

MAINE PUBLIC SERVICE CO
Form 10-Q
November 09, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15(d) of

The Securities Exchange Act of 1934

For Quarter Ended

September 30, 2001

Commission File No. 1-3429

Maine Public Service Company

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(Exact name of registrant as specified in its charter)

Maine

(State or other jurisdiction of incorporation or organization)

01-0113635

(I.R.S. Employer Identification No.)

209 State Street, Presque Isle, Maine

(Address of principal executive office)

04769

(Zip Code)

Registrant's telephone number, including area code 207-768-5811

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No .

(APPLICABLE ONLY TO CORPORATE ISSUERS:)

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the period covered by this report.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

See the following exhibits - Maine Public Service Company and Subsidiaries Condensed Consolidated Financial Statements, including a statement of consolidated income for the quarter and nine months ended September 30, 2001, and for the corresponding period of the preceding year; a consolidated balance sheet as of September 30, 2001, and as of December 31, 2000, the end of the Company's preceding fiscal year; and a statement of consolidated cash flows for the period January 1 (beginning of the fiscal year) through September 30, 2001, and for the corresponding period of the preceding year.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements present fairly the financial position of the Companies at September 30, 2001 and December 31, 2000, and the results of their operations for the three and nine months ended September 30, 2001 and their cash flows for the nine months ended September 30, 2001, and for the corresponding period of the preceding year.

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MAINE PUBLIC SERVICE COMPANY AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED INCOME

(Unaudited)

(Dollars in Thousands Except Per Share Amounts)

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2001 | 2000 | 2001 | 2000 |
| Operating Revenues | \$8,157 | \$17,912 | \$37,960 | \$53,050 |
| EA-Standard Offer Service Margin | 891 | 1,218 | 946 | 1,616 |
| Total Revenues | 9,048 | 19,130 | 38,906 | 54,666 |
| Operating Expenses | | | | |
| Energy Supply | 1,501 | 11,084 | 14,335 | 30,716 |
| T & D Operation & Maintenance | 2,980 | 2,982 | 8,677 | 8,958 |

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| | | | | |
|----------------------------------------------------------------------------------------------|--------|--------|---------|---------|
| Depreciation | 620 | 581 | 1,857 | 1,741 |
| Amortization of Stranded Costs | 2,380 | 2,459 | 7,052 | 6,424 |
| Amortization | 54 | 15 | 162 | 282 |
| Taxes other than Income | 316 | 306 | 1,008 | 560 |
| (Benefit) Provision for Income Taxes | 126 | 530 | 1,446 | 1,529 |
| Total Operating Expenses | 7,977 | 17,957 | 34,537 | 50,210 |
| Operating Income | 1,071 | 1,173 | 4,369 | 4,456 |
| Other Income (Deductions) | | | | |
| Equity in Income of Associated Companies | 60 | 87 | 242 | 247 |
| Allowance for Equity Funds Used During Construction | 22 | 14 | 62 | 18 |
| Provision for Income Taxes | (167) | (115) | (293) | (524) |
| Other - Net | 16 | 74 | (226) | 784 |
| Total | (69) | 60 | (215) | 525 |
| Income (Loss) Before Interest Charges | 1,002 | 1,233 | 4,154 | 4,981 |
| Interest Charges | | | | |
| Long-Term Debt & Notes Payable | 549 | 642 | 1,840 | 2,452 |
| Less Carrying Costs-Stranded Costs and Allowance for Borrowed Funds used During Construction | (250) | (238) | (745) | (541) |
| Total | 299 | 404 | 1,095 | 1,911 |
| Net Income Available for Common Stock | \$703 | \$829 | \$3,059 | \$3,070 |
| Average Shares Outstanding (000's) | 1,573 | 1,573 | 1,573 | 1,593 |
| Basic & Diluted Earnings Per Share of Common Stock | \$0.44 | \$0.53 | \$1.94 | \$1.93 |
| Dividends Declared per Common Share | \$0.35 | \$0.32 | \$0.99 | \$0.92 |

The accompanying notes are an integral part of these financial statements.

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MAINE PUBLIC SERVICE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

| | September 30, 2001 | December 31, 2000 |
|---------------------------|--------------------|-------------------|
| ASSETS | (Unaudited) | |
| Utility Plant | | |
| Electric Plant in Service | \$78,345 | \$78,825 |

