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. 2013-00168

SURREBUTTAL TESTIMONY

OF

TIM WOOLF

ON BEHALF OF THE

MAINE PUBLIC ADVOCATE OFFICE

March 21, 2014

Office of the Public Advocate

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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. Have you previously testified in this docket?

A. Yes. I provided direct testimony on December 12, 2013.

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

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

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to three issues raised in the rebuttal testimony of Central Maine Power Company (CMP, or the Company) and other interveners. The three issues that I will address are: (1) the role of the Alternative Rate Plan (ARP), (2) the Revenue Decoupling Mechanism (RDM), and (3) the treatment of the Customer Relationship Management & Billing System (CRM&B) surcharge.

Q. Please summarize your testimony.

A. My primary conclusions and recommendations are as follows:

- If the Commission decides to continue with an Alternative Ratemaking Plan for CMP, then the OPA's proposal is the best way to design the ARP. However, if the Commission wishes to consider a return to traditional cost-of-service regulation, the OPA would not be opposed to such a move.

- The OPA's proposed RDM mechanism does not increase risks for customers. In fact, the RDM will make customers better off, as long as the OPA's recommended consumer protection measures are also adopted.

- The OPA opposes the recovery of CRM&B costs prior to the project being placed in service and used and useful. The costs for the project should be recovered through a surcharge only at the time that the project becomes operational in order to avoid carrying costs and to ensure that customers are receiving the benefit for which they are paying.

2. ROLE OF THE ALTERNATIVE RATE PLAN IN SETTING RATES

Q. Please summarize the Staff's proposal regarding the overall role of the Company's Alternative Ratemaking Plan.

A. Staff has numerous concerns with the Company's ARP proposal and therefore recommends taking a "hiatus" from the ARP mechanism. The Staff proposes a return to traditional cost-of-service ratemaking, at least for sufficient time to assess the best option.[1]

Q. What is your position regarding the Staff's proposal?

A. As I noted in my direct testimony, a return to traditional cost-of-service ratemaking is a viable alternative to the Alternative Rate Plan.[2] However, if the Commission decides to continue with an ARP, the OPA believes that its proposal is the best way to design the ARP mechanism under current conditions.

Q. Why do you believe that the OPA's proposal represents the best means of continuing the ARP?

A. The OPA's ARP proposal, taken as a whole, includes several components that will protect customers, while maintaining the overall construct of an Alternative Ratemaking Plan and providing the Company with sufficient revenues to provide safe, reliable, low-cost electricity services.

First, the OPA's proposal requires the Company to treat the cost recovery of the CRM&B separately from the other capital costs. As noted in my direct testimony "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."[3] Many of the concerns about the Company's productivity factor arise from the fact that the CRM&B is a large, atypical, and infrequent type of investment. The OPA's proposal addresses this

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[1] Bench Analysis, December 12, 2013, p. 20
[2] Woolf Direct Testimony, December 12, 2013, p. 9.
[3] Woolf Direct Testimony, December 12, 2013, p. 17.

challenge directly by removing the CRM&B from the ARP, and therefore from the productivity analysis. The CRM&B cost recovery would be comparable to cost treatment under traditional cost-of-service ratemaking. Thus, the OPA's proposal is essentially taking a step in the direction of traditional cost-of-service ratemaking, as recommended by Staff, but only for the most significant and most challenging of the Company's future capital expenditures.

Second, the OPA proposes a more meaningful and appropriate productivity offset for O&M expenses than the Company's proposal. The OPA is proposing a productivity offset of positive 0.95 percent,[4] which is much greater than the Company's proposed productivity offset of negative 1.85 percent.[5] The OPA's greater productivity offset will reduce the revenue requirements that customers would otherwise have to pay for, and provide a stronger incentive for the Company to be more efficient with regard to O&M expenses.

Third, the OPA proposes an allowed return on equity (ROE) of 8.5 percent.[6] This is significantly lower than the Company's proposed allowed ROE of 10.15 percent.[7] The OPA's lower allowed ROE provides the appropriate ratepayer risk reduction to account for the proposed decoupling mechanism, the Company's rate of return adjustment proposal, as well as the OPA's proposed adjustment to inflation proposal that allows CMP to earn its authorized rate of return.[8]

Fourth, the OPA proposes a revenue decoupling mechanism (RDM) that incorporates appropriate consumer protection measures. The OPA's RDM proposal, taken as a whole, is likely to provide net benefits to customers, without exposing them to increased risks. I elaborate upon this important point in the following two sections.

