.

The energy price has a hourly floor of $55/MWh in the first year that escalates by $1/MWh per year until it reaches $65/ MWh in the eleventh year and remains at the level through the remaining years in the term. The contract also has an hourly energy price cap of $110/MWh.

The capacity component of the contract is a financial transaction in which the utility, essentially, obtains the capacity value of the facility for no addition cost above the energy costs. The capacity value is firm in that EWP must provide it under the contract regardless of how the capacity from the Rollins facility actually fares in the regional capacity market. This is a key feature of the contract because, although EWP expects that the Rollins project will in the future realize capacity value in the ISO-NE Forward Capacity Market (FCM), the facility is not currently qualified to participate in the Forward Capacity Auction (FCA). To provide for a capacity benefit prior to qualification, the contract specifies that, prior to qualification, EWP will pay CMP and BHE the financial equivalent of 17.91 MW[3] multiplied by the market value of capacity.[4] When the facility is qualified in the FCA, the contracts provide that EWP will pay to the utilities an amount equal to the qualified capacity value of the facility multiplied by the market value of capacity, with a capacity floor of 17.91 MW. After initial qualification, if the facility no longer has a capacity value under the regional rules, the contracts specify that EWP will pay to the utilities the financial equivalent of 17.91 MW multiplied by the lesser of (1) the market value of capacity or (2) and floor equal to $3.50/kW-month until May 2019 and $5.00/kW-month thereafter.

For security, the contracts require EWP to deliver to the CMP/BHE a second lien on the facility with the caveat that any first priority lien or security interest in the aggregate will not exceed 80% the capital cost or the appraised value of the facility, whichever is higher. EWP has the option of replacing the second lien with a letter of credit or cash in the amount of $4 million. The utilities are required to post security only if certain financial indicators show the utilities to be below investment-grade or the equivalent. The amount of security in the aggregate would be $8 million, with the amount apportioned to the utilities based on their contracted-for percent of the output of the facility. The utilities are not required to post any security if they remain rated at investment grade or the equivalent.

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[3] This capacity amount represented the expected capacity value of the facility after it is qualified as capacity resource in the forward capacity market.

[4] The market value price is capped at $5/kW-month until May 2015, than increases by $1/kW-month every five years, until it reaches $8/kW-month.

IV. COMMENTS

A. Utilities' Comments

On October 1, 2009, CMP and BHE submitted comments expressing concerns regarding the EWP contract, with CMP recommending that the Commission not direct it to enter into contract. As a general matter, the utilities note that that an evaluation of long-term contracts involve forecasts of future energy and capacity prices, which is a difficult task that carries certain inherent risk. With respect to the proposed contracts, the utilities state that the analysis also includes assumptions regarding the future differential in locational prices between the contract delivery point (node LMP) and the index pricing point (hub LMP). CMP indicated that its analysis of the contract over the first ten years of the term shows that the proposal would produce a net cost to ratepayers of several hundred thousand dollars per year over the first five years and a net present value loss of over $1.5 million for the 10-year period (assuming CMP contracts for the entire output of the facility). BHE's analysis shows a small marginal benefit to customers over the 20-year term (assuming a 20% allocation of the output to BHE). The utilities note that there would be more favorable results if market energy prices rise above current expectations or if the node LMP and hub LMP converge. Conversely, they note that the results would be worse for ratepayers if future prices are lower than projected and the LMPs do not converge.[5]

In addition, the utilities express concern that credit support provisions of the contracts are asymmetrical. The contracts provides for a second lien on the EWP facility that may be replaced at any time with cash or a letter of credit in the amount of $4 million, while the utilities must post $8 million if they fall below investment grade. The utilities state that the $4 million credit support is inadequate relative to the long term of the contract, possibly allowing EWP to take advantage of favorable economics in the first few years, but then decide to abandon the contract if market prices rise so that the performance is no longer attractive to EWP. Moreover, the utilities state that a second lien is not standard in the industry, is difficult to quantify, and is much less desirable than a liquid asset in securing the obligation.

BHE adds a concern regarding possible costs of administering the contract. BHE states that if the output of the facility is settled in the day-ahead or real-time market, there would be a cost of approximately $20,000 annually and a requirement for BHE to comply with FERC's standards of conduct that would cost approximately $25,000 in start-up costs. In the event BHE is allowed to contract for administration with its affiliate, Emera Energy, the cost would be approximately $10,000 annually.