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| | | |
|-----------------------------------------------------------|-----------|-----------|
| Less Accumulated Depreciation | 37,415 | 36,290 |
| Net Electric Plant in Service | 40,930 | 42,535 |
| Construction Work-in-Progress | 4,350 | 1,468 |
| Total | 45,280 | 44,003 |
| Investment in Associated Companies | | |
| Maine Yankee Atomic Power Company | 3,102 | 3,534 |
| Maine Electric Power Company, Inc. | 443 | 374 |
| Total | 3,545 | 3,908 |
| Net Utility Plant and Investments | 48,825 | 47,911 |
| Current Assets | | |
| Cash and Cash Equivalents | 6,389 | 611 |
| Accounts Receivable - Net | 5,398 | 9,140 |
| Unbilled Base Revenue | 732 | 3,358 |
| Inventory | 605 | 465 |
| Prepayments | 1,037 | 993 |
| Total | 14,161 | 14,567 |
| Regulatory Assets | | |
| Uncollected Maine Yankee Decommissioning Costs | 26,442 | 28,056 |
| Recoverable Seabrook Costs | 16,386 | 17,219 |
| Regulatory Assets - SFAS 109 & 106 | 7,906 | 8,101 |
| Deferred Fuel and Purchased Energy Costs | 12,188 | 11,977 |
| Regulatory Asset - Power Purchase Agreement Restructuring | 7,617 | 8,706 |
| Unamortized Debt Expense | 2,901 | 3,235 |
| Deferred Regulatory Costs, less accumulated amortization | 1,164 | 613 |
| Total | 74,604 | 77,907 |
| Other Assets | | |
| Restricted Investments | 8,582 | 9,876 |
| Miscellaneous | 662 | 708 |
| Total | 9,244 | 10,584 |
| Total Assets | \$146,834 | \$150,969 |
| CAPITALIZATION AND LIABILITIES | | |
| Capitalization | | |
| Common Shareholders' Equity | | |
| Common Stock | \$13,071 | \$13,071 |
| Paid-in Capital | 42 | 38 |
| Retained Earnings | 34,599 | 33,099 |
| Treasury Stock, at cost | (6,612) | (6,622) |
| Total | 41,100 | 39,586 |
| Long-Term Debt (less current maturities) | 34,355 | 34,940 |
| Current Liabilities | | |
| Long-Term Debt Due Within One Year | 1,110 | 1,050 |

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| | | |
|--------------------------------------------------------|-----------|-----------|
| Notes Payable | 4,000 | 4,900 |
| Accounts Payable | 6,071 | 7,987 |
| Accounts Payable - EA Escrow | 1,979 | 39 |
| Dividends Declared | 551 | 503 |
| Customer Deposits | 17 | 20 |
| Interest and Taxes Accrued | 583 | 1,073 |
| Total | 14,311 | 15,572 |
| Deferred Credits | | |
| Uncollected Maine Yankee Decommissioning Costs | 26,442 | 28,056 |
| Deferred Income Tax | 21,525 | 21,420 |
| Investment Tax Credits | 228 | 252 |
| Deferred Gain & Related Accounts-Generating Asset Sale | 4,799 | 7,446 |
| Miscellaneous | 4,074 | 3,697 |
| Total | 57,068 | 60,871 |
| Total Capitalization and Liabilities | \$146,834 | \$150,969 |

The accompanying notes are an integral part of these financial statements.

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MAINE PUBLIC SERVICE COMPANY AND SUBSIDIARIES

Statements of Consolidated Cash Flows

(Unaudited)

(Dollars in Thousands)

| | Nine Months Ended | |
|------------------------------------------------------------------------|-------------------|----------|
| | September 30, | |
| | 2001 | 2000 |
| Cash Flow From Operating Activities | | |
| Net Income | \$3,059 | \$3,070 |
| Adjustments to Reconcile Net Income to Net Cash Provided By Operations | | |
| Depreciation | 1,857 | 1,741 |
| Amortization | 1,022 | 877 |
| Amortization of Deferred Gain from Asset Sale | (3,659) | (4,158) |
| Amortization of W/S Up-front Payment | 1,088 | 0 |
| Income on Tax Exempt Bonds-Restricted Funds | (211) | 0 |
| Deferred Income Taxes - Net | 168 | 3,656 |
| AFUDC | (85) | (27) |
| Rate Stabilization Plan Deferrals, Net | 0 | (218) |
| Change in Deferred Fuel & Purchased Energy | (211) | (525) |
| Change in Deferred Regulatory and Debt Issuance Costs | (227) | 293 |
| Change in Deferred Regulatory Liability - Transition Costs | (29) | (103) |
| Gain on Sale of Non-Utility Property | 0 | (205) |
| Change in Benefit Obligation | 361 | (3) |
| Change in Current Assets and Liabilities | 5,732 | (4,096) |
| Other | 785 | 243 |
| Net Cash Flow Provided By Operating Activities | 9,650 | 545 |
| Cash Flow From Financing Activities | | |
| Dividend Payments | (1,510) | (1,445) |
| Drawdown of Asset Sale Proceeds with Trustee | 0 | 18,957 |
| Deposit of Non-Utility Property Sale Proceeds with Trustee | 0 | (211) |
| Purchase of Common Stock | 0 | (922) |
| Premium on Retirement of Long-Term Debt | 0 | (2,105) |
| Retirements on Long-Term Debt | (525) | (15,025) |

