D.T.E. 99-90-C

Petition of Commonwealth Electric Company for approval of its Transition Charge Reconciliation Filing and the accompanying tariffs filed pursuant to G.L. c. 164, § 1A(a), 220 C.M.R. § 11.03(4)(e) and D.P.U./D.T.E. 97-111.

APPEARANCES: John Cope-Flanagan, Esquire
NSTAR
800 Boyslton Street
Boston, MA 02199
FOR: Cambridge Electric Light Company
Petitioner

Robert Werlin, Esquire
Keegan, Werlin & Pabian, LLP
21 Custom House
Boston, Massachusetts 02110
FOR: Cambridge Electric Light Company
Petitioner

Thomas F. Reilly, Attorney General
By: Joseph W. Rogers, Assistant Attorney General
Regulated Industries Division
Public Protection Bureau
200 Portland Street
Boston, Massachusetts 02114
Intervenor

Steven Klionsky, Esq.
260 Franklin Street, 21st Floor
Boston, MA 02110
FOR: WESTERN MASSACHUSETTS ELECTRIC COMPANY
Limited Participant

Erica L. Tarpey, Esq.
LeBoeuf, Lamb, Greene & MacRae
260 Franklin Street
Boston, MA 02110-3173
FOR: FITCHBURG GAS AND ELECTRIC LIGHT COMPANY
Limited Participant

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I. INTRODUCTION

On October 27, 1999, Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth") (collectively, "Companies") filed for approval by the Department of Telecommunications and Energy ("Department") their first reconciliation of transition costs, transmission costs, standard offer costs, and default service costs ("Filing") for the period March 1, 1998 through December 31, 1998. The Companies filed pursuant to G.L. c. 164, § 1A(a), 220 C.M.R. § 11.03(4)(e), and the Companies' restructuring plan approved by the Department in Cambridge Electric Company/Commonwealth Electric Company, D.P.U./D.T.E. 97-111 (1998) ("D.T.E. 97-111"). The Companies proposed tariffs, effective January 1, 2000, that incorporate proposed charges and adjustments to their rates. The Department docketed this matter as D.T.E. 99-90.

II. BACKGROUND

On November 19, 1997, the Companies filed with the Department a proposed electric restructuring plan pursuant to the Electric Restructuring Act ("Act").[1] In that restructuring proceeding, D.T.E. 97-111, many issues were raised concerning the appropriate treatment of certain costs the Companies were proposing to include as transition costs. In D.T.E. 97-111, at 62, the Department deferred making findings concerning the recovery of certain proposed costs until the Companies' first reconciliation filing. Specifically, we deferred treatment and

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[1] "An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, Regulating the Provision of Electricity and Other Services, and Promoting Enhanced Consumer Protection Therein," St. 1997, c. 164.

inclusion of: (1) Blackstone Station costs; (2) Pilgrim 1 litigation costs; (3) Pepperel and Tenaska buyout costs (4) Cannon Street investment costs; (5) asbestos costs associated with Blackstone and Kendall Stations; (6) conservation and load management costs; and (7) carrying charges on pension and post-retirement benefit costs other than pensions ("PBOPs").

Similarly, in Cambridge Electric Light Company/Commonwealth Electric Company/Canal Electric Company, D.T.E. 98-78/83 (1999), the Companies' generation asset divestiture proceeding, the Companies proposed wording revisions to the Companies' transition charge formula found in their restructuring plan. The Department deferred making findings on this matter also until the Companies' first reconciliation filing. Id. at 36.

III. PROCEDURAL HISTORY

Pursuant to notice duly issued, the Department conducted a public hearing on November 19, 1999. A procedural conference was held on November 23, 1999. At the procedural conference, the Department bifurcated the proceeding to address (1) the review of revenue-neutral distribution rate redesign and inflation adjustment issues and (2) transition charge issues.

On November 24, 1999, pursuant to G.L. c. 12, § 11E, the Attorney General of the Commonwealth ("Attorney General") filed a notice of intervention in this proceeding. In addition, the Department granted limited participant status to Western Massachusetts Electric Company ("WMECo") and Fitchburg Gas and Electric Light Company.

Regarding the rate redesign and inflation adjustment issues, on December 17, 1999, the Department issued guidelines for implementation in each distribution company's 2000

reconciliation adjustment filing ("December 17, 1999 Letter"). In response, by letter dated December 22, 1999, Cambridge stated that no rate schedule changes would be required to comply with the Department's December 17, 1999 Letter. On December 22, 1999, Commonwealth filed new tariffs to comply with the Department's December 17, 1999 Letter. The Department approved the Companies' tariffs on January 5, 2000, subject to the outcome of part two of this proceeding -- the transition charge reconciliation. Cambridge Electric Light Company, D.T.E. 99-90-A (2000); Commonwealth Electric Company, D.T.E. 99-90-B (2000).

Regarding the transition charge reconciliation issues, the Department held a procedural conference on January 11, 2000. The Department then held six days of evidentiary hearings between March 6, 2000 and March 16, 2000. In support of their Filing, the Companies presented the testimony of Robert Martin, director of revenue requirements for the regulated companies of NSTAR and Henry LaMontagne, director of regulatory policy and rates for the regulated companies of NSTAR. Christopher M. Lee, audit manager for Arthur Andersen, L.L.P. ("Arthur Andersen"), also testified concerning an audit of the Companies' stranded costs. The evidentiary record consists of 335 exhibits and 68 record requests, as well as the exhibits from D.T.E. 97-111 and D.T.E. 98-78/83. The parties submitted briefs in April 2000 and reply briefs in May 2000.[2]

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[2] The Massachusetts Division of Insurance, the Low-Income Affordability Network, the Northeast Energy Efficiency Council, and The Energy Consortium filed joint comments on June 1, 2000, which were made part of the public docket of this proceeding.

IV. ARTHUR ANDERSEN INDEPENDENT AUDIT

A. Introduction

In accordance with G.L. c. 164, § 1G(a)(1),[3] the Department retained an independent auditor, Arthur Andersen, to audit the costs for generation-related assets and obligations and to ensure substantial compliance with the Act for recovery of stranded costs. The Department accepted Arthur Andersen's proposed procedures and agreed-upon procedures,[4] concluding that the procedures were sufficient to meet the audit requirements of the Act (Exh. RHM-2, August 25, 1999 letter from Arthur Andersen to the Department). Arthur Andersen performed an audit on (1) the specified elements, consisting of generation-related and regulatory assets of the Companies' financial statements, and (2) applying procedures on the specified elements of the Companies' transition cost filing in D.T.E. 97-111 (id.). In its audit report, Arthur Andersen concluded that the amounts in the Companies' filings in D.T.E. 97-111 did not require any adjustments (id.). On September 30, 1999, the Department issued the audit report to the Legislature (id., September 30, 1999 letter from the Department to the

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[3] General Laws c. 164, § 1A(a), sets "substantial compliance" as the review standard for electric companies with proposed restructuring settlements or restructuring plans on file with the Department as of the date of engrossment of what became St. 1997, c. 164. The Companies come within the ambit of this provision. D.T.E. 97-111, at 12, 89-90.

[4] Costs included in the Companies' variable component of their transition charge consist primarily of above market purchase power costs. The quantification of this portion of recoverable costs is based on estimates, including the future prices of electricity and fuels. Because of these estimates, generally accepted auditing standards do not permit the expression of a standard audit opinion on these amounts. Instead, the report on these amounts is called an agreed-upon procedures report.

Legislature). The Companies proposed to use the audit conducted by Arthur Andersen as a basis for approval of their transition cost filing (Exh. RHM-1, at 47-50).

B. Positions of the Parties

1. Attorney General

The Attorney General argues that the Department cannot rely on the Arthur Andersen audit for the determination of recoverable regulatory asset costs because Arthur Andersen: (1) served as the Companies' auditor for the last 40 years; (2) did not comply with the Act; and (3) did not comply with the agreed-upon audit procedures (Attorney General Brief at 14).

First, the Attorney General maintains that Arthur Andersen did not perform an independent audit, given that it relied on its own annual audits of the Companies' balance sheets and income statements rather than auditing each and every transition cost for accuracy (id. at 15). Second, the Attorney General contends that the general accepted auditing standards ("GAAS") used by Arthur Andersen are not appropriate in a regulatory compliance audit and, therefore, the audit is not in compliance with the Act (id. at 14). Specifically, the Attorney General argues that GAAS standards for financial statements, which require only an 80 percent probability that the jurisdictional regulatory authority will allow recovery of a claimed regulatory asset, are inconsistent with the Department's audit requirements. The Attorney General maintains that the Department required 100 percent certainty that the balances were correct and that the Department had previously approved recovery of the regulatory asset costs (id. at 7, citing Tr. 6, at 591; G.L. c. 164, § 1G(b)(1)(iii)). Finally, the Attorney General maintains that while the agreed-upon audit procedures required Arthur Andersen to review

previous Department orders for deferral and recovery, Arthur Andersen admitted that it had not complied with this requirement (Attorney General Brief at 15, citing Tr. 6, at 544).

2. The Companies

The Companies reject the Attorney General's allegation that the audit was not independent (Companies Brief at 22). Instead, the Companies argue that because the Department, and not the Companies, retained Arthur Andersen, there is no conflict of interest (id. at 22). Furthermore, the Companies state that Arthur Andersen concluded that the use of previously audited statements was critical to give an opinion on specified elements (e.g., regulatory assets) because of the need to understand the historical treatment of the elements that Arthur Andersen's audit would address (id. at 23, citing Tr. 6, at 520-521). Based on the above, the Companies maintain that the Department should use the results of the audit for its transition cost recovery (id. at 22).

C. Analysis and Findings

The Department has previously acknowledged that while the audit found that the Companies properly stated their transition costs, "[t]he purpose of the audit was not to replace the Department's determination of the specific items that are eligible for inclusion in the transition charge" (Exh. RHM-2, September 30, 1999 letter from the Department to the Legislature, Executive Summary). Furthermore, in D.T.E. 97-111, at 62, the Department specified that the Department itself would determine the appropriate treatment of certain proposed transition costs in the Companies' first reconciliation case. The Arthur Andersen audit does not relieve the Department of its responsibility to fully investigate and determine

those costs eligible for transition cost recovery. The Department merely uses Arthur Andersen's contracted-for auditing service to inform the exercise of its own independent judgment. While the Attorney General identified flaws in the audit such as the lack of audit compliance with the Act and Arthur Andersen's failure to review previous Department orders, these concerns are misplaced because the Department is not substituting the audit for its own investigation.

Arthur Andersen is an internationally recognized independent firm. Its prior association as the Companies' auditor does not taint or qualify its reputation for independence, as the Attorney General suggests. Merely affixing a negative label to Arthur Andersen's work is no substitute for proof, much less for logic, in advancing untethered claims of bias. In fact, knowledge of the Companies' past operations may fairly be rated an advantage. Under the substantial evidence standard of G.L. c. 30A, § 14, the Department may and does reasonably rely on Arthur Andersen's report.

V. DEFERRED ISSUES[5]

A. Blackstone Station

1. Introduction

Cambridge proposed to recover through the fixed component of the transition charge the undepreciated balance of $452,000 for Blackstone Station. Blackstone Station is a

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[5] This section addresses most issues deferred from D.T.E. 97-111 and D.T.E. 98-78/83. The remaining deferred issues from these proceedings are addressed in Section VI, Transition Costs, such as the Companies' unrecovered deferred fuel charge balance, which is addressed in Section VI.C.

16 megawatt ("MW") peaking station built in 1903 that produces electricity and steam as a by-product (Exh. RHM-1, Cambridge Sch. 1, at 5). In 1983, Cambridge allocated Blackstone Station costs between the steam and electric side of the plant and removed the steam side from rate base (Tr. 4, at 323; Tr. 6, at 579-580). Cambridge has not divested its Blackstone Station.

2. Position of the Parties

a. Attorney General

The Attorney General argues that because Cambridge has not sold Blackstone Station as required by the Act, it has not met its obligation under the Act to mitigate its stranded costs (Attorney General Brief at 10-11). Therefore, in order to provide the required mitigation, the Attorney General proposes that Cambridge's transition charge be credited with revenue equal to the residual value credit ("RVC") that would be applied had Cambridge sold the unit at the same time as its other plants and obtained $14.6 million or $911 per kilowatt ("KW"), the highest reported price per KW of capacity for plant sales in New England (id. at 11).

b. Cambridge

Cambridge argued that it had to separate out the Blackstone Station from the rest of its generation asset divestiture because Harvard University holds a right of first refusal with Cambridge (Companies Brief at 17). The Company maintains that although Harvard has yet to exercise its right of first refusal, Cambridge has taken all reasonable measures to divest Blackstone Station by pursuing negotiations for the sale of Blackstone to Harvard University. Therefore, it has met the provisions of the Act and is entitled to stranded cost recovery (id.

at 17). Furthermore, the Company claims that any interim mitigation as proposed by the Attorney General would unfairly penalize the Company because it would require the Company to return money it has yet to receive (id. at 17, n.9).

3. Analysis and Findings

The Act requires mitigation as a condition to an electric company's recovery of transition costs. G.L. c. 164, § 1G(b)(1). The Act also requires divestiture of non-nuclear generation assets by August 1, 1999. G.L. c. 164, § 1G(c)(1)(ii). In some instances, the Department has allowed divestiture beyond the required date, if it would benefit ratepayers. For example, in its restructuring filing, WMECo proposed to postpone the sale of its Northfield Mountain and related facilities until the end of 1999. Western Massachusetts Electric Company, D.P.U./D.T.E. 97-120, at 132 (1999) ("D.T.E. 97-120"). In an effort to maximize the sale price, WMECo proposed to delay the sale so that its minority interest in the plant could be sold in conjunction with the majority interest held by Connecticut Light & Power Company ("CL&P"). Id. WMECo also proposed that during the period prior to divestiture, the output of Northfield Mountain and related facilities would be sold into the competitive marketplace, and the net revenues would be credited to the variable component of its transition charge, essentially treating the facilities as a power purchase agreement ("PPA"). Id. at 132-133. In Western Massachusetts Electric Company, D.P.U./D.T.E. 97-120-1, at 4 (1998), the Department noted that the plan to sell the Northfield Mountain and related facilities as a whole may maximize the sale proceeds and thereby enhance transition cost mitigation.

The Department further found that the proposal to provide interim mitigation was in substantial compliance with the Act. D.T.E. 97-120, at 133.

The 1997 Electric Restructuring Act's overarching purpose was the rational and orderly reconfiguration of an industry structure and public regulation that existed for over a century. No act as ambitious as this one could foresee AND provide in detail for every circumstance with fine precision. And so, with an eye to the Act's overall purpose, the Department's Northfield Mountain Order sought to achieve an orderly and rational result.