In sum, if the Commission decides to continue with an Alternative Ratemaking Plan for CMP, then the OPA's proposal is the best way to design the ARP mechanism under

[4] King Direct Testimony, December 12, 2013, p. 38.
[5] Adams, Stinneford, and Policy Brown, Rebuttal Testimony, February 4, 2014, p. REB-POL-6
[6] King Direct Testimony, December 12, 2013, p. 3.
[7] Adams, Stinneford, and Brown, Policy Rebuttal Testimony, February 4, 2014, p. REB-POL-10.
[8] King Direct Testimony, December 12, 2013, p. 28-29.

current conditions. However, if the Commission wishes to consider a return to traditional cost-of-service regulation, the OPA would not be opposed to such a move.

3. REVENUE DECOUPLING MECHANISM: ADJUSTMENT CAP

Q. Please summarize the RDM adjustment cap that you proposed in your direct testimony.

A. In my direct testimony I recommended that the Commission establish a cap on the amount of revenues that can be recovered from customers in any one RDM adjustment. I recommended that "The cap should be set at one percent of total allowed revenues for CMP for the period covered by the annual 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."[9] Further, I recommended that unrecovered revenues could be rolled over from one year to the next, but that the Company would not be able to recover any unrecovered revenues that might remain at the end of the ARP2014 period.[10]

Q. Did you provide any clarification of your proposal in response to discovery?

A. Yes. The Company asked several discovery requests regarding the details of my proposed RDM adjustment cap.

Q. Would you like to clarify these details at this time?

A. Yes. First, I recommend that the cap be based on the revenues estimated for the first rate year in ARP2014.[11] This approach would be simpler than estimating a different RDM adjustment cap for each year throughout the ARP. It also provides more certainty regarding the magnitude of the cap throughout the ARP.

Second, I recommend that the cap should be applied separately to each of the two reconciliation groups defined by the Company (residential and commercial/industrial). In this way, each group will have some assurance that their RDM adjustments will be no more than one percent each year.

[9] Woolf Direct Testimony, December 12, 2013, pp. 28-29.
[10] Woolf Direct Testimony, December 12, 2013, p. 29.
[11] OPA Response to CMP-013-001.

Third, I wish to clarify that my proposed cap of one percent would be based on the Company's total distribution and transmission revenues combined with standard offer revenues. In its rebuttal testimony, the Company estimates that a one percent cap based on its total delivery rates (including standard offer revenues) would be approximately $8.4 million.[12]

Q. Why do you recommend that the RDM adjustment cap be based on total revenues, including standard offer revenues, given that the Company does not control standard offer revenues or costs?

A. The purpose of the RDM adjustment cap is to protect customers from significant swings in prices as a result of the RDM. There are several benchmarks that could be used to set such a cap. The two most obvious benchmarks are a percent of distribution revenues, and a percent of total revenues. I prefer that the RDM cap be based on total revenues, because this provides a better overall indication of the extent to which customers' total electric bills might be affected by the adjustment. A one percent RDM cap based on total revenues means that in general customers' total electric bills will not increase by more than one percent as a result of the RDM adjustment. This benchmark in terms of total electric bills helps to place in context concerns about price volatility and risk, as described in the next section of my testimony.

Q. Do you recommend that the RDM adjustment cap be symmetrical? That is, in the event that the Company collects more than its target revenues, should it limit the amount that it returns to customers through the RDM adjustment?

A. No. In this instance there is good reason for an asymmetrical mechanism. In the event that the Company collects significantly more than its target revenues (as a result of increased sales), the Company is not harmed in any way by returning the excess to customers. Even after returning the excess revenues to customers, the Company would have collected its target revenues, and the revenues collected should be sufficient to cover its costs, based upon the construct of the ARP and the RDM. Thus, the Company is not harmed in any way by returning all excess revenues to customers in each RDM adjustment.

[12] Lahtinen Rebuttal Testimony, February 4, 2014, p. 17.

On the other hand, in the event that the Company collects significantly less than its target revenues (as a result of reduced sales), customers could be harmed as a result of price increases at the time of the RDM adjustment. The reason for the RDM adjustment cap is to limit the extent to which customers will be exposed to such price increases. There is no need to have a comparable cap on rate decreases, to limit any harm to the Company from returning excess revenues to customers, because there is no harm in that instance.

Q. CMP believes that any RDM adjustment balance (either positive or negative) at the end of the ARP should be fully recovered or returned to customers in a subsequent rate period.[13] Do you agree?

A. No. I recommend that if there remains some uncollected revenues at the end of the 2014 ARP period, then the Company would not be allowed to collect those remaining uncollected revenues.[14] Again, this is simply a measure to protect customers in the event that uncollected revenues turn out to be greater than expected at the end of the ARP period.