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| | | |
|-------------------------------------------------------------------------------------------------------------|---------|-----------|
| Short-Term Borrowings (Repayments), Net | (900) | 5,300 |
| Net Cash Flow Provided By (Used For) Financing Activities | (2,935) | 4,549 |
| Cash Flow From Investing Activities | | |
| Payment of Taxes on Generating Asset Sale Deferred Gain | 0 | (7,853) |
| Drawdown of Tax Exempt Bonds Proceeds | 1,498 | 0 |
| Proceeds from Property Settlement | 1,050 | 0 |
| Proceeds from Sale of Non-Utility Property | 0 | 208 |
| Investment in Electric Plant | (3,485) | (3,639) |
| Net Cash Flow Used For Investing Activities | (937) | (11,284) |
| Increase (Decrease) in Cash and Cash Equivalents | 5,778 | (6,190) |
| Cash and Cash Equivalents at Beginning of Period | 611 | 6,985 |
| Cash and Cash Equivalents at End of Period | \$6,389 | \$795 |
| Change in Current Assets and Liabilities Providing (Utilizing) | | |
| Cash From Operating Activities | | |
| Accounts Receivable | \$3,742 | (\$896) |
| Unbilled Revenue | 2,626 | (1,187) |
| Inventory | (139) | (190) |
| Prepayments | (34) | (2,362) |
| Accounts Payable & Accrued Expenses | (461) | 535 |
| Other Current Liabilities | (2) | 4 |
| Total Change | \$5,732 | (\$4,096) |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash Paid During the Period For: | | |
| Interest | \$2,191 | \$2,810 |
| Income Taxes (Includes \$7.8 million payment in February, 2000 to Revenue Canada for 1999 asset sale taxes) | \$1,270 | \$7,883 |

The accompanying notes are an integral part of these financial statements.

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NOTES TO CONSOLIDATED STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements include the accounts of the Company, its wholly-owned Canadian subsidiary, Maine and New Brunswick Electrical Power Company, Limited (ME&NB) and its unregulated marketing subsidiary, Energy Atlantic, LLC (EA).

The Company is subject to the regulatory authority of the Maine Public Utilities Commission (MPUC) and, with respect to wholesale rates, the Federal Energy Regulatory Commission (FERC).

The accompanying unaudited consolidated financial statements should be read in conjunction with the 2000 Annual Report, an integral part of Form 10-K. Certain financial statement disclosures have been condensed or omitted but are an integral part of the 2000 Form 10-K. These statements reflect all adjustments that are, in the opinion of management, necessary to a fair statement of results for interim periods presented. All such adjustments are of a

normal recurring nature. The Company's significant accounting policies are described in the Notes to Consolidated Financial Statements of the Company's Annual Report filed with the Form 10-K. For interim reporting purposes, these same accounting policies are followed.

As of March 1, 2000, the Company bills customers for the energy supplied by standard offer and competitive energy providers. The Company is at risk for the collection of the standard offer supply, as it is required to remit funds within 26 days of the billing date. Competitive energy providers are paid only after the funds are collected from customers. The Company records accounts receivable for the amounts billed to Standard Offer Service (SOS) customers and a corresponding accounts payable for the amounts due to the energy supplier. No revenue is recognized as the Company is acting as an agent.

For purposes of the statements of consolidated cash flows, the Company considers all highly liquid securities with a maturity, when purchased, of three months or less to be cash equivalents.

Certain reclassifications have been made to the 2000 financial statement amounts in order to conform to the 2001 presentation.

2. ENERGY ATLANTIC

In January, 1999, Energy Atlantic, the Company's wholly-owned unregulated marketing subsidiary, formally began operations. This marketing subsidiary was involved in wholesale energy transactions during 1999 and the first two months of 2000, and began selling to retail customers on March 1, 2000, the commencement of retail competition in the State of Maine. EA's net income for the third quarter of 2001 was \$411,000 compared to \$742,000 for the third quarter of last year. The decrease primarily reflects the expiration of several large competitive retail contracts in Central Maine Power's (CMP) service territory, as well as the expiration of most medium non-residential service in the Company's service territory.

Energy Atlantic provides standard offer service (SOS) and competitive energy supply (CES) to retail customers, both of which utilize power provided via a Wholesale Power Sales Agreement with Engage Energy America, LLC, (Engage). Revenues are received and expenses are paid directly by an escrow agent pursuant to instruction from Engage. EA receives a percentage of the net profit from the sale of energy. EA is the SOS provider for approximately 525,000 residential and small non-residential customers in CMP's service territory and was awarded 20% of the medium non-residential customer base in the Company's service territory. Under the original SOS terms, EA had furnished a performance bond of approximately \$33,000,000 issued by Frontier Insurance Company. The utility (in this case CMP) bears the SOS account collection risk, as it is required to remit the amounts billed 26 days after the billing date to the escrow account mentioned above and maintain the billing and customer service relationship.

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EA records the accrued net margin of the SOS activity as revenue in the financial statements. EA's CES activity currently consists of industrial and commercial customers in Maine. CES activity is recorded on a gross basis to include the related revenues and purchased power expenses.

On December 5, 2000, the Federal Energy Regulatory Commission (FERC) issued an order requiring an increase in the Installed Capacity (ICAP) Deficiency Charge in the New England market from \$0.17 to \$8.75 per kw/month. Engage sent EA a letter giving notice that it was invoking certain contract renegotiation rights and setting forth its position that an increase of this magnitude would give it grounds to cancel its contract with EA. EA responded by stating its view that the contract requires Engage to sustain the market risks of increases in the cost of supplying power and that the notice was in breach of the contract. Without agreeing with EA's position, Engage withdrew its notice letter. Subsequently, Engage alleged that EA previously breached the contract in certain respects. EA denied these allegations.

