

# LEGISLATIVE RESEARCH REPORT

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## POWER COST EQUALIZATION PROGRAM

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You asked that we update Legislative Research Report 00.022, *Power Cost Equalization, 1981-1999*, which was itself an update of an even earlier report (95.159, *Legislative History of the Power Cost Equalization Program*).

As you know, legislators established a rural electrical rate subsidy program in 1980 called the Power Production Cost Assistance (PPCA) program (now known as PCE, or the Power Cost Equalization program). The program was created to provide subsidies to utilities to reduce the electrical rates paid by rural residents to levels comparable to rates in Anchorage, Fairbanks, and Juneau. The Regulatory Commission of Alaska (RCA) determines the equalization rate for each utility, using fuel expenses (including transportation) and non-fuel expenses such as salaries, insurance, taxes, and other "reasonable costs."<sup>1</sup> Eligible utilities then submit monthly reports to the Alaska Energy Authority (AEA), documenting the amount of power sold.<sup>2</sup> AEA then calculates the amount of equalization assistance due and reimburses each utility for the subsidy the company has already provided to its customers. AEA also determines the eligibility of customers and community facilities.<sup>3</sup>

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<sup>1</sup> "Highlights of the Power Cost Equalization Program," *Statistical Report of the Power Cost Equalization Program, Fiscal Year 2004*, December 2004, p. 3.

<sup>2</sup> AS 42.45.115 excludes any electrical utility "whose primary source of power for sale to customers is one or more of the power projects that were part of the former initial project" from the PCE program. The "former initial project" refers to the Four Dam Pool hydroelectric facilities (Tyee Lake, Swan Lake, Solomon Gulch, and Terror Lake).

<sup>3</sup> For example, 3 AAC 107.270 defines "customers" as including "an eligible electric utility's residential customer of energy for a single-family or multi-family dwelling, or residential housing unit." In addition, 3 AAC 107.260 requires that customers make "timely payments" to the electrical utility. "Community facilities" include water and sewer facilities, public outdoor lighting, and other community buildings open to the public. AS 42.45.150(1).

Over the years, legislators have made a number of modifications to the program, while maintaining the initial intent of reducing rural electrical costs. The following information shows the evolution of the program:

- ◆ **FY81:** Legislators established the *Power Production Cost Assistance Program* under the Alaska Power Authority.<sup>4</sup> The program reimbursed utilities for a percentage of eligible power costs that exceeded the “entry rate”—85 percent of eligible costs in excess of 7.65 cents per kWh. The “ceiling rate,” or maximum rate, was 40 cents per kWh—PPCA reimbursed utilities for 100 percent of costs that exceeded the maximum rate. Eligible costs included only production and transmission costs.
- ◆ **FY82:** The program’s name was changed to the *Power Cost Assistance Program*. The entry rate was increased to 12 cents per kWh, and the ceiling rate was increased to 45 cents. Eligible costs were expanded to include administrative and distribution costs. Utilities received reimbursement for 95 percent of eligible costs, but no reimbursement for costs in excess of the ceiling rate. In addition, legislators imposed “consumption caps” of 600 kWh per month for residential and commercial consumers, and 55 kWh per month per resident for community facilities.
- ◆ **FY85:** The program’s name was changed again, to the *Power Cost Equalization Program* (PCE). The entry rate was reduced to 8.5 cents per kWh, and the ceiling rate increased to 52.5 cents. Utilities received reimbursement for 95 percent of eligible costs, but no reimbursement for costs in excess of the ceiling rate. Consumption caps were increased to 750 kWh per month for commercial and residential users, and to 70 kWh per month per resident for community facilities.
- ◆ **FY94:** Legislators established the *Power Cost Equalization and Rural Electric Capitalization Fund* (PEC-RECF).<sup>5</sup> They capitalized the fund through an appropriation from the Railbelt Energy Fund. In addition, legislators stated their intent to continue to support rural electrical subsidies by maintaining the fund at a minimum of \$17 million dollars each year through 2013.<sup>6</sup>

The legislation also transferred responsibility for all rural energy programs from AEA to the newly created Division of Energy in the Department of Community and Regional Affairs. AEA retained responsibility for the state’s hydroelectric and intertie projects, under the auspices of the Alaska Industrial

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<sup>4</sup> In FY91, the Alaska Power Authority became the Alaska Energy Authority.

<sup>5</sup> The fund allows AEA to award grants to eligible utilities for up to 75 percent of costs for small power projects designed to reduce the cost of providing electrical power. According to AS 42.45.180(b), total grants may not exceed three percent of the available fund balance in any one year. In addition to the initial \$67 million appropriation from the Railbelt Energy Fund, further deposits to the fund include annual appropriations for electrical subsidies and grants, appropriations from the National Petroleum Reserve-Alaska special reserve fund, appropriations from the Power Cost Equalization Endowment Fund, interest, and “any gifts, bequests, contributions from other sources, and federal money.” AS 42.45.100(b).

<sup>6</sup> Section 1(b), Ch. 18, SLA 1993.

Development and Export Authority (AIDEA). The PCE entry rate was increased to 9.5 cents per kWh, but the ceiling rate remained the same, as did the percentage of reimbursement. Consumption caps were reduced to 700 kWh per month for residential and commercial users, and remained at 70 kWh per month per resident for community facilities. The legislature, however, eliminated the subsidies for federal and state government facilities.

