UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D. C. 20555

December 28, 1989

MEMORANDUM FOR: Harold R. Denton, Director
Office of Governmental and Public Affairs

FROM: Carlton Kammerer, Director
State, Local and Indian Tribe Programs

SUBJECT: MASSACHUSETTS DEPARTMENT OF PUBLIC UTILITIES POLICY ON PRE-APPROVAL OF UTILITY INVESTMENT IN NEW PLANTS AND MAJOR MODIFICATIONS TO EXISTING PLANTS

Your office requested that SLITP review the Massachusetts Department of Public Utilities (DPU) Annual Report-Fiscal Year 1988 for any highlights to be brought to your attention. We have identified an item for your information. The DPU announced on May 12, 1988 a new policy which would require pre-approval of utility investment in new plants or major modifications to existing plants before any funds are expended by the utility company. The pre-approval approach requires the utility to demonstrate that the proposed construction represents the least-cost alternative to meet projected electricity demand. The terms under which the utility would recover its costs and the terms under which ratepayers would pay for capacity and energy would be specified in advance of projected expenditures. Massachusetts utilities will be required to compare all of their resource options and be required to consider efficiency, cost and environmental impact in making a selection. Attachment 1, dated October 28, 1988, is a copy of the DPU rule which sets the requirements for pre-approval of major electric company investments in new plants and major modifications to existing plants.

Pre-approval of new plants appears to be consistent with the Commission's philosophy on early site permits and standardization and provides utilities with the stability and certainty for which they seek. Under the traditional regulatory approach, utility planning and construction of a plant are subject to after-the-fact review by a State public utility commission. This leads to uncertainty on the part of the utility about its ability to recover its investment. Under the new DPU policy, these matters are decided beforehand, eliminating that uncertainty.

We reviewed the DPU regulation for its potential effect on existing facilities. The DPU regulation states that pre-approval for routine maintenance on existing plants is not required. The three instances where pre-approval for modifications to existing plants will be required are if the expenditures: (1) materially extend the useful life of the

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plant; (2) materially increase the capacity of the plant; or (3) are expected to exceed $250,000 per megawatt of net capacity to be expended during a single plant outage. The regulation allows electric companies to seek recovery of costs without prior approval of the DPU if the expenditures are necessary for safety or health reasons in an emergency situation for the protection of the company's investment, or is otherwise in the public interest as determined by the DPU. Attachment 2 is a press release dated December 6, 1989 which describes the process in greater detail and provides a comparison of the DPU approach with the traditional regulatory approach. Attachment 3 is an article from the Wall Street Journal which gives some industry reaction to the Massachusetts DPU approach.

cc: EDO
OGC
SECY

Attachments:
As stated

OFFICE

The Commonwealth of Massachusetts

DEPARTMENT OF PUBLIC UTILITIES

October 28, 1988

D.P.U. 86-36-E

Investigation by the Department of Public Utilities on its own motion, pursuant to Section 76 of Chapter 164 of the General Laws, into the pricing and ratemaking treatment to be afforded new electric generating facilities which are not Qualifying Facilities as defined in 220 C.M.R. 8.02.

Attachment 1

INTRODUCTION

On May 12, 1988, the Department of Public Utilities ("Department") issued an Order and proposed regulations in this continuing investigation into the appropriate ratemaking treatment to be afforded supply and demand-management expenditures made by electric utilities to serve their customers.[1/] In our May 12 Order, we determined that the record was sufficient to decide the regulatory treatment for the recovery of investment in new plant and that the early resolution of that issue was desirable and consistent with least-cost integrated planning. D.P.U. 88-36-C, pp. 14-15 (1988). The Department recognized that the investigation would continue to resolve the outstanding issues regarding the best method(s) to ensure the inclusion of all supply and demand-management options in the context of a utility's least-cost integrated planning process.

After review of the extensive comments received during the course of the investigation, the Department announced in the May 12 Order that henceforth "it is the policy of the Department of Public Utilities that electric company investment in new generation facilities and major incremental electric company investment may be recovered only pursuant to a pre-approval contract Order of the Department...." Id., p. 98. The pre-approval approach adopted by the Department requires a

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1/ The complete history and scope of this proceeding was summarized in D.P.U. 86-36-C and the Orders cited therein. We will not repeat the detailed account of the development of this investigation in this Order.

pre-construction review by the Department to assess the economics and nonprice benefits of a utility's proposed major generating plant investment as compared to the costs and benefits of reasonable alternatives. Cost recovery of an approved proposal would be determined in advance of construction expenditures. In this manner the risks and benefits of the proposal would be explicitly considered and allocated between shareholders and ratepayers before the commencement of construction. Id., p. 52.

The regulations proposed by the Department were designed as a transitional measure to implement the Department's policy regarding pre-approval of major investment in generating facilities by an electric company pending the completion of a more comprehensive regulatory process. Id., pp. 14-15.