On May 24, 2001, the Maine Public Utilities Commission (MPUC) issued an Order authorizing a comprehensive settlement of the dispute between EA and Engage. In connection with the MPUC Order, EA, Engage, CMP, and other parties entered into a comprehensive settlement that includes the following:

- (i) Engage will continue to supply EA with all energy required to perform outstanding retail contracts and the SOS commitments.
- (ii) Engage and EA released one another from liabilities arising on or before May 24, 2001, with limited exceptions.
- (iii) EA is no longer required to purchase power exclusively from Engage.
- (iv) Before its expiration on February 28, 2002, the Wholesale Agreement cannot be terminated by EA or Engage except upon the willful and material misconduct of the other party.
- (v) The order waives the requirement that EA provide a performance bond. Frontier Insurance Company (Frontier) was released from liability under its bond and Frontier released EA and the Company from any and all claims for indemnification, subrogation or contribution under the bond and associated indemnification agreement.
- (vi) Westcoast Energy, Inc. (Engage's current parent company) has provided a \$33 million guarantee of Engage's performance, and Coastal Corporation (a former affiliate of Engage) was released from its prior guarantee of Engage's

performance.

(vii) Engage will receive \$8 million over the remaining term of the Wholesale Power Agreement consisting of the following: \$1 million received from Frontier; a \$4.5 million offset from amounts Engage was

otherwise obligated to pay to CMP for entitlements; a total of \$1.0 million of payments from EA in monthly increments through March, 2002; and a \$1.5 million payment from EA in April, 2002. Under the Order, CMP will be allowed to recover the \$4.5 million from ratepayers instead of from Engage.

In connection with this settlement, EA recognized a charge against second quarter 2001 earnings (after-tax) of approximately \$1.08 million, or \$.69 per share.

In September, 2001 after examining competitive bids, including EA's, the MPUC awarded the SOS contract for residential and small commercial customers in CMP's territory to a different marketer effective when the current contract with EA expires February 28, 2002. With the elimination of the requirement to purchase power exclusively from Engage, EA began seeking other sources of supply in June, 2001. Although unsuccessful in its bid for the SOS in CMP's territory, EA was able to negotiate a competitive arrangement with a New England Supplier for purposes of its bid. In July 2001, EA began purchasing power from ISO-New England for CES sales to a paper company in Central Maine. EA also began purchasing from NB Power in late September, 2001 to begin serving commercial customers in the Company's service territory. In November, 2001, the MPUC staff has recommended that EA be awarded 40% of the output of the Wheelabrator-Sherman energy facility for two years, beginning March 1, 2002. The MPUC is expected to approve this award. This award amounts to approximately 55,000 MWH's annually and will be used to support additional CES sales in the Company's service territory. The NB Power and Wheelabrator-Sherman supply is only available for sales in the Company's service territory. EA is actively seeking a wholesale supplier in order to begin marketing for sales in Southern and Central Maine.

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The Company operates in two segments, with Maine Public Service Company (MPS) providing regulated transmission and distribution services and EA performing power marketing activity as described above. The segments' activity for the three and nine months ended September 30, 2001 and 2000 is summarized in the tables below.

Three Months Ended

(Dollars in Thousands)

| | 9/30/01 | | | 9/30/00 | | |
|----------------------------------|---------|---------|---------------|----------|---------|---------------|
| | EA | MPS | Total Company | EA | MPS | Total Company |
| Operating Revenues | \$1,600 | \$6,557 | \$8,157 | \$11,422 | \$6,490 | \$17,912 |
| EA Standard Offer Service Margin | 891 | - | 891 | 1,218 | - | 1,218 |

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| | | | | | | |
|----------------------------------|-------|-------|-------|--------|-------|--------|
| Total Revenues | 2,491 | 6,557 | 9,048 | 12,640 | 6,490 | 19,130 |
| Operations & Maintenance Expense | 1,850 | 5,685 | 7,535 | 11,503 | 5,618 | 17,121 |
| Taxes | 265 | 177 | 442 | 495 | 341 | 836 |
| Total Operating Expenses | 2,115 | 5,862 | 7,977 | 11,998 | 5,959 | 17,957 |
| Operating Income | 376 | 695 | 1,071 | 642 | 531 | 1,173 |
| Other Income & Deductions | 38 | (107) | (69) | 127 | (67) | 60 |
| Income Before Interest Charges | 414 | 588 | 1,002 | 769 | 464 | 1,233 |
| Interest Charges | 3 | 296 | 299 | 27 | 377 | 404 |
| Net Income | \$411 | \$292 | \$703 | \$742 | \$87 | \$829 |

Nine Months Ended

(Dollars in Thousands)