In this instance, Cambridge has gone well past the prescribed date in the Act and has not offered any interim mitigation to offset the cost recovery of Blackstone Station. That negotiations are protracted does not absolve a company from its obligation to divest and provide mitigation. The Company is advised to bring the sale of Blackstone Station to conclusion. The Company shall report to the Department the status of its negotiations with Harvard University and a contingency plan if the negotiations fail. It is time to wind up Cambridge's restructuring case.

Because the Act requires mitigation as a condition to an electric company's recovery of transition costs, Cambridge is directed to credit 100 percent of its positive net revenues from generation produced from the Blackstone Station through the variable component of its transition charge effective August 1, 1999. G.L. c. 164, § 1G(b)(1). To the extent that expenses exceed revenues, the Company shall incur the expenses until the time of divestiture. At the point of divestiture, the Company shall not be allowed to collect the unrecovered costs

associated with this mitigation mechanism either through the transition charge or through a deduction in its sales proceeds and thus a reduction in the RVC.

B. Regulatory Assets

1. Pilgrim Unit 1 Litigation Costs

a. Introduction

Commonwealth included, as a regulatory asset, $5,870,000 (balance as of March 1, 1998) of Pilgrim Unit 1 ("Pilgrim") litigation costs and collected a carrying charge on the unamortized balance at the Commonwealth's cost of capital (Exh. RHM-1, Commonwealth Sch. 1, at 6, 8, 9). In 1991, Commonwealth requested approval for recovery of $7,772,267 of litigation expenses associated with claims filed against Boston Edison Company ("BECo") regarding the extended outage at Pilgrim, without a return on the unamortized balance, over the 22 years remaining in the term of its Pilgrim power supply contract. Commonwealth Electric Company, D.P.U. 89-114/90-331/91-80 (Phase One) at 31 (1991).[6] At that time, the Department found that the amortization period with no carrying charge was fair to both Commonwealth's ratepayers and shareholders, and therefore approved Commonwealth's request. Id. at 47.

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[6] In D.P.U. 89-114/90-331/91-80, at 31-34, Commonwealth asserted that it spent $20,168,737 from 1988-1990, for litigation expenses associated with the Pilgrim outage. The Company received $12,006,332 from BECo and $390,133 from ratepayers. Id. The Company proposed to recover the remaining balance of $7,772,267. Id.

b. Position of the Parties

i. Attorney General

The Attorney General argues that the litigation amount claimed by Commonwealth is inconsistent with that previously approved by the Department and violates the provisions of D.P.U. 89-114/90-331/91-80, which require that these costs be amortized without a return (Attorney General Brief at 22-23, citing D.P.U. 89-114/90-33/91-80, at 33-34). The Attorney General states that while Commonwealth agreed to recover $7,772,267 over 22 years without any carrying costs through an annual amortization charge of $353,285, in this proceeding Commonwealth is seeking recovery of an additional $497,197 in litigation expenses (id. at 23, citing D.P.U. 89-114/90-33/91-80, at 33-34). The Attorney General requests that the Department reject Commonwealth's attempt to increase the size of a previously approved regulatory asset and to include $610,000 in carrying costs (March 1, 1998 through June 30, 1999) that are specifically precluded by the Department's Order (id.).[7]

ii. Commonwealth

In response to the Attorney General's argument, Commonwealth counters that while it did request recovery of $7,772,267 in litigation expenses, costs increased by $497,197 after Commonwealth filed its rate case in December 1990 (Companies Brief at 29). Commonwealth maintains that such increases were not unexpected. Commonwealth interprets the following

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[7] Commonwealth reports that it collected $610,000 from March 1, 1998 through June 1, 1999 (RR-DTE-3, at 3).

language from D.P.U. 89-114/90-331/91-80 to mean that the Department recognized expected adjustments to the litigation expenses:

> When the Company applied for deferral, the expenses were likely to continue, since at the time, there was no way to predict how long the Pilgrim litigation would take to resolve. Likewise, there was no way to predict what expenses would be accrued in any year, though there was every reason to believe that they would continue to be substantial.

(id., citing D.P.U. 89-114/90-331/91-80, at 40).

With respect to the Attorney General's argument regarding carrying charges, Commonwealth maintains that previously allowed carrying charges are not determinative in the present statutory environment of the Act (id. at 30). Commonwealth states that the Act expressly allows carrying charges for transition charge recovery, including regulatory assets (id.).

c. Analysis and Findings

The Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as approved by the Department, where regulatory assets refers to the unrecovered balance of deferred costs that have been specifically approved for deferral and later recovery by the Department. G.L. c. 164, § 1G(b)(1)(iii).

In D.P.U. 89-114/90-331/91-80, at 31-34, Commonwealth requested and the Department approved a specific amount, $353,285, for recovery of litigation expenses in its cost of service for the Pilgrim litigation. Had Commonwealth requested an amount that was not subject to precise measurement, the Department would have been unable to find rates including the recovery of such speculative costs as "just and reasonable." G.L. c. 164, § 94.

Commonwealth asserts that, in D.P.U. 89-114/90-331/91-80, the Department recognized that the expenses were an estimate and that adjustments were to be expected (Companies Brief at 29, citing D.P.U. 89-114/90-331/91-80, at 40). We disagree. In that context, the Department was evaluating whether the deferral of litigation expenses met the Department's requirement: namely, that in order to merit deferral, the expense would not be expected to be incurred in a single year, but rather would repeat, albeit at unpredictable levels and intervals. D.P.U. 89-114/90-331/91-80, at 38-40. The Department finds that the passage cited by Commonwealth does not support its reasoning that the Department regarded Pilgrim litigation expenses as open-ended. Commonwealth's interpretation is untenable.

Because the Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as previously approved by the Department, the Department finds that the Pilgrim litigation amount approved in D.P.U. 89-114/90-331/91-80 is eligible as a transition cost and therefore recoverable through Commonwealth's transition charge. The Department finds that the additional $497,197 in expenses are not eligible as transition costs and therefore not recoverable through Commonwealth's transition charge because the Department never approved such expenses. G.L. c. 164, § 1G(b)(1)(iii).

With respect to Commonwealth introducing a carrying charge for the unrecovered litigation balance, the Department disagrees with Commonwealth's reasoning that previously allowed carrying charges are not determinative in the new statutory environment. While the Act may allow for full recovery of regulatory assets, this provision is not an opportunity for a company to experience a windfall nor is it intended to supplant previous Department orders.

G.L. c. 164, § 1G(b)(1). The Act allows for the recovery of regulatory assets that have been specifically approved for deferral and later recovery by the Department. G.L. c. 164, § 1G(b)(1)(iii). Therefore, the Department finds that Commonwealth is not allowed a carrying charge and that Commonwealth be directed to refund ratepayers the overcollection.

2. Pepperell and Tenaska Buyout Costs

a. Introduction

Commonwealth included as a regulatory asset the Pepperell Power Associates Limited Partnership ("Pepperell") and Tenaska Mass., Inc. ("Tenaska") PPA buyout costs in the transition charge. Commonwealth also included in the transition charge a return on the unrecovered balance at its pre-tax cost of capital (Exh. RHM-1, Commonwealth Sch. 1, at 6). The unrecovered balances as of March 1, 1998 for the Pepperel and Tenaska buyout costs are $17,023,112 and $416,667, respectively (id.).

b. Position of the Parties

i. Attorney General

The Attorney General submits that the Department should reject Commonwealth's proposal because the proposed carrying charge for each buyout is in excess of what has been previously approved by the Department (Attorney General Brief at 24). The Attorney General stated that the Department-approved carrying charge is 9.75 percent for the Pepperell buyout, and 8.5 percent for the Tenaska buyout (id. at 23, citing RR-DTE-3).[8] The Attorney General

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[8] For the Pepperell buyout, the carrying charge formula is (prime rate minus two percent) x 1.5; for the Tenaska buyout, the carrying charge is at the prime rate

(continued…)

further stated that Commonwealth's current cost of capital is 13.49 percent, which exceeds the carrying charge rates approved by the Department for those buyouts (id.). The Attorney General recommends that, consistent with the Act, the return on these unrecovered balances be the return authorized in the Department's prior decisions (id.).

ii. Commonwealth

In response to the Attorney General, Commonwealth maintains that it is entitled to carrying charges on its regulatory assets at its cost of capital and not what has been previously approved by the Department (Companies Brief at 30). Commonwealth reasons that recovery of these costs should not be treated as a traditional rate case, but as a part of the statutorily authorized transition cost recovery mechanism that supercedes previous Department orders (id.).

c. Analysis and Findings

The Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as approved by the Department, where the term "regulatory assets" refers to the unrecovered balance of deferred costs that have been specifically approved for deferral and later recovery by the Department. G.L. c.164, § 1G(b)(1)(iii). On July 7, 1994, Commonwealth submitted for Department approval an amendment to its PPA between Commonwealth, Pepperell, and Prudential Insurance Company

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[8](…continued)
(Attorney General Brief at 23, citing RR-DTE-3). Because of the varying nature of the prime rate, both carrying charge rates reported are as of June 30, 1999.

to effect the termination of the PPA.[9] As a condition for termination, the amendment specified that the Department shall approve without exception, qualification or change, full recovery by Commonwealth from its customers within seven years with carrying costs of all payments provided for in the amendment (Exh. DTE 4-9(R), Power Sales Agreement Amendment at 8). On January 27, 1995, the Department issued a Letter Order approving the amendment in total. Commonwealth reported that the carrying charge provided for in the amendment was (prime rate minus two percent) x 1.5 or 9.75 percent (RR-DTE-3, at 3). Commonwealth indicated that for the period March 1, 1998 through June 30, 1999, based on its cost of capital, it collected $449,000 in excess of the authorized carrying charge (id.).

In Commonwealth Electric Company, D.P.U. 91-200 (1993), the Department approved an offer of settlement from Tenaska and Commonwealth concerning a PPA executed between the parties. Under the settlement, Commonwealth must pay to Tenaska a principal sum of $1,250,000, plus interest accruing at the prime rate over a period of seven years. Id. at 4, 8. Commonwealth reports that from March 1, 1998 through June 30, 1999, based on its cost of capital, it collected $26,000 over the carrying charge rate approved in D.P.U. 91-200 (RR-DTE-3, at 3). The carrying charge approved by the Department is strictly a pass-through cost to ratepayers. To allow Commonwealth a carrying charge rate at its cost of capital exceeds what it agreed to pay Tenaska. This excess represents a windfall for Commonwealth's shareholders (RR-DTE-8, Tenaska Settlement payment schedule).

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[9] On January 25, 1995, Commonwealth submitted an amendment to the July 7, 1994 filing, which revised the amount of the payment to be made by the Company to $25,500,000 (RR-DTE-9, Att. A).

Because the Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as approved by the Department, the Department finds that the carrying charge on these unrecovered balances shall be the carrying charge authorized in the Department's prior decisions. G.L. c. 164, § 1G(b)(1)(iii). Because the carrying charge at Commonwealth's cost of capital is not allowed for transition cost recovery, Commonwealth shall refund the overcollection to ratepayers.

3. Cannon Street Investment

a. Introduction

Commonwealth included $4,057,977 as a regulatory asset in its transition charge for the unrecovered generation plant associated with the Cannon Street Station ("Cannon Street")[10] generating plant (Exhs. RHM-1, Commonwealth Sch. 1, at 6; DTE-4-11, at 15). In D.P.U. 89-114/90-331/91-80, its last rate case, Commonwealth included the plant in rate base. In December 1992, Commonwealth placed the unit in deactivated reserve. Subsequently, in the second quarter of 1993, Commonwealth abandoned Cannon Street, took the station out of

[10] Canon Street was a 1916 vintage 63 megawatt generating plant located in New Bedford, Massachusetts. The most recent active equipment included three boilers and two turbines that were installed in 1947 and 1950, respectively (Exh. DTE-4-9, att. m).

plant-in-service, discontinued depreciation, and transferred it to Account 182.2, Unrecovered Plant and Regulatory Study Costs (Exh. DTE-4-9, Att. M).

b. Position of the Parties

i. Attorney General

The Attorney General argues that the Department should reject Commonwealth's request to collect the undepreciated value of Cannon Street because the balance does not meet the statutory requirement for transition costs that may be recovered through the transition charge (Attorney General Brief at 16). Specifically, the Attorney General maintains that the Cannon Street balance does not satisfy the statutory requirements for either of the two transition costs categories claimed by Commonwealth: (1) costs associated with generating facilities that become uneconomic as a result of the creation of a competitive market; or (2) regulatory assets (id. at 17, citing G.L. c. 164, § 1G(b)(1)(i), (iii)).

First, the Attorney General maintains that it was not competition that led to the retirement of the plant, as it was retired in 1992, long before the introduction of retail competition (id. at 18). The Attorney General refers to Commonwealth's explanation that Cannon Street was abandoned in 1992 because it became uneconomic to operate due to a surplus of generating capacity and the age of the facility (id. at 18, citing Tr. 9, at 439-442). Therefore, the Attorney General argues that the unrecovered Cannon Street balance cannot be considered eligible for transition cost recovery (id.).

Second, the Attorney General argues that the Cannon Street facility balance is not a regulatory asset as defined by the Act because Commonwealth never sought Department

approval for deferral and later recovery (id.). The Attorney General maintains that while Commonwealth sought approval from the Federal Energy Regulatory Commission ("FERC"), it was only for the accounting treatment of the balance and in no way satisfies the General Court's requirement of specific Department approval for deferral and later recovery (id.).

Finally, the Attorney General argues that even if the facility had become uneconomic due to the creation of a competitive generation market, Commonwealth's proposal would only be appropriate to the extent the costs were being collected in Department approved rates on January 1, 1997 (id. at 19, citing G.L. c. 164, § 1G(b)(1)(i)). The Attorney General maintains that had the costs been in rates, the undepreciated balance would have been subject to depreciation accruals. The Attorney General calculates a balance as of March 1, 1998 of $801,034, based on plant depreciation during the abandonment period (id. at 19).

ii. Commonwealth

Commonwealth states that it classified Cannon Street as a regulatory asset for transition cost recovery because it sought and received FERC authorization to record the amount of $3,939,043 to Account 182.2, Unrecovered Plant and Regulatory Study Costs (Exh. DTE-4-9, Atts. M, O). In its 1993 FERC request for accounting treatment, Commonwealth indicated that it would seek recovery of the unrecovered balance in its next retail base rate filing. Commonwealth also indicated to FERC that it had not determined when it would submit a rate filing but would file a similar accounting request with the Department (id., Att. M). In its approval, FERC stated that Commonwealth should amortize the deferred costs over the recovery period to be specified by the Department (id., Att. O). While Commonwealth never

submitted an accounting request to the Department, Commonwealth argues that it did not have to get a separate approval to defer its unrecovered investment because an approval for deferral relates to expenditures that would normally be expensed in the year the cost was incurred and not generation plant which is capitalized over a period of years. Commonwealth further maintains that recovery of rate-base items is routinely deferred over the entire life of the rate base property (Companies Brief at 24, n.13).

c. Analysis and Findings

The Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as approved by the Department, where regulatory assets refers to the unrecovered balance of deferred costs that have been specifically approved for deferral and later recovery by the Department. G.L. c.164, § 1G(b)(1)(iii). The Attorney General argues that Commonwealth cannot recover its Cannon Street abandoned plant balance because this unrecovered balance does not satisfy the statutory criteria of G.L. c. 164, § 1G(b)(1)(iii) for recovery of a regulatory asset. The Attorney General argues that the Department never approved a deferral of the Cannon Street costs. While the Attorney General takes a strict interpretation of the Act, the treatment of plant in a company's rate base differs significantly from the way expenses deferred are accounted for in rates. The need for approval of a deferral relates to expenditures that would normally be expensed. North Attleboro Gas Company, D.P.U. 93-229, at 7 (1994). While rate base-type items may be appropriately granted amortization treatment, deferrals of the type at issue here are not applicable to capitalized items. See D.P.U. 89-114/90-331/91-80 (Phase One) at 37-47. In addition, the

Department does not make post-test year adjustments to rate base for plant additions and retirements unless extraordinary circumstances warrant a departure from that standard. See Western Massachusetts Electric Company, D.P.U. 85-270, at 140-141 (1986).