II. DESCRIPTION OF PROPOSED REGULATIONS

As described in the May 12 Order, the proposed regulations consist of four sections. The first section outlines the purpose and scope of the proposed regulations and defines several important terms. As proposed, the regulations would establish procedural rules for the recovery of the costs associated with "major incremental investment in electric power generating facilities" (Section 9.01(1)). The proposed regulations define major incremental investment in electric power generating facilities as:

> ...(a) capital expenditures to construct new generating plant; or (b) capital expenditures made in connection with a company's existing generating plant where such expenditures (1) materially extend the useful life of

the plant, (2) materially increase the capacity of the plant, or (3) are expected to exceed $250,000 per megawatt of net maximum capacity. (Section 9.01(3)).

The second section of the proposed regulations establishes that except for emergency or safety reasons determined by the Department, cost recovery by electric companies for major incremental investment in electric power generating facilities is conditioned on the prior approval of the Department (Section 9.02(1) and (3)). Costs recovery terms approved by the Department would be deemed to be just, reasonable, prudent, and required by the public interest within the meaning of G.L. c. 164, secs. 94 and 94G (Section 9.02(2)).

The third section of the proposed regulations establishes filing requirements for an electric company seeking approval of a proposal. The electric company would be required to file: (a) a complete description of the construction proposal; (b) proposed cost recovery terms; (c) a demonstration of the need for the facility including a demonstration that the proposal would result in net benefits for ratepayers in comparison with reasonable alternative investments; (d) results of any public solicitation of third-party proposals to provide the service to be met by the company's proposal; and (e) the proposed organizational and accounting methods to insulate the utility's base rate cost of capital from the effects of the proposal (Section 9.03).

The final section of the proposed regulations establishes the procedure for Department review of a proposal. The electric

company would be required to publish notice and the Department could hold hearings on the proposal. After notice, review and evidentiary hearings, the Department would issue an "...Order concerning pre-approval of such proposal and the terms of cost recovery as shall be just, reasonable and required by the public interest" (Section 9.04).

III. COMMENTS IN RESPONSE TO THE PROPOSED REGULATIONS

A. Overview

On July 6, 1988, the Department held a public hearing to accept comments on the proposed regulations. Representatives of the Executive Office of Energy Resources ("EOER"), the Attorney General of the Commonwealth ("Attorney General"), Massachusetts Electric Company ("MECo") and Boston Edison Company ("BECo") commented at the public hearing. Written comments were submitted by EOER; the Attorney General; MECo; BECo; Representative Lawrence R. Alexander, Chairman, Committee on Energy; the staff of the Energy Facilities Siting Council ("EFSC"); the Massachusetts Public Interest Research Group ("MASSPIRG"); Western Massachusetts Electric Company ("WMECo"); Fitchburg Gas and Electric Light Company ("Fitchburg"); Nantucket Electric Company ("Nantucket"); and Cambridge Electric Light Company and Commonwealth Electric Company (jointly "CEL/Com").

Before summarizing the comments received in response to the proposed regulations, the Department re[illegible]ats that it intended that this phase of the continuing inve[illegible]ation focus on the

issue of the implementation mechanism set forth in the proposed transitional regulations. We attempted to make it clear in D.P.U. 86-36-C (1) what had been decided by the Department (e.g., adoption of pre-approval contract approach); (2) what remained to be decided in the ongoing investigation (e.g., what method is appropriate to integrate all resources, whether all-source bidding should be mandated, etc.); (3) what should be decided on a case-by-case basis (specific terms for pre-approved contracts); and (4) the limited scope of this phase of the proceedings (comments regarding the specifics of the proposed regulations). Nonetheless, many of the comments addressed issues that transcend the scope of this phase of the investigation either because they involve matters that the Department has indicated will be resolved in the continuing portion of this investigation or because they involve matters that should be resolved on a case-by-case basis. In addition, some comments essentially ask the Department to reconsider decisions set forth in the May 12 Order.

For instance, the Attorney General repeats many of the arguments he made in the last phase of this proceeding and requests that the Department refrain from issuing final regulations. Accordingly, he asks the Department to reconsider its decision to implement the pre-approval contract approach (Attorney General's Comments, p. 14). Similarly, portions of the comments filed by MASSPIRG and EOER repeat positions considered by the Department in D.P.U. 86-36-C. The comments

raise no new issues that would cause us to reconsider the May 12 Order.

Some of the comments submitted in response to the proposed regulations expressed the opinion that the implementation of the pre-approval contract approach should await development of a least cost integrated planning process (Comments of Representative Alexander, pp. 1-3; EOER Final Comments, p. 21; MASSPIRG Comments, p. 6). The resolution of these issues must be considered in the context of the final disposition of the proceedings. The promulgation of regulations to ensure the integration of all resources will be the focus of the last phase of this investigation, but for the reasons outlined in D.P.U. 86-33-C, the pre-approval contract approach is consistent with least-cost integrated planning and its implementation need not be delayed pending resolution of all outstanding issues. D.P.U. 86-36-C, p. 14. While the immediate completion of the entire investigation would be desirable, it is not possible to do so. Given the time frame necessary for completion of the investigation and implementation of additional regulations, the suggestion that we delay implementing the Department's policy with regard to the ratemaking treatment of electric company investment in generating plant is not convincing. As we stated in D.P.U. 86-33-C, the cost recovery policy for new generating plant and major capital investment in existing generating plant became effective on May 12, 1988. Id.