| | 9/30/01 | | | 9/30/00 | | |
|----------------------------------|----------|-----------|-----------|----------|-----------|-----------|
| | EA | MPS | Total | EA | MPS | Total |
| | | | Company | | | Company |
| Operating Revenues | \$15,082 | \$22,878 | \$37,960 | \$24,440 | \$28,610 | \$53,050 |
| EA Standard Offer Service Margin | 946 | - | 946 | 1,616 | - | 1,616 |
| Total Revenues | 16,028 | 22,878 | 38,906 | 26,056 | 28,610 | 54,666 |
| Operations & Maintenance Expense | 15,401 | 16,682 | 32,083 | 24,794 | 23,327 | 48,121 |
| Taxes | 194 | 2,260 | 2,454 | 563 | 1,526 | 2,089 |
| Total Operating Expenses | 15,595 | 18,942 | 34,537 | 25,357 | 24,853 | 50,210 |
| Operating Income | 433 | 3,936 | 4,369 | 699 | 3,757 | 4,456 |
| Other Income & Deductions | (133) | (82) | (215) | 208 | 317 | 525 |
| Income Before Interest Charges | 300 | 3,854 | 4,154 | 907 | 4,074 | 4,981 |
| Interest Charges | 6 | 1,089 | 1,095 | 65 | 1,846 | 1,911 |
| Net Income | \$294 | \$2,765 | \$3,059 | \$842 | \$2,228 | \$3,070 |
| Total Assets | \$5,431 | \$141,403 | \$146,834 | \$5,628 | \$137,746 | \$143,374 |

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3. RESTRUCTURING AND IMPLEMENTATION OF MULTI-YEAR RATE PLAN

Restructuring

As previously reported, on May 29, 1997, legislation titled "An Act to Restructure the State's Electric Industry" was signed into law by the Governor of Maine. The principal provisions with accounting impact on the Company are described in the Company's 2000 Form 10-K.

The MPUC has conducted several rulemaking proceedings associated with the new restructuring law. In accordance with EITF 97-4, after the details of the restructuring plan were determined by the MPUC rulemaking, the Company discontinued application of the Statement of Financial Accounting Standards No. 71 (SFAS 71), "Accounting for the Effects of Certain Types of Regulations", for the retail generation segment of its business in the fourth quarter of 1999. Under EITF 97-4, the Company is permitted to continue to defer certain costs as regulatory assets in instances where recovery through future regulatory cash flows is anticipated.

At September 30, 2001, \$74.6 million of regulatory assets remained on the Company's books. These regulatory assets are being amortized over various periods, up to 15 years, in accordance with the MPUC approved Phase II filing on stranded cost recovery. The major components include the remaining investment in Seabrook, the recovery of fuel expense deferrals related to Wheelabrator-Sherman, the obligation for remaining operating expenses and recovery of the Company's remaining investment in Maine Yankee, and the recovery of several other regulatory assets. As approved by the MPUC, a portion of the amortization of these regulatory assets is offset by the recognition of the deferred gain from the sale of the generating assets. As of September 30, 2001, \$4.8 million of deferred gain remains to be utilized.

Rate Stipulation Effective March 1, 2000

On October 14, 1998, and subsequently amended on February 9, 1999 and August 11, 1999, the Company filed its determination of stranded costs, transmission and distribution costs and rate design with the MPUC. The Company's amended testimony supports its \$95.7 million estimate of stranded costs representing the return of and return on stranded cost items as described below, when deregulation occurred on March 1, 2000. The major components of stranded costs include the remaining investment in Seabrook, the above market costs of the amended power purchase agreement and recovery of fuel expense deferrals related to Wheelabrator-Sherman, the obligation for remaining operating expenses and recovery of the Company's remaining investment in Maine Yankee, and the recovery of several other regulatory assets less the available value from the sale of the generating assets.

On October 15, 1999, the Company filed with the MPUC a Stipulation resolving the revenue requirement and rate design issues for the Company's Transmission and Distribution (T&D) utility. This Stipulation was signed by the Public Advocate and approval was recommended by the MPUC staff. Under the Stipulation, the Company's total annual T&D revenue requirements were \$16,640,000, effective March 1, 2000. This revenue requirement includes a 10.7% return on equity with a capital structure based on 51% common equity. The Stipulation further provided that the precise level of stranded cost recovery cannot be determined until final determination of all costs associated with the sale of the Company's generating assets, but does set forth some general principles concerning the Company's ultimate stranded costs recovery, including agreement that the major components of the Company's stranded costs are legitimate, verifiable and unmitigable, and therefore subject to recovery in rates, and that the 3.66% recovery foregone in Docket 98-865 shall be added to stranded cost recovery in the manner specified in the stipulation in that Docket. The Stipulation also provided that the Company's recovery of unamortized investment tax credits and excess deferred income taxes associated with the Company's generating assets await a final determination ruling from the IRS, which ruling has been sought by Central Maine Power Company. On December 1, 1999, the MPUC approved this Stipulation. In early January, 2000, CMP received its ruling from the IRS which concluded that the unamortized investment tax credits and excess deferred income taxes associated with the sale of the generating assets could not be used to reduce customer rates without violating the tax normalization rules for public utilities.

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On January 27, 2000, the MPUC approved a Stipulation in Phase II of Docket No. 98-577 that provided for the recovery in rates of the Company's stranded investment. The major element of the Phase II Stipulation was the \$12.5 million of stranded investment recoverable annually beginning March 1, 2000. This revenue requirement included a return on unrecovered stranded investment based on the capital structure approved by the MPUC in its December 1, 1999 Order. The approved capital structure consists of 51% common equity with an authorized return on equity of 10.7%. The Phase II Stipulation also allowed the Company to offset its unrecovered stranded investment in Seabrook by approximately \$7 million, representing an amount equal to 35% of the available value from the sale of the generating assets. The parties to the Phase II Stipulation also resolved several rate design issues, principally the elimination of the inclining block rate for residential customers. In addition, the Company was granted several accounting orders incorporating certain accounting methodologies used in determining the elements of stranded costs. The annual revenue requirement associated with the recovery of stranded costs will be reviewed at least every three years.