4. REVENUE DECOUPLING MECHANISM: RISK VERSUS VOLATILITY

Q. Does Staff support the adoption of a Revenue Decoupling Mechanism?

A. No. Staff is concerned that revenue decoupling (together with other mechanisms in CMP's proposal) "reduces the likelihood that the ARP will produce predictable and stable rates since rates will change annually based on a number of factors other than inflation," and "significantly shifts risks onto customers and away from shareholders."[15]

Q. Do you agree with Staff's point that RDM will lead to unstable rates?

A. No. Any RDM adjustments for CMP will be based on deviations in revenues from one year to the next, and are thus likely to be small. That is, rates will be set on an on-going basis to recover the following year's target revenues, and will utilize recently forecasted customer counts and sales. Actual deviations from such forecasts are likely to be small, and therefore RDM adjustments will also be small. While fluctuations in the economy

[13] Lahitinen Rebuttal Testimony, February 4, 2014, p.REB-JAL-18.
[14] Woolf Direct Testimony, December 12, 2013, p. 29.
[15] Bench Analysis, p. 85

and weather will cause some deviation from forecasts, it is reasonable to expect that such adjustments will be both up and down, and will generally balance out over time.

Q. Do you agree with Staff's point that the RDM will shift risk from the Company onto customers?

A. No. It is a commonly held misconception that decoupling will result in shifting risk from the utility to its customers. With regard to the OPA's proposal, this is not the case. It is very important to recognize that the RDM shifts *volatility* from the utility to the customers, but while this shift in volatility reduces risk for the utility, it does not materially increase risk for customers.

Q. Please explain what you mean by RDM shifts volatility from the utility to customers.

A. Under the RDM, electricity rates will be adjusted annually to correct for over-recovery or under-recovery relative to the target revenues. This means that electric rates will be slightly more volatile than they would be in the absence of the RDM. At the same time, utility revenues will be less volatile than they would be in the absence of RDM. Consequently, it is volatility that is shifted from the utility to the customers.

Q. Is there a difference between volatility and risk?

A. That depends upon whether you are a customer or a utility shareholder.

Q. What is the impact of revenue volatility on utility shareholders?

A. For the utility, revenue volatility translates into profit volatility. For utility shareholders, profit volatility is essentially the same thing as risk. Volatility, frequently measured as the standard deviation of returns, is the most common measure of financial risk, as it exposes investors to uncertain change.[16] A reduction in volatility is equivalent to a reduction in risk for shareholders. From the utility shareholder perspective, reduced volatility from the RDM is equivalent to reduced risk. This is why it is important to reduce a utility's allowed ROE when rates are decoupled.

[16] See, for example, the definitions of risk and volatility given in: Gary Gastineau and Kritzman,M., *Dictionary of Financial Risk Management*, American Stock Exchange, New York: 1999; and Jon Danielsson, *Financial Risk Forecasting: The Theory and Practice of Forecasting Market Risk, with Implementation in R and MATLAB,* Wiley & Sons, Chichester, United Kingdom: 2011.

Q. What is the impact of price volatility on customers?

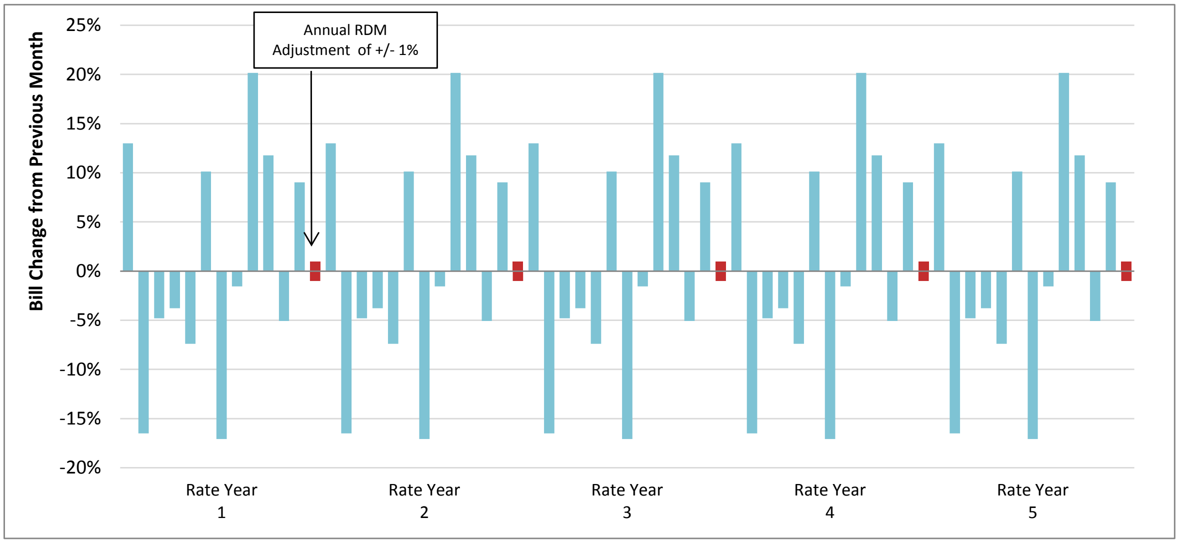
A. The impact of volatility on customers is very different than for utility shareholders. For customers, increased volatility means that their bills will be slightly higher or lower over time. If the cause of the volatility (e.g., weather or economic conditions) is roughly symmetrical, then their long-term costs will be the same. From a long-term cost perspective, customers are no worse off. Thus, from the customers' perspective, increased volatility is not equivalent to increased risk.