The Act requires the Department to develop guidelines to identify and determine which transition costs may be recovered through a company's transition charge. G.L. c. 164, § 1G(b)(1). The Department has allowed recovery of costs through the transition charge for those costs which, but for the Act, would have been allowed by the Department. See e.g., D.T.E. 97-120, at 56. As a general rule, the retirement of property is initially a management decision. However, the Department has on occasion involved itself in this process. Boston Edison Company, D.P.U. 19991, at 12 (1979); Boston Edison Company, D.P.U. 19300, at 16-20 (1978). The Department has allowed recovery of abandoned plant as long as the company demonstrated prudence in deciding whether to commence or continue the project and whether there were alternatives to deactivation. Boston Edison Company, D.P.U. 906, at 154-250 (1982); D.P.U. 19300, at 16-20. Therefore, in order to allow transition cost recovery, the Department must determine whether the Cannon Street abandonment costs are generation-related stranded costs and whether Commonwealth's decision to retire the plant was prudent.

Commonwealth constructed Cannon Street in 1916 and put the last unit in service in 1950 (Exh. DTE-4-9, Att. N at 1). The facilities at Cannon Street were used exclusively for the retail electric production function (RR-DTE-14). While the facilities were retired in 1993, well before action was taken to implement a competitive generation market, the evidence

indicates that the economics could not justify the continued operation of Cannon Street (RR-DTE-10). Due to the economy and the effect of the early 1990 recession on Commonwealth's load requirement, it had a surplus of generating capacity and thus placed Cannon Street in deactivated reserve (Exh. DTE-4-9, Att. M). As of 1993, Cannon Street had a remaining depreciable life of eight years. Commonwealth forecasted it would need no new generation resources until 1999 (RR-DTE-10). In deciding the disposition of Cannon Street, Commonwealth analyzed several options. Commonwealth forecasted a generating capacity deficit in the late 1990's and performed cost benefit analyses of: (1) returning Cannon Street to operation in 1999; (2) re-powering Cannon Street and increasing the capacity to 156.4 MWs; and (3) retiring Cannon Street (id.). The cost benefit analysis indicated that the least cost to ratepayers was for Commonwealth to retire Cannon Street. Given the surplus of generating capacity at the time, the age of Cannon Street and the cost benefit analyses, the Department finds that Commonwealth's decision to retire Cannon Street was prudent. Furthermore, no party contested Commonwealth's decision. Therefore, the Department finds that the Cannon Street is generation-related and eligible for transition cost recovery.

However, our analysis does not end here. For purposes of determining the costs to be collected through the transition charge, it is appropriate to review Department precedent for the treatment of abandoned plant. The Department has consistently excluded unamortized abandoned property from rate base. Fitchburg Gas and Electric Light Company, D.P.U. 19084 (1977), aff'd, Fitchburg Gas and Electric Light Company v. Department of Public Utilities, 375 Mass. 571 (1978); Western Massachusetts Electric Company,

D.P.U. 84-25 (1984); Western Massachusetts Electric Company, D.P.U. 18731 (1978). When amortization of abandoned plant is allowed, no return on the plant is generally permitted, and the equity rate portion of the Allowance for Funds Used During Construction ("AFUDC")[11] is excluded from the amount to be amortized.[12] Stockholders are appropriately compensated for risk through the allowed rate of return, and granting a return on the plant or permitting recovery of the equity portion of the AFUDC is considered an inappropriate shift of risk to ratepayers. Fitchburg Gas and Electric Light Company, D.P.U. 1270/1414, at 64 (1983); Commonwealth Electric Company, D.P.U. 956, at 16 (1982). In some instances, the Department has deviated from its precedent because of extenuating circumstances. For example, the very long amortization of costs related to the abandoned Pilgrim II nuclear unit warranted an exception to allow carrying charges. D.P.U. 906, at 244. In the instant case, there is no reason to deviate from the Department's longstanding policy on abandoned plant. The argument to the contrary made by Commonwealth is unpersuasive because the abandonment costs are not of unusual magnitude in relation to Commonwealth's total plant investment. Moreover, the Act does not supercede previous Department orders. The Act refers to costs that either were in Department-approved rates or were previously approved by the Department for transition cost recovery. G.L. c. 164, § 1G(b)(1). Therefore,

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[11] AFUDC is a regulatory accounting construct whereby a utility capitalizes the carrying charges incurred during the construction period.

[12] The Department determined that WMECo was entitled to recover costs related to its Millstone unit 1 as transition costs because competition was a factor in the Company's decision to retire Millstone 1. However, the Department denied a return on Millstone 1. D.T.E. 97-120, at 29-30.

Commonwealth shall remove the carrying charge associated with Cannon Street and refund to customers the amount collected through the carrying charge associated with amortization of Cannon Street and any amount collected to date associated with the equity rate portion of the AFUDC.

Turning to the issue of depreciation associated with Cannon Street, the Attorney General's assumption that Cannon Street should have continued to accrue depreciation during the abandonment period is incorrect. The Uniform System of Accounts ("USOA") requires electric plants to be in service in order to accrue depreciation. 220 C.M.R. § 1.01; 18 C.F.R. c. 1, part 101, at 357 (revised as of April 1, 1999). Because Commonwealth had in fact booked the amount to Account 182.2, Unrecovered Plant and Regulatory Study Costs, the Department finds that in accordance with USOA, Commonwealth was not appropriately collecting the depreciation expense on Cannon Street. Therefore, the Department finds that Commonwealth shall be allowed to collect the amount that was booked to Account 182.2 through the transition charge. However, the Department notes that the $3,939,043 Cannon Street balance submitted to FERC is less than the $4,057,977 Commonwealth is now seeking to recover. Commonwealth did not provide persuasive evidence to support the increase. Accordingly, Commonwealth is only allowed to collect through the transition charge the amount submitted to and approved by FERC.

The Department notes that the Act does not require divestiture or inclusion in a company's transition costs of a generation facility that ceased operation as of January 1, 1993 and retired from rate base, provided that the facility is subject to a long-term lease with a

non-profit, education entity. St. 1997, c. 164, § 341. Because Commonwealth is obligated to mitigate its transition costs, the Department directs that, to the extent Commonwealth collects through its transition charge its unrecovered plant balance of Cannon Street, it shall credit ratepayers any revenues received from a long-term lease. G.L. c. 164, § 1G(d)(1). In addition, Commonwealth shall credit to ratepayers any sales proceeds that may occur upon sale of any portion of the plant facility.

4. Asbestos Cost

a. Introduction

The Companies proposed to include, as a regulatory asset in their transition charge, $452,000 associated with the asbestos removal at Cannon Street and $418,920 associated with the asbestos removal at the Blackstone and Kendall Stations (Exhs. RHM-1, Commonwealth Sch. 1, at 6; RHM-1, Cambridge Sch. 1, at 6). These costs were incurred by the Companies from 1988-1992.

b. Position of the Parties

i. Attorney General

The Attorney General argues that the Department should reject inclusion of this expense in the transition charge for the following reasons: (1) the Companies should have expensed these costs in the year that they were incurred; (2) since the Companies did not seek Department approval for a deferral of these costs, the Companies cannot seek retroactive ratemaking treatment; and (3) FERC approval of the deferral is not controlling on this issue, since the plant in question is subject to Massachusetts jurisdiction (Attorney General Brief

at 20-21). The Attorney General asserts that it is the Department's longstanding policy to deny recovery of pre-test year operations and maintenance expenses, and that the Companies have presented no evidence or argument to warrant a change in Department policy (id. at 21).

ii. The Companies

The Companies argue that the Attorney General's premise for rejecting the asbestos costs is based on a misinterpretation of the evidence. The Companies state that the asbestos costs, including removal and installation, have been treated as capital costs for accounting and ratemaking treatment (Companies Brief at 26). The Companies state that a FERC audit was performed which showed that the Companies' accounting treatment of the cost of removing the asbestos insulation and installing new insulation was in error (id., citing Exh. DTE-4-9, Atts. E, N).[13] The Companies argue that because the costs were initially capitalized and later by direction of FERC established in a regulatory asset account, the Companies are entitled to transition cost recovery (id. at 6). The Companies reason that had they correctly accounted for the insulation as separate unit property, the costs would have been included in the plant accounts and recoverable through the transition charge. The change to regulatory assets was only for accounting treatment to correct an error and the costs are therefore recoverable as a transition cost (id.).

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[13] The Companies were not explicit in explanation of their error but submitted the FERC audit for review (Exh. DTE-4-9, Atts. E, N).

c. Analysis and Findings

The Companies state that they did not account for the asbestos insulation as a separate unit of property but included it with other plant piping (Companies Brief at 26). This accounting treatment led to FERC's directive that the costs be established in a regulatory account (id.). The Department notes that the Companies' failure to account for the insulation as a separate unit of property led FERC to state in its audit that the Companies were in error when they retired the insulation because the accounting rules do not allow for partial retirement of a unit of property unless it creates a betterment (Exh. DTE-4-9, Atts. E, N). Because the Companies booked the insulation in other retirement units, such as piping and boiler equipment, and did not set out insulation as a separate retirement unit, FERC stated that the insulation must be considered a minor item of property (id.). FERC further stated that removal or replacement of a minor item of property must be charged to maintenance expense (id.). Therefore, the FERC audit recommended that the Companies revise their accounting procedures to ensure that they account for the cost of the removal and replacement of insulation properly by booking it as a separate unit of property to be capitalized in the plant account (id.). To correct the existing accounting error, FERC recommended that Commonwealth establish a regulatory asset for the retail portion of the costs related to the Cannon Street asbestos removal that will be collected in rates over future period by debiting Regulatory Asset Account, 182.3 and crediting plant accounts (id.). FERC recommended that Cambridge charge the cost associated with the Kendall and Blackstone Stations' asbestos replacements to expense or to Regulatory Asset Account 182.3, as appropriate (id.).

FERC noted that in Commonwealth's immediately preceding retail rate case, it had filed for a retail rate increase and "the DPU approved [Commonwealth]'s rates effective July 1, 1991, that included recovery of the costs of the new installation and the removal of the old asbestos insulation as a component of depreciation expense over the life of the related facilities." (id., Att. N, citing D.P.U. 89-114/90-331/91-80 (Phase One). Further, Cambridge reported to FERC that the asbestos costs associated with the Kendall and Blackstone Stations were booked to Account 182.3 and that the costs were being amortized as a regulatory asset and recovered in rates (FERC Form 1, 1994-1997, at 232). Because the asbestos insulation removal and replacement was originally booked to plant in service, although not as a separate unit of property,[14] and was being recovered in rates, the Department finds that the Companies are entitled to recover the remaining balance of these costs as transition costs.

5. Wording Changes to Transition Charge Calculation

a. Introduction

In D.T.E. 97-111, at 61-62, the Department deferred making a finding on the specifics of the calculation of transition costs, including the wording of the transition charge formula, until the Companies' first reconciliation proceeding. Subsequently, the Companies proposed wording revisions to their restructuring plan's transition charge formula in their divestiture proceeding, D.T.E. 98-78/83. The Department again deferred making findings on this matter until the Companies' first reconciliation filing. D.T.E. 98-78/83, at 35-36. In this

[14] Future insulation will be booked to plant in service but as its own unit of property.

proceeding, the Companies proposed wording changes relating to the divestiture of their non-nuclear generating assets (Exhs. DTCA-1-2; DTCA-2-2).

b. Positions of the Parties

i. The Attorney General

The Attorney General states that the proposed changes do not accurately show the Companies' calculation of their stranded costs (Attorney General Brief at 3, n.1). The Attorney General argues that the Department should not approve the wording of the transition charge formula text for this reason (id.). The Attorney General avers that the proposed wording changes to the transition charge formula constitute a change to the Companies' restructuring plan, a change that would require the Companies to modify their restructuring plan and to file a conforming restructuring plan within 60 days of the issuance of the Department's order in this proceeding (id. at 3).

ii. The Companies

The Companies are seeking approval of their entire reconciliation filing, which includes these proposed wording changes (Companies Brief at 50). The Companies' proposed wording changes were intended to update their restructuring plan to incorporate the results of the divestiture of their non-nuclear generating assets (Exh. RHM-1, at 53-54).

c. Analysis and Findings

The Companies argue that the proposed amendments are reasonable and consistent with their restructuring plan (id. at 54). These proposed amendments include such revisions as defining the Companies' divestiture date as January 1, 1999. The Department finds that the

proposed wording changes accurately incorporate the results of the Companies' divestiture of their non-nuclear generating assets. Therefore, the Department approves these proposed wording changes. However, as a result of findings contained in this Order, the wording contained in the transition charge formula must be revised. Therefore, the Department directs the Companies to file, in their next reconciliation proceeding, updated language in the transition charge formula explaining how the Companies calculate transition costs.

VI. TRANSITION COSTS

A. Residual Value Credit

1. Introduction

The Companies' restructuring plan states that the Companies shall implement an RVC as a direct offset to the transition charge. According to the Companies' restructuring plan, the RVC shall be calculated after divestiture of its generation facilities by deducting the following from the total sales proceeds: (1) lost revenue associated with the sold generation facilities; (2) capital additions to the sold generation facilities that were placed into service after December 31, 1995, and that were excluded from the plant balances recovered in the transition charge; (3) the book value of any fuel inventory that has been included in the sale proceeds; (4) the unrecovered net book balances of generation-related investments and regulatory assets from the sold generation facilities that were not recovered in the transition charge; and (5) reasonable transaction costs associated with the sale (D.T.E. 97-111, Exh. Company-1, exhs. III, at 6-7: IV, at 7-8).