On July 12, 2001, the Company filed testimony in Docket No. 2001-240 to respond to a Commission Notice of Investigation. With this filing, the Company proposes among other things, to maintain the same level of revenue requirements as determined in Docket 98-577.

4. INCOME TAXES

A summary of Federal and State income taxes charged to income is presented below. For accounting and ratemaking purposes, income tax provisions included in "Operating Expenses" reflect taxes applicable to revenues and expenses allowable for rate making purposes, with the exception of Energy Atlantic activity, which is above the line and not allowable for ratemaking purposes. The tax effect of items not included in rate base is allocated as "Other Income (Deductions)". The income taxes on stranded cost carrying charges are allocated to "Other Income (Deductions)".

| | (Dollars in Thousands) | | | |
|----------------------|------------------------|---------|-------------------|-----------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | |
| | 2001 | 2000 | 2001 | 2000 |
| Current income taxes | \$582 | \$(555) | \$1,555 | \$(1,743) |
| Deferred income tax | (281) | 1,209 | 208 | 3,823 |
| Investment credits | (8) | (9) | (24) | (27) |
| Total income taxes | \$293 | \$645 | \$1,739 | \$2,053 |
| Allocated to: | | | | |
| Operating Income | \$126 | \$530 | 1,446 | \$1,529 |
| Other income | 167 | 115 | 293 | 524 |
| Total | \$293 | \$645 | \$1,739 | \$2,053 |

For the nine months ended September 30, 2001 and 2000, the effective income tax rates were 36.2% and 40.1%, respectively. The principal reasons for the effective tax rates differing from the US federal income tax rate are the contribution to net income of the Company's Canadian subsidiary and flow through items, principally Seabrook amortization, required by regulation and state income taxes.

The following summarizes accumulated deferred income taxes established on temporary differences under SFAS 109 as of September 30, 2001 and December 31, 2000.

| | (Dollars in Thousands) | |
|---------------------------------------|------------------------|--------------|
| | September 30, | December 31, |
| | 2001 | 2000 |
| Seabrook | \$9,372 | \$9,511 |
| Property | 6,315 | 6,516 |
| Deferred fuel | 4,268 | 4,472 |
| Generating asset sale | (1,494) | (2,551) |
| W-S up-front payment | 3,039 | 3,473 |
| Pension and post-retirement benefits | (295) | (175) |
| Other | 320 | 174 |
| Net accumulated deferred income taxes | \$21,525 | \$21,420 |

5. MAINE YANKEE

The Company owns 5% of the Common Stock of Maine Yankee, which operated an 860 MW nuclear power plant (the "Plant") in Wiscasset, Maine. On August 6, 1997, the Board of Directors of Maine Yankee voted

to permanently cease power operations and to begin decommissioning the Plant. The Plant had experienced a number of operational and regulatory problems and did not operate after December 6, 1996. The decision to close the Plant permanently was based on an economic analysis of the costs, risks and uncertainties associated with operating the Plant compared to those associated with closing and decommissioning it. The Plant's operating license from the Nuclear Regulatory Commission (NRC) was due to expire on October 21, 2008.

The Maine Agreement for the decommissioning of Maine Yankee requires the Maine owners, (Central Maine Power, Bangor Hydro-Electric Company and the Company) for the period from March 1, 2000 through December 1, 2004, to hold their Maine retail ratepayers harmless from the amounts by which the replacement power costs for Maine Yankee exceed the replacement power costs assumed in the report to the Maine Yankee Board of Directors that served as a basis for the Plant shutdown decision, up to a maximum cumulative amount of \$41 million. The Company's share of the maximum amount would be \$4.1 million for the period. For the year ended December 31, 2000, the Company selected the price based on the two year entitlement auction which was allowed under the agreement. Since this price was below the assumed replacement power price, there was no liability for this period. The Company again selected the

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two year entitlement auction price for the year ended December 31, 2001, but on October 11, 2000, the Maine Agencies, (the MPUC and the Office of the Public Advocate) rejected the Maine Owners' selection of the sales auction price as the benchmark for calendar year 2001. On December 11, 2000, in separate negotiations, the Company reached an agreement in principal with the Maine Agencies. Under this Agreement, the Company incurred no liability for 2001. For the calendar years 2002 to 2004, the Company will be required to use the auction price as the appropriate proxy. At this time, the Company cannot predict the auction price for 2002 to 2004 and, if it were to exceed the assumed replacement power price, how much, if any, of the maximum \$4.1 million will be required to be recognized during these two years.

With the closing of Maine Yankee, a provision of the Company's rate plan allowing the deferral of 50% of the Maine Yankee replacement power costs went into effect on June 6, 1997. Beginning in May, 1998, Maine Yankee replacement power costs have been offset by net savings from the restructured Purchase Power Agreement with Wheelabrator-Sherman, in accordance with the rate plan stipulation.

From April, 1999 until February, 2000, the Company amortized an additional \$150,000 per month as part of a stipulation described in Note 3 above. On March 1, 2001, the Company began amortizing \$75,000 per month of the Maine Yankee replacement power cost balance and other deferred fuel. As of September 30, 2001, the total deferred fuel is \$12.2 million.