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[5] CMP states that, because the Maine/New England price differential is largely a function of losses, not congestion, there is no reason to expect that convergence to a significant degree will occur.

Finally, BHE states there is a risk that the utilities may have to pay local transmission charges. This would occur if BHE's Keene Road upgrade is not completed as scheduled or if ISO-NE PTF designation does not occur prior to the facility's commercial operation date.

B. Evergreen Wind Power

On October 5, 2009, EWP submitted comments in response to the utilities' filings. EWP states that the proposed contracts will provide ratepayers with substantial savings and protection from price instability. Specifically, EWP states that the contracts will provide ratepayers a substantial discount from energy costs they would otherwise face, and provides the financial equivalent of the full capacity value of the facility at no additional cost to ratepayers. EWP also states that it retained a consultant to analyze the future differential between the node LMPs and the hub LMPs, and that the analysis found that there will be a general decrease in the future LMPs differential due to reduced congestion.[6]

With respect to security, EWP argues that a second lien is commercially reasonable under this circumstance in that in the current financial environment, EWP and its affiliates have found it extremely expensive to obtain letters of credit for a wind project. Thus, a second lien is far more cost-effective and has a secured value that is more than sufficient to secure the ratepayers' benefit. Moreover, according to EWP, the amounts that utilities are required to post in the event they fall below investment grade or the equivalent is necessary for the project to be financed in that it secures for the lender a certain cash flow under the contract for at least as year.

C. Public Advocate

As mentioned above, the Staff has consulted with the Public Advocate (as well as the DEP) throughout the contract evaluation process, including the provision of the economic analyses of the proposed contracts. The Public Advocate has submitted comments in general support of the approval of the EWP contracts. Specifically, the Public Advocate states his view that the contracts are reasonably likely to be beneficial over their 20 year terms.

V. DISCUSSION

We direct CMP and BHE to enter into the long-term contracts for capacity and energy with EWP for the entire output of the Rollins Wind Project. We direct CMP to enter into a contract for 80% of the output of the Project and BHE to enter into a contract for 20% of the output of the contract. For the reasons discussed below, we find that the contracts are reasonably likely to be beneficial to ratepayers and would clearly

[6] EWP commented that this analysis is conservative in that it assumed no reduction in losses, when such reductions will occur with transmission upgrades.

promote State energy policy as expressed in 35-A M.R.S.A. §3210-C and elsewhere in Maine statutes.

At the outset, we note our agreement with the utilities that there is an inherent risk to long-term contracts in that their economics depend on future projections of energy and capacity prices and, in the case of the proposed contracts, the economics are sensitive to the assumed differential between the node LMPs and the hub LMPs. It is for this reason that we take into account both quantitative economic analyses (including sensitivity analyses), as well as more qualitative considerations.

As mentioned, Staff has discussed pricing and contractual terms with EWP and the utilities for several months. Staff and its consultant, LEI, have reviewed and analyzed the proposed prices and the terms of the capacity and energy contracts using reasonably derived market price forecasts. The structure of these contracts with the value of the capacity purchased through energy prices negates a separate analysis of the capacity and associated energy components of the contracts.[7]

The contract is structured as a discount off of market prices, but contains a price floor. If market prices are primarily above the floor, the contractual structure provides a benefit in that the price is a discount off of market prices. The Staff/LEI's analysis (which analyzes the first 12 years of the contract) indicates that the contracts will likely have a small benefit in the early years of the contract that grows over time as electricity and capacity prices are forecasted to increase. These benefits are likely to continue to increase in the outer years of the contract given the trajectory of projected wholesale prices.

The Staff/LEI's analysis included sensitivities around various levels of differentials between the node LMPs and the hub LMPs. This analysis shows that the benefits decrease with higher assumed differentials. However, the analysis shows positive ratepayer benefits, even when a constant 15% differential is assumed. In addition, we note that the EWP analysis shows significantly greater ratepayer benefits due primarily to a higher natural gas price forecast, suggesting that that the Staff/LEI analysis may be conservative to some degree.