B. Coordination with EFSC

Many comments urged the Department to establish a procedure

to coordinate its review with that of the EFSC (EFSC Comments, pp. 1-9; EOER Final Comments, p. 19; Fitchburg Comments, pp. 5-6; CEL/Com Comments, pp. 3-4; BECo Comments, pp. 2-4). The Department agrees that any potential conflict or redundancy in the roles of the two agencies should be mitigated and intends to consider this issue in the context of establishing procedures in the next phase of this case. Formal regulatory changes at this time do not appear to be necessary given the transitional nature of the regulations being issued today. The Department will be working with the EFSC to discuss ways to avoid any administrative inefficiencies. To the extent that any regulatory change is deemed necessary or desirable, a formal rulemaking proceeding would be initiated.

C. Project Substitution or Cancellation

Many of the comments were submitted regarding the circumstances and manner in which the Department would permit cancellation, substitution or reopening of a previously approved ratemaking treatment for a project to be constructed by an electric company (EOER Preliminary Comments, pp. 9-14; MASSPIRG Comments, pp. 8-9; Fitchburg Comments, pp. 10-11; CEL/Com Comments, pp. 14-15; Nantucket Comments, p. 2; BECo Comments, p. 8; NEP Comments, p. 1). In D.P.U. 86-36-C, the Department addressed this issue in some detail and outlined the limited circumstances in which a company would be relieved of its obligation to supply electricity under the terms of an approved agreement. The Department determined that the benefits of the pre-approval contract approach would be substantially undermined

if approved ratemaking terms were subject to ongoing reconsideration and that appropriate incentives existed for electric companies to cancel and substitute a project if it were held to the pricing provisions initially allowed. Id., pp. 83-85. None of the comments filed in response to the proposed regulations would compel us to alter the determination that strict limitations on any change in ratemaking terms are necessary to ensure fairness and symmetry of ratemaking treatment. Nonetheless, the Department agrees that the circumstances and manner of project substitution is something that should be addressed on a case-by-case basis as part of the consideration of a pre-approval contract proposal.

In that regard, NEP has proposed the following sentence to be added at the end of Section 9.03(1)(b):

> Such terms must address the circumstances and terms under which the utility would be allowed to fulfill the energy and/or capacity obligations under the requested Order with alternative sources.

The Department finds that this procedural requirement is appropriate so that it may consider the issue on a case-by-case basis consistent with the policies outlined in D.P.U. 86-36-C. The provision has, therefore, been added to the final regulations in substantially the same form proposed by NEP.[2/]

2/ The addition of this language is not intended to alter the substance of the Department's discussion in the May 12 Order regarding project substitution and the finding that "...pre-approval Orders should not be reopened to accommodate changed circumstances." Id., p. 83. Rather, the language is intended only to require the electric company to address procedurally the manner and conditions by which the substitution of an alternative source "comparable to the original project" could be proposed by the company and evaluated by the Department. Id., p. 84.

D. Allocation of Risks and Rewards

A number of comments can be categorized as addressing the appropriate allocation of risk and reward associated with the new regulatory framework. BECo and WMECo express the concern that there should be some limit to the electric company's liability in the event of a project's failure (BECo Comments, pp. 11-12; WMECo Comments, pp. 6-7). CEL/Com comment that inflation risks for a company could be reduced by permitting adjustments linked to accepted price indices (CEL/Com Comments, p. 3). They also argue that a two-stage review process should be established to allow for the electric company to obtain all necessary permits before final approval of ratemaking terms. Under this system, a company should be entitled to recover costs incurred for an abandoned project if it were unable to receive other regulatory approvals (id., pp. 4-5).

In D.P.U. 86-36-C, the Department made explicit findings regarding the appropriate allocation of risk and reward envisioned by the new regulatory framework. Some comments address issues that were decided in D.P.U. 86-36-C, and the Department finds that the commenters have presented no new information or argument that has not already been considered or would justify reconsideration at this time. Other comments seek a determination as to whether a particular risk allocation would be acceptable. The Department finds that risk allocation decisions, other than the general framework established in D.P.U. 86-36-C, are better left to review in the context of

a specific investigation of a company's petition for ratemaking approval. The Department would then be able to consider the allocation of risks, rewards and incen s presented relative to a specific project proposal and to determine if the proposed allocation is appropriate for ratepayers and the company.