Furthermore, the magnitude of the volatility will be quite small, by design. The OPA proposes that the RDM adjustments be capped at one percent of total revenues. This means that RDM will cause customers' bills to change by a maximum of only one percent each year. This is a very small increase in the volatility of electric bills, especially compared with the extent to which customer bills typically fluctuate from month to month, season to season, and year to year based on changing consumption levels and changing costs.

I offer Figure 1 for illustrative purposes. It presents month-to-month electricity bill volatility for a sample electricity customer. Each of the blue bars indicates the month-to-month percent change in the customer's bill resulting from varying consumption levels from one month to the next. Each of the smaller red bars indicates a one percent (positive or negative) change in bills between rate years, as a result of the OPA's proposed RDM.[17] As indicated, increased volatility of one percent of bills once a year is essentially *de minimus*, relative to the month-to-month volatility that ratepayers experience.

[17] For this illustration, an actual residential customer's historic monthly consumption levels were used to indicate the monthly percent change in bills. The historic monthly percent changes were then simply extended out over all of the rate years, without changing distribution, transmission or generation rates over time. In practice, actual bills would experience a different volatility pattern due to the changes in rates over this period.

Figure 1. Month-to-Month Volatility in the Electric Bill of a Sample Residential Customer



Q. What, then, are the ultimate implications of shifting volatility from the utility to customers?

A. In sum, utility shareholders are better off with reduced volatility of revenues, while customers are essentially no worse off with increased volatility of bills (as long as the OPA's proposed cap is applied).

The Commission should accept the OPA's proposal to reduce the Company's allowed ROE due to the reduced volatility of revenues, because this is fair to shareholders and provides important additional benefits to customers in terms of lower rates. With this additional component of the OPA's RDM proposal, customers are likely to be better off with RDM than without it, despite the very small increase in the volatility of bills.

Q. Please explain why you believe that customers will be better off with the RDM than without it.

A. As described immediately above, customers have little, if anything, to lose from the OPA's proposed RDM. While there will theoretically be an increase in the volatility of rates, in practice this will be so small as to be un-noticeable, and will be offset by the reduced ROE.

Furthermore, there will be additional benefits to customers as a result of the RDM. First, as I describe in my direct testimony, an RDM eliminates the pressure to increase fixed customer charges as the Company has requested in this docket. From the customers' perspective, an RDM is a far superior way to address revenue uncertainty and volatility than increasing customer charges.

Second, the RDM should result in greater investment in cost-effective energy efficiency and distributed generation resources. These resources can provide multiple benefits to customers, including lower-cost electricity services.

Third, in the context of the ARP, when sales are flat or declining, the RDM reduces the need for inflation adjustments to the Revenue Index Mechanism. The RDM helps to ensure the Company will recover the revenues needed to cover its costs, regardless of actual sales volumes. In the absence of RDM, the Company's proposed X-factor would need to be greater (under the Company's proposal), or the OPA's proposed inflation adjustment[18] would need to be greater (under the OPA's proposal) to offset flat or declining sales.

Fourth, if the Commission decides to revert to traditional cost-of-service ratemaking (under the Staff's proposal), then the RDM will allow for less frequent rate cases.