In this proceeding, the Attorney General and the Companies commented on two of the five components of the RVC calculation: lost revenues and capital additions. Regarding lost revenues, the Companies and the Attorney General addressed whether: (1) the Companies should be allowed recovery of lost revenues, (2) the generation costs to calculate lost revenues should be (a) those included in the Companies' most recent rate cases or (b) those included in the Companies' 1995 cost of service study ("COSS"), (3) the fuel costs to calculate lost revenues should be actual or historic test year, and (4) Cambridge should be allowed to recover lost revenues for Blackstone Station even though the plant has not been sold yet. Regarding capital additions to the Companies' generation facilities that were incurred after December 31, 1995, and that were eligible to be recovered through the RVC, the Companies and the Attorney General addressed whether or not they should be depreciated from the retail access date through the divestiture date.

2. Lost Revenues

Under the Companies' restructuring plan, lost revenues which were incurred between the March 1, 1998, retail access date and the divestiture date, are calculated by taking the difference between the revenues that the Companies would have collected from the fully allocated generation portion of rates from their most recent rate cases[15] and the actual revenues received from these generation facilities (id., exhs. III, IV). In this proceeding, the Companies proposed to calculate their lost revenues based on the revenues that the Companies would have

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[15] Cambridge's most recent rate case was Cambridge Electric Light Company, D.P.U. 92-250 (1993) and Commonwealth's most recent rate case was decided in 1991in D.P.U. 89-114/90-331/91-80 (Phase One).

collected from the fully allocated generation portion of rates from their 1995 COSS, instead of the COSS from their most recent rate cases (Exhs. RHM, Sch. 6, NP-WP2-1; RHM, Sch. 6, NP-WP2-2).[16] The Companies also proposed to include lost revenue for all their generation facilities, whether or not such facilities had been divested (Companies Brief at 41, citing Exhs. RHM, Sch. 6, NP-WP2-1; RHM, Sch. 6, NP-WP2-2).

a. Position of the Parties

i. Attorney General

While the Attorney General maintains that there is no statutory authority for recovery of lost revenues, he asserts that if the Department were to allow the Companies to recover lost revenues, then lost revenues must be calculated in strict accordance with the Companies' restructuring plans using the fully allocated generation portion of rates from the Companies' most recent rate cases (Attorney General Brief at 34-35, citing Exhs. RHM-8: RHM-9). The Attorney General argues that to do otherwise would allow the Companies to recover costs never adjudicated and determined to be just and reasonable (id. at 36).

The Attorney General also contends that actual fuel costs should be used when calculating lost revenues (Attorney General Reply Brief at 16-17). The Attorney General notes that prior to retail access, the Companies recovered actual fuel costs on a dollar-for-dollar basis through the fuel charge. Therefore, the Attorney General contends that fuel expenses should continue to be recovered on an actual basis in the lost revenue calculation (id. at 17).

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[16] The Companies initially proposed in this proceeding to use actual costs allocated to each generation unit rather than the revenues generated by each company's owned generation facilities (Exhs. RHM Sch. 6, NP-WP2-1; RHM Sch. 6, NP-WP2-2).

In response to the Attorney General's record request, the Companies calculated lost revenues using the fully allocated generation portion of rates from their most recent rate cases and using their historic test year fuel costs (id. at 17, citing RR-AG-25). The Attorney General disagrees[17] with the Companies' response, arguing that the lost revenues calculation should only include actual fuel costs (id. at 17).[18]

Finally, the Attorney General notes that Cambridge included Blackstone Station costs in its lost revenue calculation, even though the unit was not included as part of any sale during 1998 (Attorney General Brief at 36, n.25). The Attorney General maintains that this can be done only if the Department adopts his proposal for the Companies to conduct an administrative market valuation of Blackstone Station (id. at 10-11, citing Exh. AG-8-4).

ii. Companies

The Companies disagree with the Attorney General's argument that they may not recover lost revenues (Companies Brief at 40-41). The Companies contend that the Act provides for the recovery of lost revenues, claiming that such revenues fall within the category of costs for "generation-related assets, investments, and obligations" (id. at 40, citing G.L. c. 164, § 1G(a)(1)). The Companies also note that neither the Attorney General nor any other party objected when the Department approved the inclusion of lost revenues as an element of

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[17] The Attorney General's disagreement takes the form of argument on brief based on a calculation he requested the Companies to perform rather than on countervailing evidence proffered by the Attorney General.

[18] The Attorney General also opposes the inclusion of wholesale costs in calculating the lost revenues. Wholesale issues are addressed in Section VI of this Order.

the Companies' restructuring plan in D.T.E. 97-111, as well as in other restructuring plans and settlements (id. at 41).

The Companies assert that their 1995 COSS, which was the basis for unbundling rates in their restructuring plan, should be used to determine lost revenues (id.). The Companies argue that these costs are more representative of the costs being incurred at the time of retail access as opposed to using the COSS from their last approved rate cases in D.P.U. 92-250 (Cambridge) and D.P.U. 89-114/90-331/91-80 (Commonwealth), which extend back in time for a period of up to ten years (id. at 41-42). By way of example, the Companies point out that the depreciation expense levels approved in their most recent rate cases are significantly different from the plant amortization levels used in the Companies' calculation of lost revenues (id. at 42). According to the Companies, the reason for this difference is that while depreciation rates were based on the life of the units, the amortization of plant under their restructuring plan had been accelerated to allow the full recovery of all generation-related fixed costs by the year 2009 (id.). The Companies state that their lost revenue calculation reconciles the revenues collected from company-owned generation with generation-related costs incurred by the Companies and is consistent with the unbundled generation costs that were allocated in accordance with the Companies' most recent rate cases (Companies Reply Brief at 13). The Companies contend the Attorney General's method produces a meaningless calculation that ignores the accelerated amortization of generation-related costs that were approved by the Department in D.T.E. 97-111 (id. at 12).

Regarding the Attorney General's proposal that actual fuel costs be used in the lost revenues calculation, the Companies fault the Attorney General's proposal as an attempt to manipulate an outcome by "mixing and matching" rate case-determined costs with 1998 fuel expenses (id.). The Companies note that this proposal is inconsistent with the restructuring plan, which uses historical rate case data (id.).

b. Analysis and Findings

With respect to whether the Companies should be allowed to collect lost revenues, the Department has allowed distribution companies recovery of lost revenues as part of settlement agreements and litigated proceedings. See Massachusetts Electric Company, D.P.U./D.T.E. 96-25 (Offer of Settlement, Book 2, Att. 1, at 5) (1997); Boston Edison Company, D.P.U./D.T.E. 96-23 (Settlement Agreement at Att. 3, § 1.4(b)) (1997); D.T.E. 97-120, at 87-92. The Attorney General agreed that Massachusetts Electric Company and BECo should be allowed recovery of lost revenues as part of restructuring settlements. See D.P.U./D.T.E. 96-25 (Offer of Settlement, Book 2, Att. 1, at 5); D.P.U./D.T.E. 96-23 (Settlement Agreement at Att. 3, § 1.4(b)). Settlement provisions on lost revenue recovery were contemplated by the Legislature when it authorized the Department to approve restructuring plans if these plans were substantially compliant with the Act. D.T.E. 97-111, at 12, 89-90; Standard Offer Service Fuel Adjustments, D.T.E. 00-66/00-67/00-70, at 10 (2000). There is nothing new here: the Attorney General negotiated settlements and participated in the adjudication of the Companies' restructuring plan, which essentially has similar terms. Although the Act is silent on the treatment of lost revenues, recovery of lost

revenues meets the Act's intent of allowing distribution companies recovery of their generation costs consistent with those costs that were allowed prior to electric industry restructuring. Therefore, the Department finds that the Companies are entitled to recovery of lost revenues.

Lost revenue provisions allow the distribution companies to recover, for each of their generation facilities, for the period between the retail access date and divestiture date, the level of costs they were allowed to collect prior to electric industry restructuring. D.T.E. 97-120, at 87-92. The principle in this WMECo case controls here. The level of costs the Companies collected prior to electric industry restructuring is found in the rates approved by the Department in the Companies' most recent rate cases. D.P.U. 92-250; D.P.U. 89-114/90-331/91-80. Therefore, the Department finds that the use of the generation costs as approved in the Companies' most recent rate cases is appropriate to calculate lost revenues.

With regard to depreciation expense, on March 1, 1998, the Companies accelerated their generation-related depreciation rate and recovered the depreciation expense through the fixed component of the transition charge. The Companies accelerated their depreciation rate because the Act did not allow carrying costs on generation assets beyond the year 2009. G.L. c. 164, § 1G(b)(3)(d). To calculate lost revenues, the transition charge revenues associated with a facility's generation fixed costs, which would include depreciation expense, are deducted from the facility's generation costs approved in the Companies' most recent rate cases. Consequently, if the depreciation rate for the fixed costs collected through the transition charge is higher than the depreciation rate approved in the Companies' most recent rate cases, then the Companies would not collect all of their fixed generation costs. The Companies

correctly note that if the depreciation expense approved in the Companies' most recent rate cases is used to calculate lost revenues, then their depreciation expense would not be fully recovered. To correct this shortcoming, the Department finds that, for the purpose of calculating the RVC, the associated book value of the generation facility being sold shall be determined, at the time of sale, by using the depreciation rates from the Companies' most recent rate cases instead of the depreciation rates that were implemented after retail access.

Regarding the fuel costs used to calculate lost revenues, the Department notes that, prior to electric industry restructuring, the Companies collected their actual fuel costs on a dollar-for-dollar basis through the fuel charge. Therefore, to allow recovery at the level that would have been allowed absent electric restructuring, the Department directs the Companies to calculate lost revenues using actual fuel costs.

While the Companies' restructuring plan provides for recovery of lost revenues upon the divestiture of their generation facilities, the Companies included the costs for Blackstone Station, a generation facility not divested, in their lost revenue calculation (D.T.E. 97-111, Exh. Company-1, exhs. III, IV). The Department addressed the treatment of Blackstone Station in Section V.B, above.

3. Capital Additions

The Companies booked no depreciation on their generation facilities capital additions from March 1, 1998, through their divestiture date. The Companies proposed to recover through the RVC the undepreciated amount of net capital additions that were incurred after December 31, 1995, and that were excluded from plant balances recovered in the transition

charge (Exh. RHM, Sch. 6, NP-WP1). The Companies' restructuring plan is silent on whether the capital additions recovered through the RVC should be depreciated or not.

a. Positions of the Parties

i. Attorney General

The Attorney General argues that the Companies are double-collecting the depreciation expense associated with the capital additions because they are collecting the gross, instead of net, depreciated capital addition balances from the sales proceeds of their generating facilities (Attorney General Brief at 37). The Attorney General maintains that because the Companies should have been depreciating these capital additions from the time they were placed in service until the date of divestiture, the Department should reduce the capital additions that are deducted from the sale proceeds by the depreciation accumulated on those capital additions during the referenced period (id.).

ii. Companies

In response to the Attorney General's contention that the Companies are attempting to "double recover" the depreciation expenses associated with capital additions, the Companies maintain that there is no double recovery of depreciation expense as capital additions have not been depreciated since February 1998. Therefore, the Companies respond that they applied the gross amounts of the post-1995 plant additions as of March 1, 1998, against the proceeds from the sale of the generation facilities, which had the effect of reducing the RVC (Companies Brief at 43).

The Companies state that their restructuring plan allows them to recover through the amortization of the fixed component of the transition charge the unrecovered balance of generation-related assets beginning on March 1, 1998 (id. at 43-44, citing Exh. AG-4-24). Thus, according to the Companies, if they had depreciated post-March 1998 capital additions until they divested the asset, then the depreciation expense would have been included in the calculation of lost revenues (id. at 43-44). The Companies state that the just-described treatment would have increased the amount of lost revenues by the same amount as it would have decreased capital additions (id. at 44). Therefore, the Companies maintain that either alternative would have calculated the same RVC (id. at 44).

b. Analysis and Findings

The Companies discontinued depreciation of the post-1995 capital additions as of March 1, 1998, and recovered the balance through a deduction in the plant sales proceeds and thus a reduction in the RVC. At issue is whether the Companies should have continued the depreciation of the post-1995 capital additions until divestiture. Prior to retail access, plant investments, including any capital additions, were recovered in base rates through depreciation expense pursuant to an appropriate amortization schedule. Further, depreciation of any capital additions commences as soon as the capital addition is placed into service. Western Massachusetts Electric Company, D.P.U. 85-270, at 172-130 (1986). In discontinuing depreciation of the capital additions, the Companies departed from this traditional ratemaking treatment.

The Department has stated that distribution companies may recover, for each of their generation facilities, for the period between the retail access date and divestiture date, the level of costs they were allowed to collect prior to electric industry restructuring. D.T.E. 97-120, at 87-92. Recovering capital additions based on the Department's traditional ratemaking treatment will allow the Companies to recover, for each of their generation facilities, the level of costs they were allowed to collect prior to electric industry restructuring. Therefore, the Department finds that the Companies inappropriately ceased taking depreciation expenses on post-1995 capital additions for the period March 1, 1998 through the divestiture date of the unit.

The Companies contend that if they had depreciated their capital additions that were incurred after December 31, 1995, during the March 1998 through divestiture time period, they would have recovered this unrecovered depreciation expense through lost revenues. As discussed in Section V.A., above, lost revenues are to be calculated by taking the difference between the revenues that the Companies would have collected from the fully allocated generation portion of rates from their most recent rate cases and the actual revenues from these generation facilities plus any transition charge revenues related to the units sold. Lost revenues recover those capital additions included in the generation-related depreciation expense reported in the COSS from the Companies' most recent rate case that have not been recovered through the transition charge. Therefore, since the capital additions at issue were not included in the Companies' last rate cases, the Companies could not recover their post-1995 capital additions through their lost revenue calculation.

Because of the Department's ratemaking treatment of capital additions and the Companies' ability to recover the level of costs they were allowed to collect prior to electric industry restructuring, the Companies must recognize the depreciation of the post-1995 capital additions. Accordingly, the Companies will be allowed to deduct from their sales proceeds their post-1995 capital additions, net of depreciation.

B. Unrecovered Conservation and Load Management Costs

1. Introduction

Commonwealth proposed to recover, as a regulatory asset, its unrecovered conservation and load management costs ("C&LM") (Exh. RHM-1, Commonwealth Sch. 1, at 6). Commonwealth's balance as of March 1, 1998 is $540,000 (id.). The C&LM costs were part of a Department-approved settlement, which, prior to electric industry restructuring, were being recovered through the conservation charge (Exh. DTE-4-9, Att. P). Cambridge Electric Light Company/Commonwealth Electric Company, D.P.U. 95-2/3-CC (1995).

2. Position of the Parties

a. Attorney General

The Attorney General argues that Commonwealth should not be allowed recovery of C&LM costs through the transition charge because these costs are not eligible for recovery under the Act. The Attorney General maintains that these costs do not qualify as generation-related assets, investments, and obligations as required by the Act for transition cost recovery (Attorney General Brief at 21, citing G.L. c. 164, § 1G(b)(1)).

b. Commonwealth

Commonwealth maintains that the Department has long held that generation and conservation are potentially interchangeable (Companies Brief at 33). Therefore, Commonwealth argues that, based on Department precedent, the Act's reference to "generation related assets and obligations" should be interpreted to incorporate unrecovered C&LM costs (id. at 34).