CEL/Com comment that the reference in Section 9.02(2) to G.L. c. 164, secs. 94 and 94G is unnecessarily limiting. They argue that specifying that costs incurred under the terms of the Department's pre-approval of ratemaking are deemed reasonable pursuant to those statutory provisions could result in their being interpreted to be imprudent under the terms of another or future statutory provision (CEL/Com Comments, pp. 10-11). CEL/Com suggest that the Department end the proposed regulation after the words "...and incurred reasonably and prudently." The Department agrees that the intent of Section 9.02(2) is to ensure that the terms of the pre-approval shall be deemed reasonable for all cost recovery purposes. Accordingly, to avoid any other implication, the Department adopts CEL/Com's suggestion.

BECo recommends that requests for approval of financing authority relating to a pre-approved project be isolated and treated as part of the pre-approval process (BECo Comments, p. 14). The Department reiterates the view expressed in D.P.U. 86-36-C that the pre-approval of the project will essentially establish an irrebuttable presumption that the project is reasonable for purposes of financing approval, thus limiting the

scope of review for financing cases. Id., pp. 112-113. Accordingly, no changes to the proposed regulations are necessary.

In D.P.U. 86-36-C, the Department also solicited comments regarding accounting, financing or other structural mechanisms that could be adopted to insulate ratepayers from the impacts of losses and gains of a pre-approved project. Id., p. 113. The comments submitted on this issue acknowledge the Department's concerns, but do not offer a solution that can be applied in all cases (BECo Comments, pp. 8-12; CEL/Com Comments, pp. 17-18; Fitchburg Comments, pp. 12-13; WMECo Comments, pp. 6-7; MASSPIRG Comments, p. 12). The Department finds that the resolution of this issue must be viewed in the context of the entire risk allocation package presented by a specific proposal and an electric company's corporate organization. Accordingly, the issue is not addressed in the regulations and will be decided on a case-by-case basis.

E. Pre-Approval and Integrated Resource Planning

Several of the comments address how the pre-approval process will relate to third party contracts for purchased power and major transmission projects that would substitute for generating capacity (BECo Comments, p. 13; CEL/Com Comments, pp. 6-7; EOER Final Comments, p. 14; Fitchburg Comments, p. 13). The question of how all resources should be integrated in the Department's review of a utility's least cost planning process is the subject of the ongoing investigation in this docket. For the interim,

the present statutory and regulatory structure requires Department approval of most long-term third party contracts for electricity.[3/] QFs are reviewed in the context of the provisions of 220 C.M.R. 8.00. Purchases of electricity for a period in excess of one year must be pre-approved by the Department pursuant to G.L. 164, sec. 94A. Transmission facilities must be approved in accordance with G.L. 164, sec. 72. Accordingly, no further regulatory change is necessary, pending the completion of the final phase of this docket.

F. Threshold for Department Review for Pre-Approval

In response to questions posed by the Department, numerous comments were submitted regarding the $250 per KW threshold for capital expenditures on existing generating plant. Section 9.01(3) requires pre-approval of all expenditures in existing plant that either materially extend the life of the plant or materially increase the capacity of the plant (Sections 9.01(3)(b)(1) and (2)). Additionally, all expenditures in an existing plant that exceed $250 per KW of net maximum capacity are subject to pre-approval (Section 9.01(3)(b)(3)). EOER and MASSPIRG argue that the $250 per KW threshold is too high. EOER states that while annual capital expenditures for nuclear generating plants average about $32 per KW, "...major

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3/ The reasonableness of short-term purchasing practices of electric companies is subject to the Department's review quarterly pursuant to the provisions of G.L. c. 164, sec. 94G.

incremental investments are sometimes made on the order of $100 to $150 per KW per year" (EOER Final Comments, pp. 15-16). EOEP asserts that the threshold should capture such major investments.

MASSPIRG suggests that any meaningful threshold should consider the remaining life of capital additions and incremental operation and maintenance expenses of an existing plant (MASSPIRG Comments, pp. 9-11).

WMECo comments that the $250 per KW threshold is appropriate if it applies to a single project or group of closely related projects undertaken at a single point in time, but suggests that the amount set forth in the regulations be indexed to account for inflation (WMECo Comments, pp. 5-6).

Fitchburg supports the threshold, but suggests that projects below the threshold be allowed into the pre-approval process if a company believes that benefits associated with the pre-approval approach justify the procedural effort required to obtain Department approval (Fitchburg Comments, pp. 2-3).

BECo suggests that the regulations should be clarified to provide that the pre-approval threshold apply to capital expenditures that are to occur in one generating unit through planned outages over two years or less (BECo Comments, p. 12).

CEL/Com argue that the proposed threshold is unrealistically low (CEL/Com Comments, p. 8) and should also apply to any life extension or capacity expansion projects. CEL/Com suggest that pre-approval be obtained only for projects that exceed

10 percent of a company's rate base. CEL/Com also assert that the threshold should be applied to investments in new generating capacity to avoid the unnecessary administrative delays and cost for relatively small projects (id., pp. 8-9).

None of the comments submitted on this issue persuade us to amend substantively the definition of "major incremental investment in electric generating facilities" contained in the proposed regulation. While we share CEL/Com's concern that administrative costs associated with a project might represent a small portion of a company's total generating capacity, we are confident that the scope of the Department's investigation into a proposal can take into account the magnitude of a proposed project relative to the size of a company.