- ◆ **FY98:** Governor Knowles established the PCE Blue Ribbon Committee to “consider and recommend an overall policy on the future of PCE.”<sup>7</sup> The committee was composed of legislators, industry representatives, and one public member. Among the committee’s recommendations were the following items:
  - ◆ The legislature should extend PCE or an alternative rate support program into the future;
  - ◆ Rate support should be available only for residential consumers and for community facilities that are directly related to public health and safety; and
  - ◆ The legislature should establish a stable source of funding for the program.<sup>8</sup>
- ◆ **FY99:** The entry rate for PCE was increased to 12 cents per kWh, and the consumption caps were reduced to 500 kWh per month for residential users. The consumption cap for community facilities remained at 70 kWh per month per resident. Legislators abolished subsidies for commercial users and schools. The legislature approved HB 40, which reorganized several state departments, abolished the Department of Community and Regional Affairs, and transferred the agency’s responsibilities to other departments.<sup>9</sup> Rural energy programs, including PCE, were transferred to AEA, with AIDEA oversight. Former Division of Energy staff became AIDEA employees.
- ◆ **FY01:** Legislators established the *Power Cost Equalization Endowment Fund* (PCE-RECF) to support the PCE and Rural Electric Capitalization Fund.<sup>10</sup> The endowment fund consists of legislative appropriations and any interest earned by the fund. Lawmakers appropriated \$100 million from the Constitutional Budget Reserve Fund as the initial capitalization for the fund. The proceeds from the sale of the Four Dam Pool and the balance of the Four Dam Pool Insurance Fund were deposited into the fund in 2002, bringing the total deposits into the fund to approximately \$192 million.

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<sup>7</sup> “Introduction,” *Power Cost Equalization: Report and Recommendations of the Governor’s Blue Ribbon Committee*, February 1, 1999, p. 1.

<sup>8</sup> “Summary of Recommendations,” p. 3.

<sup>9</sup> Ch. 58, SLA 1999.

<sup>10</sup> AS 42.45.070 and 42.45.085.

The legislature has continued to appropriate funds to the PCE-RECF for the operation of the PCE program. The FY06 appropriation is \$18.7 million.

Table 1 shows the changes in program provisions over the past 25 years.

<b>Table 1: Changes in PCE Program Requirements, FY81-FY05</b>					
<b>Program Requirements</b>	<b>FY81 Power Production Cost Assistance Program</b>	<b>FY82-FY85 Power Cost Assistance Program</b>	<b>FY85-FY94 Power Cost Equalization Program</b>	<b>FY94-FY98 Power Cost Equalization Program</b>	<b>FY99-Present Power Cost Equalization Program</b>
<b>Entry Rate <sup>1</sup></b>	7.65 cents/kWh	12 cents/kWh	8.5 cents/kWh	9.5 cents/kWh	12 cents/kWh
<b>Ceiling Rate <sup>2</sup></b>	40.0 cents/kWh	45.0 cents/kWh	52.5 cents/kWh	52.5 cents/kWh	52.5 cents/kWh
<b>Percentage of Eligible Costs Reimbursed</b>	85 percent	95 percent	95 percent	95 percent	95 percent
<b>Eligible Costs in Excess of the Ceiling Rate Paid</b>	Yes	No	No	No	No
<b>Consumption Cap for Residential and Commercial Customers<sup>3</sup></b>	None	600 kWh/month	750 kWh/month	700 kWh/month	500 kWh/month
<b>Consumption Cap for Community Facilities</b>	None	55 kWh/month per resident	70 kWh/month per resident	70 kWh/month per resident	70 kWh/month per resident
<b>NOTES:</b>					
1. <i>Entry Rate</i> : A rural utility is reimbursed a percentage of its costs when those costs exceed the minimum amount per kilowatt hour.					
2. <i>Ceiling Rate</i> : This is the maximum amount for eligible costs--under the current program, a rural utility receives no reimbursement for costs in excess of this figure.					
3. In FY94, the legislature eliminated subsidies for federal and state government facilities. In FY99, the legislature eliminated subsidies for schools and commercial users.					
<b>SOURCES:</b> AS 42.45.100-190; Alaska Energy Authority; Legislative Research Reports 95.159 and 00.022.					

Over the life of the program, the state has spent \$378 million for power cost equalization (this figure does not include the FY06 appropriation of \$18.7 million, nor does it include power project grants from the PEC-REC fund). Table 2 shows the amount spent or appropriated for PCE by fiscal year.

**Table 2: Power Cost Equalization Program Expenditures, FY1981-2006**

<b>Fiscal Year</b>	<b>Amount<sup>1</sup></b>	<b>Fiscal Year</b>	<b>Amount</b>
1981	\$2,658.6	1994	\$17,679.9
1982	\$9,300.0	1995	\$18,620.5
1983	\$8,300.0	1996	\$19,329.7
1984	\$8,298.2	1997	\$17,967.9
1985*	\$14,128.2	1998	\$18,664.2
1986	\$17,532.0	1999	\$18,050.0
1987	\$13,787.5	2000	\$14,562.2
1988	\$15,000.0	2001	\$16,091.6
1989	\$16,823.6	2002	\$15,619.7
1990	\$19,715.5	2003	\$15,700.0
1991	\$16,747.1	2004	\$15,700.0
1992	\$15,029.6	2005	\$15,700.0
1993	\$17,533.0	2006	\$18,700.0
<b>Total PCE 1981-2006</b>		<b>\$397,239.0</b>	
<b>Notes:</b> 1. Amounts for FY1981-2005 are actual expenditures. Amounts for FY1981-1984 include administrative costs. FY2006 is the authorized budget amount. * The large increase in program expenditures in FY85 was due to a reduction in the entry rate and increases in the consumption caps for residential and commercial consumers, and community facilities.			
<b>Sources:</b> Legislative Finance Division, Historical Budgets online and Operating Budget Books ("shortforms").			

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I hope you find this information to be useful. Please do not hesitate to contact us if you have questions or need additional information.