3. Analysis and Findings

The Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as approved by the Department, where the term "regulatory assets" refers to the unrecovered balance of deferred costs that have been specifically approved for deferral and later recovery by the Department. G.L. c.164, § 1G(b)(1)(iii). In D.P.U. 95-2/3-CC, at 21, the Department approved recovery of costs related to C&LM. Because the Department approved Commonwealth's C&LM costs, these costs qualify as transition costs pursuant to the Act. Accordingly, the unrecovered costs are eligible for transition cost recovery.

A larger reason also counsels equitable treatment of these costs. The recently announced National Energy Policy envisions an important role for load management and efficiency/conservation programs in coming years. National Energy Policy Development Group, National Energy Policy (May 2001). Electric and gas utilities will be expected to play a central part in achieving the goals of these important programs. Opportunistic conduct by a

regulator over past CL&M expenditures will hardly inspire confidence in future fairness and may stifle future response.

C. Unrecovered Deferred Fuel Charge Balance

1. Introduction

Commonwealth proposed to recover, through the transition charge, deferred fuel costs associated with a Department-approved offer of settlement from Commonwealth and the Attorney General designed to stabilize Commonwealth's fuel charge. Commonwealth Electric Company, D.P.U. 94-3A (1994). [19] As of March 1, 1998, the balance of these deferred costs was $26,779,000 (Exh. RHM-1, Commonwealth Sch. 1, at 6). Commonwealth also proposed that this balance earn a carrying charge equal to its overall pre-tax cost of capital (id.).

2. Positions of the Parties

a. Attorney General

The Attorney General argues that the deferred fuel charge balance has not been previously approved by the Department and that Commonwealth's carrying charge proposal contravenes D.P.U. 94-3A, which fixed a specific rate of return to be paid on any balance of deferred fuel costs (Attorney General Brief at 24). The Attorney General contends that the instant situation is similar to an issue addressed recently by the Department in D.T.E. 97-120

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[19] Commonwealth's fuel charge stabilization settlement capped the fuel charge at 6.5 cents per kilowatthour ("KWH") for three years, 1994-1996, and at 6.7 cents per KWH for the fourth year, 1997. D.P.U. 94-3A at 4. Any unrecovered fuel-related costs were to be recovered, with interest, over the subsequent six years. Id. Under the stabilization plan, no more than $16 million could be deferred in any one calendar year, and no more than $40 million could be deferred during the four-year period. Id. at 5.

(id. at 25). The Attorney General submits that the Department should apply the same approach in this proceeding, which would entail rejecting Commonwealth's proposal and requiring that the final amount of the deferred fuel charge balance be resolved in Commonwealth's performance review proceedings (id.).[20] The Attorney General contends that these two proceedings present a similar situation because both WMECo's and Commonwealth's fuel charges were stabilized to reduce volatility in the fuel charge rate (Attorney General Reply Brief at 14). The Attorney General states that the Department determined in D.T.E. 97-120, at 61, that because we had not approved the amount of WMECo's deferred fuel costs as a regulatory asset, "they do not qualify as a transition cost pursuant to the Act" (Attorney General Brief at 25). The Attorney General contends that the Department should adopt the same approach in this proceeding (id. at 26).

The Attorney General also disputes the outstanding balance of the fuel charge deferral account (Attorney General Reply Brief at 14). The Attorney General claims that the exact amount of the recoverable deferred fuel charge balance is subject to Department review in the Companies' performance review proceeding (id. at 14).

Finally, the Attorney General states that the balance should only be allowed to earn interest at a rate consistent with the settlement approved in D.P.U. 94-3A, which allowed a carrying charge at the lesser of Commonwealth's overall cost of capital as determined in its

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[20] The Department has since approved an offer of settlement from the Attorney General and the Companies resolving all of the Companies' outstanding performance review proceedings. Cambridge Electric Light Company/Commonwealth Electric Company, D.P.U./D.T.E 95-2C-1/3C-1; D.P.U./D.T.E 96-2C-1/3C-1; D.P.U./D.T.E 97-2C-1/3C-1; D.P.U./D.T.E 97-2C-1/3C-1, at 5 (2000).

most recent rate case or the Bank of Boston prime rate less two percent multiplied by 150 percent (Attorney General Brief at 25, citing Exh. DTE-4-9). The Attorney General contends that Commonwealth's proposal to apply a carrying cost at its overall pre-tax cost of capital would allow Commonwealth to recover $2,781,000 more in carrying costs than previously authorized by the Department (id. at 26, citing RR-DTE-3, at 3). The Attorney General argues that the Department should reject Commonwealth's proposal and reduce the carrying costs to the level approved in D.P.U. 94-3A (id. at 26-27).

b. Commonwealth

Commonwealth argues that the Attorney General's attempts to draw similarities between this proceeding and D.T.E. 97-120 regarding the unrecovered fuel charge balance is misplaced because of significantly different facts present in this proceeding (Companies Brief at 31). First, Commonwealth contends that the amount of unrecovered fuel costs as of March 1, 1998 has been accounted for in accordance with D.P.U. 94-3A (id.). Commonwealth avers that WMECo's unrecovered fuel charge balance contained an element of uncertainty because there were replacement power costs included in the unrecovered balance (id. at 32). Commonwealth claims that, in D.T.E. 97-120, the Department determined that it had not had the opportunity to fully investigate the calculation of these replacement power costs (id.). Commonwealth states that D.P.U. 94-3A did not contain such elements of uncertainty (id.). Commonwealth claims that the Attorney General's arguments are without merit and that the fuel stabilization regulatory asset should be approved by the Department in this case (id.). Commonwealth also argues that these "Department-approved" deferred costs fall squarely

under the definition of a generation-related regulatory asset under the Act (Companies Reply Brief at 10).

Commonwealth contends that the Attorney General's proposal would be detrimental to ratepayers (id.). Commonwealth claims that if the Department were to deny the inclusion of the deferred fuel costs as transition costs, they would continue to be deferred according to D.P.U. 94-3A, with associated carrying charges (id.). Commonwealth argues that because it has proposed to treat these costs as a regulatory asset, they can be bought down using Energy Investment Services, Inc. ("EIS") funds (id.).[21] Commonwealth argues that using the EIS funds to buy out the deferred fuel costs would stop the accrual of carrying charges, which reduces overall costs to ratepayers (id.).

On the issue of the level of carrying charges that should be applied to the unrecovered fuel cost balance, Commonwealth maintains that previously allowed carrying charges are not representative, given the statutory environment created by the Act (Companies Brief at 30). Commonwealth argues that its proposal treats regulatory assets as authorized under the Act and in the same manner as other electric companies in Massachusetts, i.e., as fixed transition costs that, like any other fixed transition cost, accrue carrying charges over the amortization period (Companies Reply Brief at 5, citing G.L. c. 164, § 1G(b)(3)).

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[21] EIS is a special-purpose affiliate that was created by the Companies to hold and manage the funds that it received from the divestiture of the Canal generating station. D.T.E. 98-78-A at 3. The Department approved the creation of EIS in D.T.E. 98-78-A. Id. at 13.

3. Analysis and Findings

Commonwealth's fuel charge stabilization plan was intended to stabilize Commonwealth's fuel charge for a four-year period, followed by a six-year period of recovery of any fuel-related deferred amounts. D.P.U. 94-3A at 4. The Act limits the recovery of regulatory assets to the unrecovered amount of generation-related regulatory assets, as approved by the Department. G.L. c.164, § 1G(b)(1)(iii). The term "regulatory assets" refers to the unrecovered balance of deferred costs that have been specifically approved for deferral and later recovery by the Department. Id. The Department finds that our approval of the settlement agreement in D.P.U. 94-3A constitutes prior approval by the Department for recovery of the unrecovered deferred fuel charge balance. Therefore, the $26,779,000 deferred fuel charge balance qualifies as a regulatory asset under the Act. Consequently, Commonwealth is permitted to offset the unrecovered deferred fuel charge balance using EIS funds.

Although the Attorney General takes issue with the exact total of the deferred fuel charge account, the Department notes that, throughout the stabilization period, Commonwealth made quarterly fuel charge filings in which, after public hearing and notice, the Attorney General had ample opportunity to intervene and, in many cases, did intervene.[22] In these

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[22] Commonwealth Electric Company, D.P.U. 94-3A (1994); Commonwealth Electric Company, D.P.U. 94-3B (1994); Commonwealth Electric Company, D.P.U. 94-3C (1994); Commonwealth Electric Company, D.P.U. 94-3D (1995); Commonwealth Electric Company, D.P.U. 95-3A (1995); Commonwealth Electric Company, D.P.U. 95-3B (1995); Commonwealth Electric Company, D.P.U. 95-3C (1995); Commonwealth Electric Company, D.P.U. 95-3D (1996); Commonwealth Electric

(continued…)

proceedings, Commonwealth updated the deferral balance based on actual fuel costs incurred during the stabilization period. Any intervening party, including the Attorney General, had untrammeled opportunity to question these updates. The matters at issue were essential to those adjudications. Therefore, the Department finds that the unrecovered deferred fuel charge balance, as of March 1, 1998, as calculated through Commonwealth's quarterly fuel charge filings, accurately represents the outstanding fuel charge balance.

With respect to Commonwealth's proposal to modify the carrying charge applied to the unrecovered deferred fuel charge balance, we disagree with Commonwealth's contention that previously allowed carrying charges are not representative in the new statutory environment. While the Act may allow for full recovery of investments, including a return of and on investments, this provision is not intended to supplant prior Department decisions. The Act allows for the recovery of regulatory assets that have been specifically approved for deferral and later recovery by the Department. G.L. c. 164, § 1G(b)(1)(iii). Therefore, Commonwealth is directed to apply the carrying charge that was approved by the Department in D.P.U. 94-3A and to refund the difference between the two carrying charge rates to ratepayers through a reduction to the unrecovered deferred fuel charge balance.

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[22](…continued)
Company, D.P.U. 96-3A (1996); Commonwealth Electric Company, D.P.U. 96-3B (1996); Commonwealth Electric Company, D.P.U. 96-3C (1996); Commonwealth Electric Company, D.P.U. 96-3D (1997); Commonwealth Electric Company, D.P.U. 97-3A (1997); Commonwealth Electric Company, D.P.U. 97-3B (1997); Commonwealth Electric Company, D.P.U. 97-3C (1997); Commonwealth Electric Company, D.T.E. 97-3D (1998); and D.T.E. 98-13.

D. Primary Service and Farm Discounts

1. Introduction

The Companies proposed to recover shortfalls they attribute to the primary service discount. The primary service discount is available to Commercial and Industrial ("C&I") customers whose electricity is metered at the primary voltage level, which is 2,400 to 4,160 volts for Cambridge and 13,200 to 25,000 volts for Commonwealth. These are tariffed arrangements. Cambridge, M.D.T.E. No. 621; and Commonwealth, M.D.T.E. No. 371. The primary service discount is a two percent discount applied to all rate elements applicable to the customer (id.; Tr. 6, at 610-611). Primary service customers who furnish and maintain the necessary transforming, switching, and protective equipment are given an additional discount of three percent applied to delivery service rates.[23] Cambridge, M.D.T.E. No. 621; Commonwealth, M.D.T.E. No. 371. The Companies state that the discounts were applied equally to each rate component (Tr. 6, at 610-611). The Companies seek recovery of those primary service discounts applied to the transition, standard offer service, and default service charges through the respective charges themselves.

In addition, the Companies seek to recover shortfalls they attribute to the farm discount. The farm discount, authorized by St.1997, c. 164, § 315, applies to customers who are taking service under any of the Companies' retail delivery service rates and who are engaged in the business of agriculture or farming as defined in G.L. c. 128, § 1A. The farm

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[23] Delivery service rates include the following: customer charge, distribution charge, transition charge, and transmission charge.

discount provides eligible customers a ten percent discount on their total electric bill. The Companies state that the discounts apply equally to each rate component. The Companies seek recovery of those farm discounts associated with the transition, standard offer service, and default service charges through the respective charges themselves.

2. Position of the Parties

a. Attorney General

According to the Attorney General, the treatment of the primary service and farm discounts should not be determined as part of a transition charge true-up (Attorney General Brief at 46). The Attorney General argues that the revenue shortfall resulting from the primary service discount is subsumed in the revenue requirements of other rate classes as part of the rate design in a general rate case where issues of cost causation and inter- and intra-class subsidies are decided (id. at 45-46). The Attorney General asserts that the recovery of the farm discount costs has already been determined by the Department to be a part of a company's general rate case revenue deficiency calculation (id. at 46, citing 220 C.M.R. § 11.04 (6)). The Attorney General asserts that the Companies have not provided any basis to warrant transferring the question from general rate case to transition charge true-up for the determination of the treatment of these discounts (id. at 46). He advocates that the Department continue its practice of reviewing these revenue shortfalls in a general rate case (id.).

b. The Companies

The Companies claim that a base rate case would only address shortfalls concerning distribution service. Therefore, shortfalls concerning the collection of transition costs are

properly reconciled in a transition charge true-up proceeding (Companies Brief at 48). The Companies state that the primary service and farm discount shortfalls they propose to recover in the transition charge are associated with the transition charge only (id.). Accordingly, the Companies state that the Department should reject the Attorney General's argument and allow for recovery through the transition charge (id.).

With respect to primary service and farm discounts associated with standard offer service and default service, the Companies state that the costs and revenues for these generation-related services also are collected and reconciled outside of base rates. Therefore, the Companies assert that the Attorney General's proposal to address these discounts in a base rate proceeding is without merit (Companies Reply Brief at 18).

3. Analysis and Findings

While the Companies assert that they experience shortfalls from the two percent primary service discount, this effect results from the Companies' method of accounting. The Companies' "booked revenues" do not equal the revenues collected from the primary service customers (Exh. RHM-1, at 19-20). The Companies book the primary service customers' transition charge revenues at the uniform transition charge but only receive actual revenues net of the primary service discount (id.). The cost for the Companies to deliver electricity at the primary voltage level is less than the cost to deliver electricity at the secondary voltage level because of lower line losses. Massachusetts Electric Company, D.P.U. 89-21, at 67 (1989). The primary service discount passes on these lower costs to customers who are metered at the primary voltage level. Because the lower costs to serve customers at the primary voltage level

results in having to supply less electricity, the Department finds that the appropriate treatment to account for the primary discount is through the metered consumption and not the rates. Therefore, for the two percent primary service discount, the Department directs Companies to discount the metered consumption instead of the rate.

With respect to the three percent primary service discount that customers receive for maintaining and furnishing the necessary transforming, switching, and protective equipment, such discount is given to account for the lower distribution costs to serve these customers. Further, the lower distribution costs have been included in the design of the current distribution rates. Accordingly, the Companies have been recovering fully in distribution rates costs attributable to the three percent primary service discount. Therefore, the Department rejects the Companies' proposal regarding treatment of the three percent primary service discount.