We are similarly unconvinced by the comments of EOER and MASSPIRG that the threshold is too high. MASSPIRG raises a legitimate issue regarding the life-cycle capital expenditures for generating units, but this issue would be considered in the context of the economic necessity of a capital expenditure. Whether a capital expenditure is submitted as part of the pre-approval procedure or is reviewed after construction under the traditional prudent, used and useful standard, the Department would be required to consider future capital additions in determining the cost-effectiveness of the expenditure. WMECo, D.P.U. 85-270, pp. 86-87 (1986). Thus, the life-cycle capital expenditures of a generating unit are

reviewed under either approach before a large capital project may be reflected in rates.

We wish to clarify one point to address the concerns expressed by the EOER. It was not our intent that the $250 per KW threshold be an annual limit, but rather would apply, as suggested by WMECo, to a project or combination of closely related projects on a single generating unit. Accordingly, we have modified the final regulations to clarify the Department's intent that the threshold apply to the total capital expenditures that are to be incurred during a capital project involving a generating unit, even if the time to complete the project exceeds one year in duration.

G. Time Frame for Department Review

Several commenters address the issue of an appropriate time limit for the Department's review of an electric company's proposal for pre-approval of a project. BECo states that a six-month review process would be desirable (Tr. XII, pp. 115-117). BECo contends that a six-month review might be achievable if the Department also adopted BECo's suggestion to engage the services of a mutually agreeable consultant. The consultant would be available to the Department to assist in its review of the proposal and would be paid by the electric company and included as a development cost of the project (BECo Comments, pp. 4-5). Fitchburg and Nantucket also favor the six-month review limitation (Fitchburg Comments, pp. 4-5; Nantucket Comments, p. 2).

The Attorney General suggests that a twelve-month time frame would be adequate, except in the case of a very complicated case (Tr. XII, p. 136). The EOER suggests that the length of the review process should be linked to the present RFP review cycle (Tr. XII, p. 83).

We agree with the EOER that there should be a direct linkage between the review of company proposals and the review of alternatives. This issue will be of paramount importance in the next phase of this investigation. Because of the transitional nature of the regulations promulgated today and the wide range of proposals that could be submitted under these regulations, the Department finds that it is appropriate to establish a general eight-month time limitation for review. A provision codifying the eight-month review period has been inserted in Section 9.04 of the regulations.

H. Pre-Approved Contract Analysis Time Frame

BECo and CEL/Com also filed comments regarding the appropriate time frame for analyzing the net present value of the benefits and costs of a proposal (BECo Comments, pp. 14-15; CEL/Com Comments, p. 16). The Department in the past has looked to a 20-year planning horizon when evaluating proposed QF contracts. We agree, however, with both BECo and CEL/Com that, in light of the possible cost and non-cost attributes associated with any proposed project in comparison to any other options, a rigid application of a particular time frame may not be appropriate for the purposes of these regulations. Accordingly,

the Department will not establish any such requirements for these transitional regulations. Instead, we will consider the appropriate time frame over which to consider costs and benefits in the context of our continuing investigation in this docket.

I. Pre-Approval and Additions to Existing Facilities

WMECo filed comments regarding the applicability of the regulations to existing facilities (WMECo Comments, pp. 3-4). WMECo argues that because existing facilities were reviewed pursuant to other regulatory standards, they should not be subject to pre-approval. In the case of Millstone 3, WMECo contends that the Department has already reflected future capital additions in its calculation of the used and useful portion of the facility and, therefore, those additions should be exempted from the regulations (id.).

On the issue of the applicability of the new standard to existing facilities, the Department reiterates that the pre-approval contract approach only applies prospectively to existing plant if the capital expenditure materially extends the useful life of the plant, materially increases its capacity, or exceeds $250,000 per megawatt of net maximum capacity (Section 9.01(3)(b)). As to the allegation that future capacity additions to the Millstone 3 plant should be exempted from the process, the Department finds no merit to WMECo's argument. As we stated supra, the Department did consider WMECo's estimate of future capital additions in Millstone 3 in determining the life cycle economic usefulness of the plant. WMECo, D.P.U. 85-270,

pp. 86-87 (1986). Nonetheless, there will be no double penalty associated with subjecting any such additions that would be covered by the regulations to the pre-approval process. Assumptions regarding these and other future events were incorporated in the Department's analysis based on the best information available at the time. The assumptions about future capital additions in that case were used to determine the economic usefulness of Millstone 3, but the Order did not purport to pre-approve or limit the level of future capital expenditures or projects. Accordingly, rate treatment of any future capital additions to Millstone 3 was not decided in D.P.U. 85-270 and will be decided, in the future, on the merits of the investment. Thus, the fact that Millstone 3 capital additions were considered for limited purposes by the Department in D.P.U. 85-270 is irrelevant for deciding the issue of whether the ratemaking standard should be the traditional prudent, used and useful method, or the pre-approval contract approach. Ratemaking treatment of capital projects for existing generating plant will be reviewed under the pre-approval contract approach if they meet the definition set forth in Section 9.01(3)(b).