On a more qualitative basis, the contracts provide a ratepayer hedge against a future of higher than expected market prices. Maine's ratepayers are generally at risk of high and volatile market prices. Because the contracts contain a firm price ceiling of $110/MWh, they provide a hedge against high and volatile prices over their 20 year term. We acknowledge that the contracts will have lower or negative benefits if future prices turn out to be lower than expected. However, the potential cost of the hedge is

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[7] To the extent that our review is inconsistent with that contemplated by Chapter 316, we waive, for good cause, any inconsistent provisions pursuant to Chapter 316, § 10. Such a waiver is appropriate because the approach contemplated by the rule is not mandated by statute and a waiver in this case, if necessary, will promote the policies of section 3210-C.

relatively low in that the contracts are small relative to the size of the utilities. In the event that market prices are lower than the expected, any costs of the contracts will occur in an environment of generally lower prices, thus reducing the impact of the contracts on ratepayers.

With respect to the utilities concerns regarding credit support provisions, we agree that second lien is less desirable than more liquid security, and liens are not standard in the industry. As such, we do not favor this type of security. However, we recognize that the letters of credit are difficult to obtain and are very expensive in the current financial environment, especially for wind projects and conclude that this security provision does not warrant rejecting the contracts.[8] Moreover, the provisions that require the utilities to post security if they fall below investment grade or the equivalent is consistent with our long-standing approach with standard offer arrangements and were authorized in our December 3, 2008 order approving the RFP. Although the specific amounts of the security provision may not be ideal, they are not unreasonable and appear necessary for the financing of the project.

In response to BHE's concern regarding local transmission charges, BHE has provided a memorandum, in consultation with its FERC counsel, that states that effective on or about June 30, 2010 it will place into service a new Keene Road substation (long before the expected commercial operation of the Rollins project), which it expects to be classified by the ISO-NE as a PTF facility. Thus, we view the risk that the utilities may have to pay local transmission charges as minimal.

Finally, EWP has represented that the contracts are necessary for the projects to obtain financing and, as such, these contracts are necessary for the construction of the Rollins facility. Thus, these contracts will result in new generating capacity being built in Maine, helping to contribute to lower capacity prices within the State[9] and increase the diversity of the resource mix in the State and in the region. Moreover, as necessary to develop a wind facility in Maine, the contracts promote clearly articulated State energy policy of encouraging the development of wind facilities in Maine.[10]

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[8] We note that the contracts provide that any first priority lien or security interest may not exceed 80% of the capital cost or appraised value, whichever is larger and, therefore will secure a relatively large amount compared to the expected ratepayer benefit.

[9] As a general matter, the more generation that is constructed in the region, the lower the regional capacity prices. Moreover, new generation capacity built in Maine could result in lower capacity costs in Maine than the rest of the region.

[10] For example, Maine's Legislature has established wind energy development goals in the State of at least 2000 MW by 2015 and at least 3000 MW by 2020. 35-A M.R.S.A. § 3404(2).

As a wind facility, there will be no carbon air emissions associated with the generation of electricity. Thus, the long-term contracts are consistent with the States goals for greenhouse gas reduction and the regional greenhouse gas initiative, as required by statute.

The major benefits of these contracts occur over the 20 year term. As such, we find that contracts of 20-year terms are, in this case, prudent and in the ratepayer's interest as required by statute and rule.[11]

Consistent with provisions in statute and the rule, 35-A M.R.S.A. § 3210-C (8) and Ch. 316, § 8, the Commission will allow CMP and BHE to recover in rates the costs of this contract. In particular, the utilities will recover in rates through full reconciliation all costs paid for capacity and energy under the contracts net of any value realized from the disposition of the resources; will be allowed to defer and recover in rates all prudently incurred incremental costs associated with the administration of the contracts; and will be allowed to recover in rates any impact on their cost of capital that results from the entering into these contracts.

Finally, through future order, we will direct CMP and BHE as to the disposition of the contracted for resources consistent with statute and rule. 35-A M.R.S.A. § 3210-C (7) and Ch. 316, § 7.

Dated at Augusta, Maine, this 8th day of October, 2009.

BY ORDER OF THE COMMISSION

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Karen Geraghty
Administrative Director

COMMISSIONERS VOTING FOR: Reishus
Vafiades

COMMISSIONER ABSENT: Cashman

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[11] The standard for authorizing contracts beyond 10 years in statute is "prudent." 35-A M.R.S.A. SEC 3210-A (5). The standard in the implementing rules is "ratepayer interest." The Commission views the two standards as essentially the same.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.