The Department has stated that "distribution companies may defer costs associated with the implementation of the farm discount for consideration in a subsequent rate case." Electric Industry Restructuring, D.T.E. 96-100, at 22-23 (1998); 220 C.M.R. § 11.04 (6). Furthermore, revenue shortfalls associated with the farm discount do not meet the criteria set forth in the Act to be eligible for recovery through the transition charge. G.L. c. 164, § 1G(b)(1). Those criteria are: (1) unrecovered fixed costs that were being collected in Department-approved rates prior to January 1,1997, (2) nuclear entitlements and those previously incurred and known liabilities incurred for post-shutdown and decommissioning costs associated with nuclear power plants, (3) the unrecovered amount of the book balances of

existing generation-related regulatory assets that have been approved by the Department for deferral and later recovery, and (4) the amount by which the costs of existing contractual commitments for purchased power exceeds the competitive market price for such power. G.L. c. 164, § 1G(b)(1). All of the costs under those criteria are costs that are stranded as a result of the distribution companies exiting the generation supply business. Revenue shortfalls incurred by the Companies resulting from implementing the farm discount are not costs that have been stranded as a result of the Companies exiting the generation supply business. Therefore, such shortfalls are not reconcilable through the transition charge. Accordingly, the Department finds that the Companies shall not recover the amount of transition cost revenue attributed to the farm discounts through the transition charge but can defer costs associated with the implementation of the farm discount for consideration in a subsequent rate case. For the same reason, the Department finds that the Companies shall not recover the amount of standard offer and default service attributed to the farm discounts through their respective charges for such services but can defer such costs for consideration in a subsequent rate case.

E. Distribution Revenues

1. Introduction

General Laws c. 164, § 1B(b), required each investor-owned electrical company to implement a 15 percent rate reduction for its customers for electricity consumption on and after September 1, 1999. On August 19, 1999 the Department issued a guidance letter to clarify what is required pursuant to G.L. c. 164, § 1B(b) to receive Department approval to implement the 15 percent rate reduction. To comply with the Department's August 19, 1999

letter and G.L. c. 164, § 1B(b), the Companies proposed to temporarily lower the distribution rates of some of their smaller rate classes instead of lowering the uniform transition charge (Exh. HCL-1, at 8-9). The Companies, however, objected to the Department's August 19, 1999 letter, claiming that the Department's directive established a rate-design objective that could not be accomplished on a revenue-neutral basis. The Companies stated that they would seek recovery of these lost distribution rates in their reconciliation filing (Exh. RHM, Sch. 2, RD-WP2). In this proceeding, Cambridge proposed to recover, through the transition charge, $32,000 in lost distribution revenues due to a reduction in its base distribution rates (Exhs. RHM-1, Cambridge Sch. 2, at 3; RHM, Sch. 2, RD-WP2). Similarly, Commonwealth proposed to recover $277,000 (Exhs. RHM-1, Commonwealth Sch. 2, at 3; RHM, Sch. 2, RD-WP2).

2. Position of the Parties

a. Attorney General

The Attorney General opposes any recovery of reduced distribution revenues as it constitutes retroactive ratemaking (Attorney General Brief at 47). The Attorney General maintains that recovery of base rate revenue deficiencies generally requires a base rate case, not a reconciliation of rates as the Companies propose (id. at 48). The Attorney General further maintains that if the Companies could not meet the required 15 percent rate reduction, they should have availed themselves of the provisions in the Act that allow companies to petition the Department to explore options to achieve rate reduction compliance (id. at 48, citing G.L. c. 164, § 1G(b)(4).

b. The Companies

The Companies maintain that reconciliation of their distribution revenues does not constitute retroactive ratemaking (Companies Brief at 49). The Companies reason that because they established distribution rates lower than those previously allowed by the Department to meet a Department directive and noted their objection to the Department's mandate, the approved rates were only temporary and subject to reconciliation in this proceeding (id. at 49). Furthermore, the Companies maintain that a reduction in the distribution rates was the only method available in order to meet the Department's August 19, 1999 letter (id. at 49).

3. Analysis and Findings

While the Companies proposed to reduce their distribution rates to comply with the mandated rate reduction, other options were available to the Companies. The Companies could have proposed to modify their transition charge, which is a reconcilable account, or they could have petitioned the Department to explore options to achieve rate reduction compliance as provided for in the Act.

In the Department's August 19, 1999 letter, the Companies were not explicitly directed to reduce distribution rates. In making their determination, the Companies balanced the class-specific under-recovery of distribution revenues against a reduction of a uniform transition charge. Finally, this reduction in distribution revenues is not a transition cost permitted by the Act. G.L. c. 164, § 1G(b)(1). Based on the foregoing, the Department finds that the Companies shall not be allowed to recover any voluntary reduction in distribution revenues through the transition charge.

F. Mitigation Incentive

1. Introduction

In D.T.E. 97-111, at 69-70, the Department required the Companies to modify their mitigation incentive proposal and to submit a revised plan. Specifically, the Department ordered the Companies to alter their incentive proposals so that incentive payments would be tied to actual mitigation results. Id. In response to the Department's Order, the Companies filed a modified mitigation incentive proposal that was subsequently approved by the Department in Cambridge Electric Light Company/Commonwealth Electric Company, D.T.E. 97-111-A (1998).

The Companies modified their mitigation incentive to a monetary incentive of four percent applied to mitigated costs collected under the fixed and variable components of the transition charge as described below. Id. at 1-2. For mitigation of the costs collected under the fixed component of the transition charge, the four percent incentive was to be applied to the positive difference between the purchase price of the generation asset sold and the book value of the asset on the date of divestiture, or net proceeds. Id. at 2. Consequently, if the generation asset sold for less than the book value, the Companies would not earn a mitigation incentive. Id. at 3-5. For mitigation of the costs collected under the variable component of the transition charge, the four percent incentive was to be applied to the amount that the Companies reduced their above-market costs for power from purchased power contracts. Id. at 2, 5-6. Under the proposal, the above-market cost of power was the difference between the

amount paid under contract and the projected cost for the same power based on the Companies' forecast of the market price for power. Id.

In this proceeding, the Companies calculated the mitigation incentive for costs collected in the fixed component of the transition charge as four percent of the net proceeds from the sale of their generation assets (Exh. RHM-1, Cambridge Sch. 1, at 4; Commonwealth Sch. 1, at 4). For the variable component, the Companies calculated the mitigation incentive as four percent of the savings that customers were forecast to receive as a result of PPA renegotiations (Exh. RHM-1, Cambridge Sch. 1, at 4A-4C; Commonwealth Sch. 1, at 4A-4C). The Companies calculated the above-market costs pre- and post-mitigation using the National Economic Research Associates Base Load Market Forecast (Exh. RHM-1, Cambridge Sch. 1, at 4A-4C; Commonwealth Sch. 1, at 4A-4C). The Companies proposed that the entire mitigation incentive, for both the fixed and variable components, be recovered as a reconciliation adjustment to their transition charge (Exh. RHM-1, Cambridge Sch. 2, at 3; Commonwealth Sch. 2, at 3).

2. Positions of the Parties

a. Attorney General

The Attorney General recommends that the Department modify the Companies' mitigation incentive proposal (Attorney General Brief at 30). According to the Attorney General, the Companies' mitigation incentive provides the Companies with excessive returns and the design of the mitigation incentive for the variable component of the transition charge

allows them to manipulate the earned incentive simply by changing the market price forecast the Companies use to calculate the level of mitigation of PPA costs (id.).

The Attorney General asserts that the Companies' mitigation incentive formula allows the Companies to earn much higher returns compared to their original filing and compared to the returns of other electric companies in Massachusetts that use a mitigation incentive formula based on the cumulative average transition charge (id.). According to the Attorney General, under the Companies' original mitigation incentive proposal, Commonwealth would have earned $428,000 in 1999 (id. at 32). In addition, the Attorney General claims that the Companies' original mitigation incentive proposal, based on the cumulative average transition charge, capped the return on equity ("ROE") at twelve percent (id. at 31). The Attorney General contends that this limitation would have resulted in a maximum cumulative incentive of $2 million for Commonwealth and $887,000 for Cambridge over the twelve-year life of the transition charge on a net present value basis (id.).

In comparison, according to the Attorney General, the Companies' proposal in this filing would result in a mitigation incentive payment of $1.6 million and an ROE of over 13.83 percent for the year 1999 for Commonwealth (id. at 32). The Attorney General further contends that excess returns will continue each year into the future as the Companies continue to recover their proposed mitigation incentives over the life of the original transition cost recovery (id.). Therefore, the Attorney General argues that the current mitigation incentive mechanism provides the Companies with returns that are far higher than their costs of capital

and more than the returns that will be earned by "other efficient, lower-cost" companies that have been more successful at mitigating their transition costs (id.).

In addition, the Attorney General asserts that the current mitigation incentive mechanism gives the companies an incentive to manipulate market price forecasts rather than actually lower transition costs (id.). Because the benefits of a PPA renegotiation are estimated by comparing the obligations under the PPA with forecast market prices, the Attorney General asserts that the mitigation incentive mechanism is too dependent on the Companies' own forecast of market prices (id. at 33). The Attorney General argues the Companies have more of an incentive to manipulate the market price forecasts rather than lower the actual transition costs paid by ratepayers (id.). Furthermore, the Attorney General contends that rather than simply determining whether there is a benefit from mitigation, the mitigation incentive mechanism forces the Department to choose one "correct" forecast for the market price (id.). The Attorney General argues that the mitigation incentive mechanism puts parties in "the worst of all positions" of having to make more precise forecasts of market prices; therefore, he recommends that the Companies' mitigation incentive mechanism be rejected (id. at 33).

In the event that the Department allows the use of the Companies' mitigation incentive mechanism, the Attorney General recommends that the incentive earned should be adjusted over time as actual market prices become known (id. at 33, n.23). Responding to the Companies' argument that the mitigation incentive should not be adjusted after the fact as the forecast values become actual values because the actual operation of the unit from which the purchased power is derived will not be known at the time of the termination of the contract, the

Attorney General argues that market prices of power can and should be measured (id.). The Attorney General argues that this adjustment would eliminate at least one aspect of the "perverse" incentives built into the mechanism (id.).

b. The Companies

The Companies state that the Department has already considered the mitigation incentive mechanism twice, and that the Attorney General "seeks a third bite at the apple," effectively requesting reconsideration of the Department's Order approving the mitigation incentive mechanism (Companies Brief at 37). The Companies state that the initial mitigation incentive proposal was rejected by the Department because the Department found that the incentives were not tied to actual mitigation and would not encourage aggressive mitigation (id., citing D.T.E. 97-111, at 69). According to the Companies, it is ironic that the Attorney General is recommending modification of the mitigation incentive mechanism because it implies that the Companies have been too successful in mitigating their transition costs and that the incentive mechanism has worked too well (id. at 37).

The Companies assert that the Attorney General's argument is essentially a motion for reconsideration of the Order approving the mitigation incentive mechanism and should be rejected because it is untimely and provides no new unknown or undisclosed facts that would have an impact on the decision already rendered (id. at 38). The Companies contend that the Attorney General is merely rearguing issues already considered and decided by the Department (id. at 38). The Companies state that their mitigation incentive mechanism, previously

approved by the Department, is reasonable and should not be modified by the Department (id. at 38).

Referring to the Attorney General's suggestion that, if the Department allows the Companies to use the mitigation incentive mechanism, the earned incentive be adjusted as actual market prices become known, the Companies contend that this suggestion is inappropriate and inconsistent with the intent of the mitigation incentive (id. at 39). According to the Companies, the purpose of the mitigation incentive is for the Companies to pursue mitigation aggressively and to do so based on information available at the time the decision to renegotiate a PPA was made. The purpose is not to establish a system that rewards or penalizes the Companies for subsequent changes in market prices (id. at 39).

Further, the Companies argue that adjusting the mitigation incentive for updated market prices would not be appropriate because the market price is often linked to pricing indices in the power contracts, and therefore it is impossible to adjust total mitigation without also updating the obligation to be paid under the contract (id. at 39). In addition, the Companies contend that currently there is no reliable index for the market price of electricity and, therefore, it is not clear how to determine the actual market value of power contracts (id. at 40).

3. Analysis and Findings

The mitigation incentive mechanism should be designed in order to ensure that the Companies pursue mitigation of transition costs aggressively as they divest their generation assets and renegotiate PPAs. The Department found that the mitigation incentive mechanism,

approved in D.T.E. 97-111-A, achieves this goal. We do so yet again. The Department reaffirms its finding in D.T.E. 97-111-A at 3-4 that the mitigation incentive appropriately ties the incentive received by the Companies to actual mitigation results. Therefore, the mitigation incentive mechanism will remain unchanged.

The Attorney General recommends that, if the Department allows the use of the Companies' mitigation incentive mechanism, the incentive earned should be adjusted over time as actual market prices become available. The earned incentive is proportional to the reduction in the above-market payments for PPAs, and the above-market payments are, in turn, dependent on the market price forecast used to arrive at the market value of the contracts. The Attorney General claims that the earned incentive can be increased by simply manipulating the market price forecast. Using the actual market price to calculate the earned incentive in a particular year would address the Attorney General's concerns.

This approach, however, has a major flaw: using the actual market price would be probably unworkable because there is not yet a reliable index for the market price of electricity and there will not likely be one until the competitive market for electricity is more fully developed. The prices established by the Independent System Operator-New England ("ISO-NE") are not a good proxy for the actual market value of a long-term contract, because they are for short-term power purchases, which are more volatile than long-term supply prices (RR-DTE-12). Furthermore, even if the Department were to use the ISO-NE spot market prices as a proxy for the market price of electricity, we would not be able simply to sum up the

prices for the eight components (id.).[24] In order to arrive at a market price from the spot prices for the eight components, the Department would need to use weights for each component, and there is not general agreement on what the appropriate weights should be (id.).

Another troubling aspect of updating forecast market prices with actual market prices is that doing so puts the Department in a position of second-guessing a company's decision to renegotiate a PPA. The acceptance of the market price forecast presented in the cost-effectiveness analysis of a PPA has always been express or at least implicit in the Department's review of that PPA, be it the original PPA or a subsequent renegotiation. In addition, truing up market forecasts with actual market prices could have a chilling effect on future mitigation efforts because it would introduce uncertainty into the Companies' decision to renegotiate a PPA. This amounts to the classic 20/20 hindsight regulatory trap. Leaving the mitigation incentive unchanged does result in a situation in which the market price forecast that is presented to the Department at the time of a proposed PPA renegotiation takes on greater importance, as it will be the basis for the calculation of the mitigation incentive. However, this situation is consistent with the Department's precedent regarding the treatment of market price forecasts for PPA-related approvals. The Department has traditionally based its decision on a "snapshot" market price forecast, but has not revisited that forecast at a later date. Given the difficulty in determining a market price and given established Department precedent, the

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[24] These eight components include the costs for energy, capacity, automatic generation control regulation, ten minute spinning reserve, ten minute non-spinning reserve, 30 minute reserve, congestion uplift costs, and energy uplift costs.