BECo addresses the applicability of the regulations to existing facilities that are jointly owned by a number of utilities, located outside of Massachusetts and whose lead owner is not regulated by Massachusetts (BECo Comments, p. 17; Tr. XII, p. 111). BECo's primary concern involves the possibility that a Massachusetts company might not be able to

dictate future capital expenditures in an existing, jointly owned facility. The Department recognizes that under existing contractual arrangements, Massachusetts electric companies may be effectively precluded in certain circumstances from avoiding capital expenditures on existing facilities that would normally be subject to the regulations. Where Massachusetts electric companies or their affiliates jointly do not exert effective control over a decision to make an investment in an existing facility that normally would be subject to the pre-approval process, the Department will consider an exception to the regulations. The Department has included a general exceptions provision as Section 9.05 which may be used, among other things, to review any request by an electric company that it be granted an exception from a generally applicable regulation, where circumstances may warrant. The Department notes, however, that while minority joint ownership may preclude an electric company from seeking approval of a capital expenditure in advance, such company is in no way relieved of responsibility of the decisions of joint owners. Under traditional ratemaking principles, "[w]here the minority participant agrees to cede a broad grant of authority to the lead participant, the actions of the lead participant are imputed to the minority participant. Fitchburg Gas and Electric Light Company, D.P.U. 84-145-A, p. 11 (1985).

J. BECo's Request for Clarification

In its comments, BECo included eight questions about which it seeks clarification. Two of the questions involve the rate

treatment of common facilities and additions to existing facilities that may be partially subject to traditional rate base regulation (id., p. 18, questions b and d); three questions deal with the possibility of selling a pre-approved unit, selling electricity from a unit on the spot market and ceasing operation of a unit (id., pp. 18-19, questions c, e and g); one question asks whether the Department's review of generating unit performance will be limited to the conditions specified in the Department's pre-approval (id., p. 19, question f). The Department finds that each of these issues cannot be resolved in the abstract, but would more properly be the subject of consideration in the context of a proposal. Accordingly, the Department declines to address them in this Order.

BECo also asks that the Department clarify the meaning of the term "useful life" as set forth in Section 9.01(3) (id., p. 18, question a). Because as was stated in D.P.U. 86-36-C, the Department did "...not intend that pre-approval be required for routine maintenance on existing plant," it included in the regulations three instances where capital expenditures on existing plant were tantamount to investment in new generating plant and, therefore, would have to be pre-approved. D.P.U. 86-36-C, pp. 105-106. The situation in which investment would "materially extend the useful life of the plant" is intended to distinguish conceptually those expenditures needed to maintain the plant's operation for the life of the plant as would be projected before the capital improvements. If any company has

any doubts about whether a future project is covered by the regulations, it may submit the specific facts and seek an advisory ruling from the Department pursuant to 220 C.M.R. 2.08.

Finally, BECo comments that Section 9.03(b) seems to suggest that any pre-approval unit must be dispatchable. The Department did not mean to imply that an electric company would necessarily be precluded from making an investment in a "must-run" unit. Accordingly, the Department has deleted the words "on a dispatchable basis" from Section 9.03(b) in the final regulations.

IV. ORDER

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

ORDERED: That 220 C.M.R. is amended by adding Part 9.00 as attached hereto; and it is

FURTHER ORDERED: That the attached regulations shall take effect when published by the Secretary of State in the Massachusetts Register pursuant to G.L. c. 30A, sec. 6.

By Order of the Department,

Bernice K. McIntyre, Chairman

Commissioners participating in the decision of D.P.U. 86-36-E were; McIntyre, Chairman; Werlin and Tierney

220 C.M.R. 9.00: COST RECOVERY FOR MAJOR ELECTRIC COMPANY GENERATION INVESTMENTS

Section

9.01: Purpose, Scope, and Definitions

(1) Purpose. The purpose of these regulations is to establish rules for the recovery by electric companies of the costs of major incremental investments in electric generation.

(2) Scope. These rules apply to major incremental investments in electric power generation facilities by electric companies made on or after the effective date of these rules.

(3) Definitions. As used in this rule, the term "major incremental investment in electric power generation facilities" means capital expenditures to construct (a) new generating plant; or (b) capital expenditures made in connection with a company's existing generating plant where such expenditures: (1) materially extend the useful life of the plant; (2) materially increase the capacity of the plant; or (3) are expected to exceed $250,000 per megawatt

of net maximum capacity to be expended during a single plant outage, or uninterrupted construction project or combination of closely related projects.

9.02: Standard for Recovery of Costs Associated with Major Incremental Investment in Electric Company Generating Facilities

(1) Except as set forth in 9.02(3), below, no electric company may recover costs associated with major incremental investment in electric power generating facilities without obtaining the prior approval of the Department pursuant to these rules for the incurrence of such costs.