On September 1, 1997, Maine Yankee estimated the sum of the future payments for the closing, decommissioning and recovery of the remaining investment in Maine Yankee to be approximately \$930 million, of which the Company's

5% share would be approximately \$46.5 million. In December, 1998, June, 1999, September 2000, and again in February, 2001 Maine Yankee updated its estimate of decommissioning costs based on the Settlement. Legislation enacted in Maine in 1997 calls for restructuring the electric utility industry and provides for recovery of decommissioning costs, to the extent allowed by federal regulation, through the rates charged by the transmission and distribution companies. Based on the Maine legislation and regulation precedent established by the FERC in its opinion relating to the decommissioning of the Yankee Atomic nuclear plant, the Company believes that it is entitled to recover substantially all of its share of such costs from its customers and, as of September 30, 2001, is carrying on its consolidated balance sheet a regulatory asset and a corresponding liability in the amount of \$26.4 million, which is the September, 1997 cost estimate of \$46.5 million discussed above reduced by the Company's post-September 1, 1997 cost-of-service payments to Maine Yankee and reflects the cost adjustments agreed to in the settlement.

The MPUC, on January 27, 2000, approved a Stipulation providing for the recovery of stranded investment, which includes the Company's share of Maine Yankee decommissioning expenses, Maine Yankee replacement costs, and the remaining Maine Yankee investment.

On May 4, 2000, Maine Yankee notified its decommissioning operations contractor, Stone & Webster Engineering Corporation (Stone & Webster), which was experiencing liquidity problems, that it was terminating its decommissioning operations contract pursuant to the terms of the contract. Since then, Stone & Webster has been disputing Maine Yankee's grounds for terminating the contract.

On June 2, 2000, Stone & Webster filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the District of Delaware. On July 14, 2000, pursuant to a Bankruptcy Court Order, Stone & Webster sold substantially all of its assets to The Shaw Group, Inc., (Shaw), for cash, stock, and the assumption of certain liabilities of Stone & Webster. Stone & Webster reported that it would continue to operate as a Debtor-in-Possession subject to the supervision and orders of the Bankruptcy Court.

Commencing in May, 2000, Maine Yankee entered into interim agreements with Stone & Webster in order to allow decommissioning work to continue and avoid the adverse consequences of an abrupt or inefficient

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demobilization from the Plant site. After obtaining assignments of several subcontracts from Stone & Webster, Maine Yankee at least temporarily assumed the general contractor role. Decommissioning of the Plant site continued with major emphasis directed to maintaining the schedule on critical-path projects such as construction of the ISFSI and preparation of the Plant's reactor vessel for eventual shipment to an off-site disposal facility. During this period Maine Yankee performed a comprehensive assessment of its long-term alternatives for safely and efficiently completing the decommissioning, which included the solicitation and evaluation of detailed competitive-bid proposals from prospective successor general contractors. On January 26, 2001, Maine Yankee announced its decision to reject the proposals and continue to manage the decommissioning project itself without an external general contractor.

On June 30, 2000, Federal Insurance Company (Federal), which provided performance and payment bonds in the amount of \$37.6 million each in connection with the decommissioning operations contract, filed a Complaint for Declaratory Judgement against Maine Yankee in the United States Bankruptcy Court for the District of Delaware, which was subsequently transferred to the United States District Court in Maine. The Complaint alleges that Maine Yankee improperly terminated the decommissioning operations contract with Stone & Webster and had failed to give proper notice of the termination to Federal under the contract, and that Federal, therefore had no further obligations under the bonds.

On August 24, 2000, Maine Yankee also filed a \$78.2 million (later increased to approximately \$86 million) proof of claim in the Stone & Webster Bankruptcy Court proceeding in Delaware seeking to recover its additional costs caused by Stone & Webster's contract default. However, any recovery by Maine Yankee from Federal in the District Court proceeding in Maine would reduce Maine Yankee's claim as a general creditor in the Bankruptcy Court proceeding. On July 26, 2001, in a Memorandum Decision regarding defenses raised by Stone & Webster in the Bankruptcy Court proceeding, the presiding judge found, among other matters, that Stone & Webster was insolvent, that Maine Yankee had a right to terminate for insolvency, that Maine Yankee had a right to recover damages following such a termination, and that, if Maine Yankee owed Stone & Webster any unpaid amounts at termination, such amounts could be set off against those damages. The amount of such recovery, if any, will be determined later in the proceeding. The trial in the Bankruptcy Court proceeding is scheduled for November 26, 2001. In the Federal proceeding in the U. S. District Court in Maine, a hearing to resolve issues related to the payment bond is scheduled for November, 2001. Maine Yankee cannot predict the outcome of either proceeding.

In December 2000, Maine Yankee distributed approximately \$20 million to its owners from proceeds received as a result of the termination of Maine Yankee's membership in a nuclear industry mutual insurance company. The Company received its 5% ownership share, or \$1.0 million, and recorded a regulatory liability, awaiting rate treatment. On September 27, 2001, Maine Yankee's Board of Directors voted to redeem 75,200 shares, 15% of the shares outstanding, of Maine Yankee's Common Stock in accordance with a plan approved by the Securities and Exchange Commission on September 10, 2001. The plan calls for the redemption of Common Stock periodically through 2008. On October 4, 2001, the Company received approximately \$500,000 for 15% of its Common Stock in Maine Yankee according to the first step of the plan.