Department will not require the Companies to update their mitigation incentive using the actual market price.

VII. WHOLESALE ISSUES

A. Wholesale Power Costs

The Companies sell a portion of their power on the wholesale market either through sales on the spot market or through long-term wholesale contracts.[25] The treatment of the costs and revenues from these sales and the effect that this treatment has on lost revenues and the transition charge is at issue in this proceeding.

Prior to March 1, 1998, Cambridge credited the revenues from the Town of Belmont's ("Belmont") wholesale contract back to ratepayers as a credit to the fuel charge. The Companies proposed to allocate the costs incurred after March 1, 1998 to provide wholesale power across all sources of power and then credit the wholesale power revenues to their retail customers through lost revenues and the variable component of the transition charge. Those costs that are allocated to the Companies' owned generation assets are recovered as lost revenues, which are netted against the RVC (Exh. RHM Sch. 6, NP-WP2). Those costs that are allocated to the Companies' PPAs are recovered through the variable component of the transition charge (id.).

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[25] Commonwealth has no long-term wholesale contracts but does sell excess power into the spot market. Cambridge has had a wholesale contract with the Town of Belmont for 28 years. This contract was a "total requirements" contract until 1993, when it became a "net requirement" contract. At that time, Belmont solicited competitive proposals for electric service. On January 1, 1999, the rate charged under the contract was adjusted from a demand and energy rate to a flat customer charge and an energy rate. This contract is scheduled to expire in 2003.

1. Position of the Parties

a. Attorney General

The Attorney General states that the Companies are "allocating" all power sales revenues by spreading the revenues received by the Companies across all sources of power based on the total KWH provided by each source (Attorney General Brief at 40-41). The Attorney General avers that this "allocation" method involves applying a revenue credit for wholesale contract sales to total power supply costs (id. at 41). The Attorney General states that this "allocation" method results in a subsidization of wholesale customers by retail customers (id.). According to the Attorney General, this method leaves the retail ratepayer responsible for the residual costs of producing the power needed to meet the obligations of the wholesale contracts (id.).

The Attorney General disagrees with the Companies' position that the wholesale sales to Belmont are "opportunity sales" that contribute "to costs that otherwise would be borne solely by Cambridge's retail customers" (Attorney General Reply Brief at 17). The Attorney General argues that the fact that Cambridge has served Belmont as a wholesale customer for the last 28 years discredits the Companies' argument that these sales can be classified as "opportunity sales" (id. at 18). The Attorney General argues that the Companies should treat the costs and the revenues associated with wholesale sales on a stand-alone basis and not as "opportunity sales" (id. at 17).[26]

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[26] The Attorney General provided calculations demonstrating how he believes the Department should treat wholesale revenues in Attachments A through D of his Reply (continued…)

b. The Companies

The Companies claim that their reconciliation of revenues and costs associated with wholesale sales is appropriate and should be approved by the Department (Companies Brief at 48). The Companies state that, rather than accounting for wholesale costs and revenues separately, the Companies have credited revenues from wholesale sales back to its retail customers (id. at 47). The Companies argue that wholesale sales represent opportunity sales that provide a contribution to the Companies' fixed costs that would otherwise be borne by the Companies' retail customers (id.; Companies Reply Brief at 13). The Companies aver that this treatment of wholesale sales provides an effective way to mitigate the fixed costs associated with the Companies' generating facilities, rather than creating a "forced subsidization" of wholesale customers by retail customers (Companies Brief at 47; Companies Reply Brief at 13).

The Companies claim that because the Attorney General did not request reconsideration of the issue of the treatment of wholesale revenues in the D.T.E. 97-111 proceeding, the Order there represents a final disposition of this matter (Companies Reply Brief at 14). Further, the Companies state that, since the Order is final, the Attorney General's attempt to revisit this issue constitutes an untimely request for reconsideration (id.).

The Companies stated that the Attorney General's calculations presented as an attachment to his Reply Brief violate FERC ratemaking principles because they would deprive

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[26](…continued)
Brief.

the Companies from recovering all of their costs relating to wholesale sales by allocating to wholesale sales more costs than FERC allows the Companies to recover through wholesale sales (id. at 13-14). In addition, the Companies argue that the Attorney General's approach would provide the Companies with a disincentive to pursue wholesale sales (id.). Further, the Companies claim that the Attorney General's calculations were not accompanied by any explanation to support his assumptions or methods (id. at 14, n.13). The Companies state that the Attorney General's calculations are rife with erroneous assumptions and appear to contradict his own theory on how the revenues from wholesale sales should be treated (id. at 14-15).

2. Analysis and Findings

The Department must decide if costs and revenues associated with wholesale contracts should be included in calculations that determine retail rates for the Companies. According to the Attorney General, the revenues that are generated by the wholesale contracts are below the Companies' average cost to produce power. The remaining wholesale power sales that are at issue here have been categorized by the Companies as "opportunity sales." These are sales into the New England power exchange, made only when the Companies have excess power (Tr. 2, at 221; Tr. 3, at 291). Therefore, any revenues that are derived from these "opportunity sales" truly serve to lower costs to retail customers because the Companies would have to incur the entire fixed cost of producing or procuring that power if it was not sold into the power exchange.

The Department is not convinced by the Companies' argument that the issue of the treatment of wholesale revenues was decided in D.T.E. 97-111 and that the Attorney General's attempt to "revisit" this issue constitutes a late-filed motion for reconsideration. This issue was not raised effectively in D.T.E. 97-111. The Companies' restructuring plan did reference their intent to revenue-credit the proceeds from the Belmont whole sale contract to Cambridge's retail ratepayers. In addition, the Companies did not provide a calculation of lost revenues in the D.T.E. 97-111 proceeding; nor could they. While the Department approved the Companies' restructuring plan in D.T.E. 97-111, it was not until the Companies presented their initial filing in the instant proceeding that it became clear how the Companies intended to calculate their lost revenues. Therefore, the Attorney General would have been unable to file a motion for reconsideration in D.T.E. 97-111, because the Companies' method for calculating lost revenues was not at issue until the instant proceeding.

The Department is also not convinced by the Companies' argument that the Belmont wholesale contract can be classified as "opportunity sales." Cambridge has had a wholesale contract with Belmont for the last 28 years. While the original Belmont wholesale contract may have been agreed to during a period in which Cambridge had excess generation capacity, the fact that this contract has now been in place for 28 years indicates that there was an evident level of expectation from Belmont that it would continue to receive power from Cambridge. While Cambridge ratepayers have certainly benefitted from the Belmont wholesale contract, as claimed by the Companies, the Department will not classify this contract as "opportunity sales."

While the Attorney General asserts that Cambridge's treatment of the Belmont wholesale contract revenues results in a subsidization of wholesale customers by retail customers, the Act allows recovery of those costs that were being collected in Department-approved rates on January 1, 1997. G.L. c. 164, § 1G(b)(1)(i). The Department has allowed companies to include the costs to serve wholesale contracts in retail rates because revenues received from such contracts benefit retail ratepayers. In fact, the Department has allowed Cambridge to credit the Belmont wholesale contract revenues in its fuel charge for the last 28 years because there was a benefit to ratepayers. While it may be unclear at this juncture whether the cost of serving Belmont exceeds the revenues received, it would be inequitable to now eliminate this contract after ratepayers have benefitted for the last 28 years.

Cambridge revenue-credited the Belmont wholesale contract revenues through its fuel charge pursuant to long-standing Department precedent. D.P.U. 1300, at 64-66. Until the traditional § 94G fuel charge ended on March 1, 1998, the Belmont wholesale contract revenues served to reduce the fuel charge paid by Cambridge's retail ratepayers. The Department has accepted the treatment of the Belmont wholesale contract revenues through fuel charge proceedings. Cambridge is proposing to continue this treatment of the Belmont wholesale contract revenues by crediting the Belmont wholesale contract revenues against Cambridge's lost revenues. Although the onset of retail access eliminated the need for a fuel charge, through which the Belmont wholesale contract revenues were credited, the fundamental treatment of these revenues, i.e., revenue-crediting, need not be altered. Cambridge merely proposes to continue to follow Department precedent on the treatment of expenses and costs

related to wholesale contracts. Revenue-crediting the Belmont wholesale contract revenues against Cambridge's lost revenues and deferrals mirrors the treatment of these revenues prior to March 1, 1998. The Department finds that this treatment of the Belmont wholesale contract revenues is consistent with Department precedent regarding the treatment of expenses and costs related to wholesale contracts. Therefore, the Department will allow the Companies' proposed treatment of wholesale expenses and revenues.

The Department notes that the Belmont wholesale contract expires in 2003. Upon expiration of this contract, Cambridge shall exclude from its calculations that determine retail rates any costs and revenues associated with the Belmont wholesale power contract. To the extent the Companies have excess capacity that is sold on the spot market, the Companies shall continue to credit the transition charge.

B. Transmission Rate Adjustments

1. Introduction

As part of their transmission rate adjustments, the Companies determined the retail transmission revenue requirement by subtracting their wholesale transmission revenues from their FERC-approved 1998 transmission revenue requirement (Exhs. HCL-1, at 5-6; AG-6-3). The Companies' FERC-approved transmission revenue requirement includes transmission expenses to serve both wholesale and retail customers (Exh. AG-6-3).

Cambridge's wholesale transmission customers are Belmont and the Massachusetts Bay Transportation Authority ("MBTA") (RR-AG-30). Commonwealth provides non-firm point

to point transmission service to Nantucket under FERC- approved transmission rates (Exh. AG-6-3).

2. Positions of the Parties

a. Attorney General

According to the Attorney General, the result of the Companies combining the wholesale and retail transmission costs and then crediting the wholesale revenues in the calculation of the retail transmission revenue requirement is that the residual is incurred by the retail ratepayers (Attorney General Brief at 44). The Attorney General stated that in the case of Belmont, rates have been restructured and decreased over time through settlements between Cambridge and Belmont (id., citing Exh. RHM, Sch. 2, WLS-WPI, PR-AG-29; Tr. 6, at 622). The Attorney General asserts that retail customers should not be responsible for any shortfall Cambridge may incur in recovering its costs to serve Belmont (id. at 44). Therefore, the Attorney General states that the wholesale costs and revenues should be removed from the calculation of the retail transmission cost reconciliation (id.).[27]

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[27] The Attorney General proposes that wholesale customers pay the same transmission rate as retail customers. Accordingly, the Attorney General proposes that the retail transmission revenue requirement be determined by subtracting the product of the average cost to serve all customers and the 1998 wholesale KWH sales from the FERC-approved 1998 transmission revenue requirement. The Attorney General calculated the average cost to serve all customers by dividing the total wholesale and retail KWH sales by the FERC-approved 1998 transmission revenue requirement (Attorney General Reply Brief, Att. 1).

b. The Companies

The Companies assert that their wholesale contracts represent opportunity sales that provide a contribution to their fixed costs that otherwise would be solely the responsibility of their retail customers (Companies Brief at 47). According to the Companies, if the Department adopts the Attorney General's method of allocating their transmission costs to their wholesale and retail customers, then the Companies will not be allowed to recover their transmission costs allocated to wholesale customers that are above the level allowed by FERC (Companies Reply Brief at 13). The Companies state that not allowing them to recover wholesale costs that are above the level allowed by FERC provides a disincentive for the Companies to pursue such sales in the future (id. at 14).

3. Analysis and Findings

In an effort to promote wholesale competition through open access, FERC has required that public utilities provide non-discriminatory transmission tariffs. Promoting Wholesale Competition through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 76 FERC 61, 220, at 1 (1997). Further, FERC reasoned that the same open access tariff that serves wholesale customers will be equally appropriate for retail customers. Order Clarifying Order Nos. 888 and 889, 76 FERC 61, 009, at 157 (1996). While the Company asserts that its wholesale contracts reduce fixed costs that otherwise would be incurred by retail ratepayers, the Department cannot ignore FERC's order on non-discriminatory tariffs and its goal of providing lower-cost power to all electricity consumers. Therefore, as of March 1, 1998, the

Companies shall reconcile its rates based on setting its retail transmission rates the same as any wholesale contracts that were entered into after FERC's issuance of Order Nos. 888 and 889, the commencement of open access. The Department directs the Companies to demonstrate in their next reconciliation proceeding that transmission rates for retail electric service are at the non-discriminatory open access rate.

With respect to existing contracts that were entered into prior to open access, FERC has stated that its Order No. 888 does not supersede an existing transmission agreement that has been accepted by FERC. 76 FERC 61,009, at 8. The Companies submitted evidence indicating that only Cambridge's contract for transmission service with Belmont was entered into prior to open access (Exh. AG-6-28, at 40). Therefore, to determine its retail transmission revenue requirement, Cambridge shall continue to credit the transmission revenues received from Belmont to its FERC-approved transmission revenue requirement, until the contract expires or is terminated whichever happens first.

VIII. STANDARD OFFER AND DEFAULT SERVICE

A. Introduction

The Companies' restructuring plan states that the Companies will defer the difference between the wholesale and retail standard offer prices for later collection through a standard offer reconciliation account (D.T.E. 97-111, Exh. Company-1, Tab D, exh. III). In addition, the restructuring plan states that any standard offer service under-collection shall be deferred until such time as there is room under the inflation cap to allow for recovery from standard offer customers (id.). The restructuring plan is silent on the treatment of any default service

deferrals. In this proceeding, the Companies now propose to recover both standard offer service and default service deferrals through the transition charge (Exh. RHM, Sch. 6, NP-WP2).

In 1998, the approved wholesale cost of standard offer service and default service was 3.2 cents per KWH (id.). The revenues the Companies received from their customers for standard offer service and default service were 2.8 cents per KWH and 3.2 cents per KWH, respectively (id.). The Companies proposed to collect the four mill difference between the wholesale and retail standard offer service prices through the transition charge (id.).

B. Position of the Parties

1. Attorney General

The Attorney General argues that the Companies' reconciliation of standard offer service deferrals is not in compliance with their restructuring plan, which requires separate accounting of such deferrals (Attorney General Brief at 39). The Attorney General further states that while the Act is silent on the recovery of default service costs, these costs that have been deferred for later recovery are not transition costs under the Act (id. at 40). The Attorney General argues that the Companies should implement the proper accounting for both standard offer service and default service so that the appropriate retail customers pay the actual costs incurred for providing such service (id.).