(2) Cost recovery under the terms of a Department Order issued pursuant to these rules is, by virtue of having been approved in such an Order, proper, just and reasonable and required by the public interest, and incurred reasonably and prudently.

(3) Electric companies may seek recovery of costs associated with major incremental investment in electric power generating facilities without prior approval of the Department only if such expenditures are made on existing generating plant and the immediate commencement of construction activities is necessary for safety or health reasons in an emergency situation for the protection of the company's investment in existing plant, or is otherwise in

the public interest as determined by the Department. In such a case, the company must file a petition for approval immediately upon becoming aware that such a capital project will constitute a major incremental investment in electric power generating facilities.

9.03: Filing Requirements

(1) Each electric company shall file, together with any petition for pre-approval of cost recovery under this rule, the following:

(a) A description of the proposed new facility, or addition, life-extension, repowering, or other incremental source of utility-owned generating capacity, including size in megawatts ("MW") (both summer and winter capability ratings); technology, including major pollution control equipment and whether the plant is a cogenerator; heat rate; expected availability; expected life of plant; primary fuel and any back-up fuel(s); source(s) of fuel(s); related facilities to deliver and/or store fuel(s), to transmit power from the facility, and to reinforce the bulk power transmission system; location (including address, parcel map, zoning designation); joint or common ownership, if any; complete list of applicable state, local and federal licenses necessary for the

facilities; and project schedule (including major milestones relating to licensing, financing, construction, in-service dates).

(b) Proposed cost recovery terms consistent with the Order in D.P.U. 86-36-C, including length of the cost recovery period, provision for treatment of construction, fuel, fixed and variable operations and maintenance and capital additions costs, and provision for treatment of costs in the event of cancellation or abandonment of the facility. Such terms must include the provision that the company is unconditionally obligated to provide the energy and/or capacity under the terms set forth in the requested Order, or their reasonable equivalent. Such terms must address the circumstances and terms in which the electric company would be allowed to fulfill the energy and/or capacity obligations under the requested Order with alternative sources.

(c) A demonstration of the need for the facility, and a demonstration that the construction and operation of the proposed facility pursuant to the proposed cost recovery terms will result in positive net present value benefits for ratepayers over the life of the facility, considering quantifiable externalities, compared with reasonable alternative investments, consistent with safe and reliable electric service.

diversity of supply and demand options, and reasonable protections against uncertainty of future costs and demand.

(d) To the extent the company has chosen to solicit proposals or bids to provide the capacity and/or energy in question, the results of the solicitation shall be submitted as evidence regarding the issue of whether the proposal will result in positive net present value benefits set forth in 9.03(1)(c). The results of the solicitation must be accompanied by a description of the solicitation process, including eligibility to participate and criteria for selection, and a demonstration that, in the event the company chose to participate in such solicitation process in competition with other potential providers of such electricity services, the risk of bias through self-dealing was eliminated and has not affected the selection of the company's proposal as a winning proposal or bid.

(e) Proposed organizational or accounting methods to insulate the utility's base rate cost of capital from the effects, positive or negative, of the proposed pre-approval terms.

9.04: Procedure for Review

Upon the filing by any electric company of a petition for pre-approval of cost recovery under this rule, the

Department shall issue an Order of Notice, directing the company to publish such notice as due process and the public interest may require, and to mail a copy of such notice to the Attorney General, the Energy Facilities Siting Council, and to all persons who have stated to the Department their desire to receive such notices. The Department may hold one or more hearings on the petition, and shall issue such Order concerning pre-approval of such proposal and the terms of cost recovery as shall be just, reasonable and required by the public interest. Unless otherwise ordered, the Department shall issue such Order within eight months from the date of filing by the electric company.

9.05: Exceptions

The Department may, where appropriate, grant an exception from any provision of these regulations.

The Commonwealth of Massachusetts
Department of Public Utilities
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FOR IMMEDIATE RELEASE
December 6, 1989

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DPU PROPOSES PACESETTING REGULATIONS FOR MASSACHUSETTS ELECTRIC UTILITIES

The Department of Public Utilities (DPU) today proposed new regulations for electric utility companies requiring that planning for future energy needs include a comparison of all possible ways to meet those needs, and that the environmental impact of each option be considered. The proposed regulations will give the companies the certainty of pre-approved projects. Consumers will be protected from charges for cost-overruns or other inefficiencies and provided with reliable electric supply at the lowest possible cost.

In announcing the proposed regulations, DPU Chairman Bernice K. McIntyre said, "This proposal sets out a more effective way for the state to ensure that adequate resources are in place to meet anticipated demands for electricity. Changes in the electric industry, including alternative sources of supply

Attachment 2

and new conservation technology, require new kinds of regulation. Through the innovative all-resource bidding process, Massachusetts utilities will be required to compare all of their resource options and to select those which will provide the most efficient, least costly, and most environmentally sensitive service to their customers."