5. THE SEPARATE CRM&B SURCHARGE

Q. Please summarize your proposal for a separate CRM&B surcharge.

A. As noted above, one of the biggest challenges in this rate case is how to provide the Company with the flexibility to undertake large, atypical, infrequent capital projects such as the CRM&B project. The ARP mechanism is not well-suited to account for this type of major capital expenditure, because the year-to-year rate increases are based upon inflation minus a productivity factor, which is not capable of adequately accounting for large, atypical, infrequent capital projects.[19] To address this challenge I recommend that major capital expenditures such as the CRM&B be accounted for outside of the ARP, in a separate surcharge. These major capital expenditures would be treated in a way that is comparable to traditional cost-of-service ratemaking, where (a) the utility decides whether and when to undertake major capital projects; (b) the capital costs are not put

[18] Catlin Direct Testimony, December 12, 2013, p. 13.
[19] Woolf Direct Testimony, December 12, 2013, p. 18.

into rates until the capital project is operational, used and useful; and (c) the Commission has the ability to review the capital project for prudence retrospectively when the costs are formally entered into rates during the subsequent rate case.

Q. Would you like to provide more detail on your recommendation regarding the Commission review and approval of major capital expenditures that are placed into the separate surcharge?

A. Yes. I wish to expand upon my recommendation that "The Commission would not review such capital projects in advance, and would not provide any sort of pre-approval for such capital projects."[20] By this I mean that the Commission would not pre-approve the *magnitude* of capital expenditures associated with the proposed project. The Company would have the responsibility to implement the capital project as efficiently as possible, and to ensure that the magnitude of costs is reasonable and prudent. Any concerns about the magnitude of the capital expenditures would be addressed after the project is complete, in the subsequent rate case, consistent with traditional cost-of-service ratemaking.

However, the Commission could make a finding with regard to the *need* for the proposed capital project, or in this case, the need to replace the existing billing system. Such a finding would provide the Company with some comfort that it is not likely to be subject to a challenge at a future date about the decision to proceed with the proposed capital project.

Q. Would you like to provide more detail on your recommendation regarding the timing of when major capital expenditures can be placed into the separate surcharge?

A. Yes. I wish to expand upon my recommendation that "When the Company undertakes a major capital project, it would be allowed to place those expenditures into an account for on-going recovery."[21] It is important to clarify when the capital project expenditures would be placed into the separate surcharge.

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[20] Woolf Direct Testimony, p. 19.
[21] Woolf Direct Testimony, p. 19.

In its rebuttal testimony, the Company proposes that the CRM&B surcharge go into effect beginning on July 1, 2016, despite the fact that the Company does not anticipate that the CRM&B will go into service until January 2017. This timing is proposed in order to avoid carrying costs on the project from February 2017 to June 2017, and to help smooth the rate impact.[22]

The OPA does not agree with the Company's proposal of placing the costs of the CRM&B into the surcharge before the project is operational. The costs of major capital expenditures should not be placed into rates until the capital project is in-service, and is used and useful. This is a standard concept that is applied under traditional cost-of-service ratemaking, and is relevant in this context as well. Put simply, customers should not be charged costs for a project that is not in-service and is therefore not providing them benefits. In addition, there may be project delays or deviations from projected costs, making the costs placed in rates that much more inappropriate.

The OPA believes that the best option would be to place the capital project expenditures into the capital cost surcharge at the time the project becomes operational. In the case of the CRM&B, the Company expects this to be January 2017. At that point in time, the appropriate costs would go into the capital cost surcharge. This would mean adjusting rates in January, which would require a separate rate adjustment in addition to the CMP rate adjustments that typically occur in July. The OPA believes that making the adjustment at this time is preferable to making the adjustment in July, because it ensures that rates are not increased until the project is operational, and it eliminates the need for interest costs that would be incurred if the project costs were placed in the surcharge at a later date.

Q. Would you like to provide more detail on your recommendation regarding the types of costs that should be placed in the separate surcharge?

A. Yes. The rationale for the separate surcharge is to provide the Company with the ability to undertake major, infrequent capital projects between rate cases during the ARP period and still be able to recover those costs in a way that is comparable to what they would

[22] Adams, Stinneford, and Brown, Policy Rebuttal Testimony, February 4, 2014, pp. REB-POL-48-49.

recover if there were a rate case. At the time of a rate case, capital costs are typically placed into rate base, and the Company is allowed to collect the depreciation expense, taxes, and the return on equity associated with those costs. The capital expenditure surcharge should work the same way. Once the project enters service, the Company should be able to recover in the surcharge the depreciation, taxes, and return on equity associated with the costs. At the time of the next rate case, the surcharge account is zeroed out, the undepreciated portion of the costs is added into the Company's rate base, and the remainder of the project costs are recovered through rate base going forward.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.