The Attorney General proposes that the standard offer service and default service costs be calculated by taking the average cost per KWH of power sold to each Company and multiplying that by the KWH sold to standard offer service customers and by the KWH sold to

default service customers for the period March 1, 1998 through December 31, 1998 (id. at 40-42). Based on this formula, the Attorney General submitted a new calculation of standard offer service and default service deferrals as attachments to his reply brief (Attorney General Reply Brief, Atts. C, D).[28]

2. Companies

The Companies argue that because all their customers were receiving standard offer service in 1998, the four mill difference between the retail standard offer charge and the wholesale price should be recovered through the transition charge (Companies Brief at 46). The Companies further argue that imposing a standard offer surcharge as the Attorney General suggests would shift the cost responsibility from customers who no longer take standard offer service or default service to customers who presently take such services. The Companies contend that those remaining customers would pay for costs incurred on behalf of customers who have or will take service from competitive suppliers (id.). The Companies maintain that this would be inequitable because the deferral was accrued when all customers were taking standard offer or default service (id.).

The Companies argue that the Attorney General's calculation of standard offer service and default service deferrals submitted in his reply brief results in the Companies not recovering their total costs to provide these services (Companies Reply Brief at 18). Further, the Companies state that the Department should reject the Attorney General's calculations

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[28] The Attorney General did not present this calculation method during hearings but offered it for the first time in his Reply Brief. No witness sponsored this calculation method, nor was it, therefore, subject to cross-examination.

because he has cited no record evidence and has provided no explanation as to the rationale or method for his proposed new calculations (id. at 17, 18).

C. Analysis and Findings

While the Act does not expressly categorize deferrals from standard offer service and default service as costs as recoverable through the transition charge, the Act does not preclude recovery of such costs. G.L. c. 164, §§ 1B(b),(d), 1G(b)(1). However, with respect to standard offer service deferrals, the Department has stated "that any deferrals associated with the under-recovery of standard offer costs would not qualify as transition costs." D.T.E. 97-120, at 192-193. Nonetheless, the Department has recognized that such costs are recoverable through a deferral mechanism. Id. at 191. The Department approved the Companies' recovery of standard offer deferrals through a surcharge to the standard offer rate as part of their restructuring plan. D.T.E. 97-111, at 23, 76. The Department has also addressed default service deferrals. In a generic proceeding, Pricing and Procurement of Default Service, D.T.E. 99-60-C at 13 (2000), the Department stated that default service benefits all customers in that it assures that such optional service will be provided. The Department concluded the over- or under-recovery of default service should be recovered from all retail customers through a uniform cents per KWH charge. D.T.E.99-60-C at 13.

The Department acknowledges the Companies' claim that recovery of standard offer service deferrals through a surcharge leaves the remaining customers of standard offer service to pay for costs incurred on behalf of customers who have left standard offer service. While the Companies' proposal resolves this inequity, it creates another difficulty. The Companies'

proposal burdens all customers with the standard offer service deferrals and penalizes those customers that have never benefitted from standard offer service, such as new customers after March 1, 1998. Also, the Department notes that it was the Companies who initially proposed recovery of standard offer service deferrals through a surcharge in their restructuring plan (D.T.E. 97-111, Exh. Company-1, Tab D, exh. III). The Department is not persuaded by the Companies' argument and sees no reason to depart from our precedent.

Based on Department precedent set forth in D.T.E. 97-111, D.T.E. 97-120 and D.T.E. 99-60-C, the Department rejects the Companies' proposal to recover standard offer service and default service deferrals through the transition charge. Instead, the Department reaffirms its previous directives regarding standard offer service and default service deferrals. The Department directs the Companies to recover any standard offer service deferral in the manner approved in D.T.E. 97-111 (D.T.E. 97-111, Exh. Company-1, Vol. 1, Tab D, exh. III). The Department also directs the Companies to recover any default service deferral in the manner approved in D.T.E. 99-60-C.

IX. PENSIONS AND POST RETIREMENT BENEFITS OTHER THAN PENSIONS

A. Pensions and Post Retirement Benefits Other than Pensions Transition Obligations

1. Introduction

Cambridge proposed to include as regulatory assets $7,002,000 in generation-related unamortized transition obligation balances associated with pensions as determined in accordance with the provisions of Financial Accounting Standard 87 ("FAS 87"), and $4,394,000 in unamortized transition obligations associated with Postretirement Benefits other

than Pensions ("PBOP") as determined in accordance with the provisions of Financial Accounting Standard 106 ("FAS 106") (Exh. RHM-1, at 33-34, Sch. Cambridge-1 (Rev.) at 6, 6A).[29] Commonwealth proposed to include as regulatory assets $4,822,000 in FAS 87 transition obligations and $4,474,000 in FAS 106 transition obligations (Exh. RHM-1, Sch. Commonwealth-1 (Rev.), at 6, 6A).

Both companies included in their respective transition charges an allocated portion of the FAS 87 and FAS 106 transition obligations associated with Canal Electric Company ("Canal") (Exh. RHM-1, Schs. Cambridge-1 at 6A, Commonwealth-1 at 6A).[30] Prior to the divestiture of Canal Unit No. 2 ("Canal 2"), a unit jointly owned by Canal and Montaup Electric Company ("Montaup"), Canal's operating agreement with Montaup provided for collection of current operating costs (RR-DTE-19). In accordance with the terms of the divestiture of Canal 2 approved by the Department in D.T.E. 98-78/83, the Canal 2 operating agreement was terminated and the proceeds of the divestiture of Canal 2 were divided between Canal and Montaup. D.T.E. 98-78/83, at 7. The Companies claim that after the sale of the Canal units, Canal no longer had a mechanism to recover future pension and PBOP costs from Montaup, and therefore all of these costs formerly associated with Canal 2 were allocated between Cambridge and Commonwealth (RR-DTE-19).

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29 On brief, the Companies acknowledge an error in their FAS 87 calculations, which results in a reduction in Cambridge's FAS 87 transition obligation balance to $1,422,000, and a reduction to Commonwealth's FAS 87 transition obligation balance to $2,423,000 (Companies Brief at 36, n. 23, citing RR-DTE-21). The Companies represent that this error will be corrected in subsequent filings (id.).

30 Canal Electric Company is owned by COM/Energy.

The Companies claim that in D.T.E. 98-78/83-A, the Department required them to eliminate their remaining FAS 87 and FAS 106 regulatory asset balances by netting them against the Companies' asset divestiture proceeds (Exh. RHM-1, at 33). Accordingly, the balance of the Companies' remaining FAS 87 and FAS 106 assets were netted against the Companies' RVC on July 1, 1999 (id.).

2. Positions of the Parties

a. The Attorney General

The Attorney General opposes the Companies' proposed increase in pension and PBOP transition obligations (Attorney General Brief at 28). The Attorney General maintains that by seeking recovery of an additional $12,386,000 in FAS 87 and FAS 106 transition obligations above those initially sought, the Companies have rejected the financial accounting definitions of transition obligations (id. at 28, n.20). The Attorney General asserts that the Companies' "moving target" approach to these proposed transition costs makes recognition and approval of these balances by the Department impossible (id. at 29). The Attorney General also contends that these charges have not been reviewed by the Companies' outside accountants (id. at 29, n.21). Therefore, the Attorney General urges the Department to defer a finding on these balances until such time as the liabilities are finally determined, with any accruals for related transition charges subject to future audits and adjustments as updated information becomes available (id.).

b. The Companies

The Companies contend that the Attorney General misunderstands the changing nature of FAS 87 and FAS 106 transition obligation balances (Companies Brief at 34). The Companies argue that the nature of FAS 87 and FAS 106 obligations makes it impossible to establish a single "fixed" transition cost with certainty until all such benefits have fully been paid out to former employees, and that interim changes are not indicative of any anomalies or impropriety on the part of the Companies (id. at 34, 36). In recognition of the dynamic nature of these obligations, the Companies indicated that any differences between the estimates used to produce these amounts and the actual results will be reconciled in future annual transition reconciliation filings (id. at 36, citing Exh. DTE-7-21).

The Companies deny that their proposal serves to alter the technical definition of transition obligations (id. at 36). Rather, the Companies claim that they have appropriately reported the FAS 87 and FAS 106 transition costs as the difference between the projected benefit obligation and the current market value of the plan assets available, plus any recognized accrued post-retirement benefits cost at the time of the adoption of FAS 87 and FAS 106 (id.). The Companies defend their revised FAS 87 and FAS 106 calculations against those presented in D.T.E. 97-111 as normal changes in actuarial assumptions, including (1) a change in the discount rate from 7.5 percent to 6.5 percent, (2) use of an updated mortality table, (3) the effects of the passage of time on interest and final average pay, (4) additional employees becoming eligible for certain benefits, net of plan payment benefits, (5) refinements in the estimates of pension amounts for employees with prior employer service credits, and

(6) higher-than-anticipated increases in per capita claims costs (id., citing Exh. RHM-1, Sch. 3, WW-WP-4, at 1). Additionally, the Companies note that Commonwealth's FAS 87 and FAS 106 generation-related obligations used in D.T.E. 97-111 were understated, because it had been assumed that there were no Commonwealth employees allocated to the production function, when in fact a number of Commonwealth employees were allocable to production (id. at 35, n.22, citing Exhs. AG-3-6; AG-3-7; AG-3-8). The Companies maintain that, although those regulatory assets have not been previously included in Commonwealth's transition charge calculations, the obligations have been on Commonwealth's books since the adoption of FAS 87 and FAS 106 (id. at 35, citing Exhs. AG-3-6; AG-3-8; Tr. 4, at 393).

3. Analysis and Findings

Although the Companies claim that the Department approved their original formulas for calculating transition charges in D.T.E. 97-111 (D.T.E. 97-111, Exh. RHM-1, at 53-54), the Department's Order in that proceeding stated that the Department would defer its decision on the appropriate treatment of regulatory assets until the Companies' first reconciliation filing. D.T.E. 97-111, at 62. The Companies were permitted to include their proposed FAS 87 and FAS 106 transition obligations in their transition charges on a provisional basis, subject to refund with interest. Id.

As the Department has previously stated, estimates of future pension obligations are subject to considerable variation as circumstances change. Massachusetts Electric Company, D.P.U. 92-78, at 46 (1992). Moreover, we have serious concerns regarding the uncertainties surrounding FAS 106, especially regarding the effect of several potentially volatile factors,

including inflation rates, discount and investment rates, medical cost predictions, and medical trend assumptions. D.T.E. 97-120, at 66; D.P.U. 92-78, at 80-81. The characteristics inherent in the FAS 106 calculation assure substantial variation between expected and actual results. D.T.E. 97-120, at 66.

The Companies' calculations of their FAS 87 and FAS 106 transition obligations remain subject to significant variation and are dependent upon potentially volatile factors. As the Attorney General has pointed out, the Company's FAS 87 and FAS 106 estimates provided during these proceedings increased approximately fourteen-fold from those levels in the Companies' initial filings (Exhs. AG 2-5; RHM-1, Schs. Cambridge-1 (Rev.) at 6, 6A, Commonwealth-1 (Rev.) at 6, 6A). While a portion of this variation can be attributed to the use of updated information and the inclusion of Commonwealth's production-related employees, the magnitude of the difference between the Companies' initial filing and later revisions serves to emphasize the inherent variability of pension and PBOP calculations.

Additionally, the Companies are required to deposit that portion of the transition charge proceeds associated with FAS 87 and FAS 106 obligations into trust funds designated for those purposes. In D.T.E. 98-78/83-A at 13, the Companies were required to eliminate the remaining regulatory asset balances by netting them against the Companies' asset divestiture proceeds, and thus netted the balances against their respective RVCs on July 1, 1999 (Exh. RHM-1, at 33). This netting against asset divestiture proceeds gives rise to a large one-time lump sum payment associated with FAS 87 and FAS 106 transition obligations. While the Companies stated that they intend to discuss the disposition of the FAS 87 and

FAS 106 transition obligation with their actuaries in order to determine the most advantageous use of the funds, including the appropriate funding vehicles, no final determinations had been made as of the close of this record (Exh. DTE 7-18; RR-DTE-30).

In addition to the volatility of FAS 87 and FAS 106 transition obligations, the Department is concerned with the Companies' allocation of FAS 87 and FAS 106 costs associated with Canal 2. As stated above, Canal owned 50 percent of Canal 2, and Montaup owned the remaining 50 percent (Exh. RHM-1, Sch. 1, at 6A, n.(b)). Despite this ownership division, the Companies intend to to absorb 100 percent of Canal 2's remaining FAS 87 and FAS 106 transition obligations, with no allocation to Montaup. The Companies have not sufficiently established the appropriateness of Cambridge and Commonwealth ratepayers being called upon to pay transition costs that are more appropriately attributable to Montaup. The record is not clear enough to permit ruling on this question.

In light of the continuing uncertainty over the assumptions used in the Companies' FAS 87 and FAS 106 calculations, the disposition and use of the transition obligations, and the issue of transition obligations associated with Canal 2, the Department finds it appropriate to defer a final determination on this issue, pending the Companies' reconciliation of 1999 transition costs. Accordingly, the Companies shall use the levels of FAS 87 and FAS 106 transition obligations that were provisionally approved in D.T.E. 97-111 as a component of their transition costs. The Companies shall address this question more completely in their next reconciliation filing.

B. Pension Costs

1. Introduction

In Commonwealth's last rate case, the Department denied Commonwealth's request to compute pension expenses based on FAS 87, and limited rate recovery of pension expenses to Commonwealth's actual cash contributions. D.P.U. 89-114/90-331/91-80, at 65-66. On the premise that accruals based on the provisions of FAS 87 and cash contributions to the trust funds will equalize over time, both Cambridge and Commonwealth deferred the difference between the pension levels accruable under FAS 87 and the respective cash contribution levels to the Companies' pension funds (Exh. DTE-4-9, at 2). As of July 1, 1999, the balance was $482,000 for Cambridge and $129,000 for Commonwealth (Exh. RHM-1, Schs. Cambridge-1, at 6, Commonwealth-1, at 6). None of the intervenors commented on this matter.

2. Analysis and Findings

The Department authorized the Companies to defer any costs computed under FAS 106 which were not included in cost of service for ratemaking purposes. Cambridge Electric Light Company/Commonwealth Electric Company/Commonwealth Gas Company, D.P.U. 92-172, Letter Order (November 10, 1992). However, the Companies have failed to present any evidence that the Department has authorized the deferral of FAS 87 costs. Inclusion of the deferred difference would constitute a reversal of the Department's findings in D.P.U. 92-250 and D.P.U. 89-114/90-331/91-80, as well as long-standing precedent. Western Massachusetts Electric Company, D.P.U. 87-260, at 41-46 (1988). Accordingly, the Department shall exclude these pension costs from the present calculation of the Companies' transition charges.

The Department will address the issue of any pension overcollections as part of the Companies' 1999 reconciliation proceeding.

X. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That Cambridge Electric Light Company and Commonwealth Electric Company comply with any and all directives contained in this Order.

By Order of the Department,

_____
James Connelly, Chairman

_____
W. Robert Keating, Commissioner

_____
Paul B. Vasington, Commissioner

_____
Eugene J. Sullivan, Jr., Commissioner

_____
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).