The proposed regulations include the following:

o Inclusion of environmental considerations in the criteria used to select resources. The Department has ordered that the selection criteria used to rank the proposals must include a way to measure the degree to which any project will affect the environment. The criteria must incorporate both the environmental standards in the existing licensing process and other environmental factors such as global warming.

o Coordination with the Energy Facilities Siting Council ("EFSC"). The proposed regulations would fully integrate the review process of the DPU and the EFSC to provide for a more efficient way for each agency to fulfill its statutory obligations in one coordinated proceeding.

o Pre-approval of contracts for new generating facilities or for conservation and load management. Under traditional regulatory procedures, utility planning and construction of new plant were subject only to after-the-fact review by the DPU. This led to uncertainty on the part of the utility companies about their ability to recover their investment and sometimes to cost overruns and inefficiencies paid for by ratepayers.

In May, 1988, the DPU announced that all utility investment in new plant or major modifications to existing plants required DPU approval before any funds were expended. This policy, by which both the price of power and the ratemaking treatment for plant were determined before construction, was designed to protect ratepayers from bearing the brunt of construction cost overruns or of plants which perform poorly or are not producing electricity and remains an integral part of the regulations proposed today. The proposed regulations include the pre-approval procedure for, not only utility company construction projects, but all projects for supplying power or lowering electricity demand.

o Flexibility for utility companies in deciding which resources to use to meet energy needs of their customers. The Department has allowed for each utility company to exercise its judgement in determining which mix of possible resources is most appropriate. A ranking system which attempts to capture price, reliability and other factors provides a good tool for ranking individual projects, but can not evaluate the effect on the total mix of one project versus another.

Since the Department first announced its plans to draft new regulations a year ago, a series of informal technical sessions and a formal hearing process have provided voluminous comments on the new regulatory procedures. The DPU has incorporated many of these suggestions to ensure that the proposed regulations can be successfully implemented. The Department has also asked for further comments in order to fine tune this proposal.

The proposed regulations will be the subject of public hearings beginning on February 28, 1990. Final comments will be due ten days after the close of these public hearings. The

Department encourages those wishing to comment at the public hearings to submit preliminary written comments by February 16, 1990.

The Department will also sponsor a series of four half-day technical sessions to discuss in a more informal setting, the proposed regulatory structure and remaining issues. Representatives of the Energy Facilities Siting Council will be in attendance. The first session will be on January 3. Interested organizations should contact the Department for further information.

The following electric companies are regulated by the Department of Public Utilities:

Boston Edison Company
Cambridge Electric Light Company
Commonwealth Electric Company
Eastern Edison Company
Fitchburg Gas & Electric Company
Massachusetts Electric Compar
Nantucket Electric Company
Western Massachusetts Electric Company

HIGHLIGHTS OF DPU PROPOSAL

TRADITIONAL REGULATORY APPROACH	DPU PROPOSAL
1. Utilities construct new generating plant and seek DPU approval to collect costs of plant in utility rates after-the-fact.	1. The DPU must give pre-approval to decisions involving construction of new plant, as well as contracts for power supply from independent power producers, small power producers or conservation.
2. Utilities construct power plants and only seek other power sources or conservation when they deem necessary.	2. Utilities must use all-resource bidding process to test market for best mix of projects to increase supply and/or use electricity more efficiently.
3. Utility company must go through separate review process with two state agencies: the Energy Facilities Siting Council and the DPU.	3. Coordinated EFSC/DPU review to provide for a more efficient way for each agency to meet its statutory obligations.
4. Environmental impact considered only when individual facility construction permits sought from environmental agencies.	4. Environmental impact considered at the time of DPU/EFSC review so that projects can be compared and those more environmentally sound are more likely to be pursued.

Massachusetts Rule Makes Utilities Show New-Plant Economy

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By a Wall Street Journal Staff Reporter

BOSTON—The Massachusetts Department of Public Utilities adopted regulations requiring the state's electric utilities to show that proposed power-generating plants are the cheapest way to provide additional power before building them.

The new regulations were adopted because "many new plants have had cost overruns, and there is growing concern about fairly allocating the risk of building new plants between ratepayers and utilities," said Bernice K. McIntyre, chairman of the state utilities department.

Under the new regulations, utilities may show that building plants are the cheapest alternative through a bidding process in which "energy conservation providers, cogeneration providers and others can participate," she added. The new regulations also require utilities to bear the risk of cost overruns, she said.

The new policy represents a major departure from the customary "after-the-fact" regulation of utility-construction costs, under which utilities are allowed to charge ratepayers for plant-construction costs that are deemed prudent by regulators after construction has begun.

The regulations are "part of an increasing focus on prospective reviews" of new-plant construction by utility regulators, said a spokesman for the Edison Electric Institute, a utility trade group in Washington. Some other states require utilities to obtain prior regulatory clearance for construction, he added.

A spokesman for Boston Edison Co., a Boston-based utility, said the new regulations "look like a step in the right direction." He added that, under the new regulations, utilities will know the terms under which they can recover construction costs before committing to construction, which "will provide clarity for a utility pondering making an investment."

Spokesmen for several other Massachusetts utilities declined to comment pending review of the new regulations.

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