6. GENERATING ASSET DIVESTITURE

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On July 7, 1998, the Company and WPS Power Development, Inc. (WPD-PDI) signed a purchase and sale agreement for the Company's electric generating assets. WPS-PDI agreed to purchase 91.8 megawatts of generating capacity for \$37.4 million, which is 3.2 times higher than the net book value of the assets. This

sale of assets is required by the State's electric industry restructuring law and required the approvals of the MPUC and the FERC.

On June 8, 1999, after receiving all of the major regulatory approvals, the Company completed the sale to WPD-PDI for \$37.4 million. The Company's 5% ownership in Maine Yankee was not part of the sale, since

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the plant is being decommissioned. After paying Canadian, Federal and State income taxes, the remaining proceeds will be used to reduce the Company's debt. The gain from the sale is currently deferred, and is being recognized according to the Maine Public Utilities Commission's (MPUC) decision on the Company's determination of stranded costs, transmission and distribution costs and rate design.

The components of the deferred gain are as follows:

| | (Dollars in Millions) |
|-----------------------------------------|-----------------------|
| Gross proceeds * | \$38.6 |
| Settlement adjustment | (.1) |
| Net proceeds | 38.5 |
| Net book value | (11.5) |
| Excess taxes on sale of Canadian assets | (3.4) |
| Transition costs, net | (1.9) |
| Other | .7 |
| Available deferred gain | 22.4 |

| | |
|------------------------------------------------|--------|
| Utilization of available value per MPUC orders | (17.7) |
| Remaining deferred gain, net of tax** | \$4.7 |

* Gross proceeds were increased by \$1.05 million before tax in September, 2001 due to a MPUC approved settlement between CMP and other former owners of Wyman Unit No. 4, including the Company. The proceeds increased the deferred gain and further reduced stranded costs.

**The \$4.7 million deferred gain above is the \$4.8 million "Deferred Gain and Related Accounts-Generating Asset Sale" as of September 30, 2001 reduced by the remaining deferral of transition costs allowed by the MPUC.

The sale of the Company's generating assets in 1999 significantly impacted long-term debt. Proceeds from the sale and the partial liquidation of ME & NB were deposited with the first mortgage trustee and subsequently withdrawn to redeem the remaining \$2.5 million of 9.6% second mortgage bonds and \$1.4 million of the variable rate 1996 Public Utility Refunding Revenue Bonds. On June 14, 2000, the Company redeemed the 9.775% first mortgage bonds in the amount of \$15.0 million and paid a related premium on the retirement of \$2.1 million. In all, the Company has reduced long-term debt by \$18.9 million using generating asset sale proceeds consistent with past treatment, the Company has deferred premiums on the early redemption of debt issues and will amortize the balance over the remaining life of the original debt issues. With the sale of the Company's generating assets in June, 1999, the Company purchased energy from the new owners, PDI, under an agreement that expired February 29, 2000, and these purchases are classified as purchased energy .

As part of the generating assets sale on June 8, 1999, the Company has entered into two indemnity obligations with the purchaser, WPS-PDI. First, the Company will be liable, with certain limitations, for certain Aroostook River flowage damage. This liability will continue for ten years after the sale and shall not exceed \$2,000,000 in the aggregate. Second, the Company has warranted the condition of the sites sold to WPS-PDI, with an aggregate limit of \$3,000,000 for two years after the date of sale, and five years after the sale for environmental claims. The Company is unaware of any pending claims under either of these indemnity obligations.

7. WPS COMPLAINT

October 30, 2000, WPS Energy Services (WPS), a Competitive Electricity Provider (CEP) offering retail sales of electricity in the Company's service territory, filed a Complaint against the Company as well as a Petition to Alter or Amend the MPUC's September 2, 1998 Order in Docket No. 98-138.

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The Complaint alleges that the Company has violated various provisions of Chapter 304 of the MPUC's Regulations governing relations between the Company and all CEPs, including the Company's own marketing subsidiary, Energy Atlantic, LLC (EA). According to the Complaint, various of the Company's employees have engaged in conduct that either awards EA a competitive advantage over other CEPs or has burdened WPS with an unfair disadvantage relative to EA.

These allegations include such practices as denying WPS information made available to EA, or providing EA with information about WPS's customers that is not available publicly. The Company does not believe it has in any way violated any provisions of Chapter 304 and intends to so argue before the MPUC.

In its September 2, 1998 Order in Docket No. 98-138 authorizing the formation of EA, the Commission allowed the Company and EA to share the services of certain employees under certain conditions on the ground that such sharing was in the public interest and would not have any anti-competitive effect on the retail market for electricity. WPS claims that the sharing does not conform to the conditions set forth in the order and that, in any event, the Commission should now find such sharing not in the public interest, thereby amending its original September 2, 1998 Order.

The Complaint and Petition to Amend the September 2, 1998 Order, in addition to requesting a prohibition on the sharing of certain employees, particularly Maine Public Services Company's General Counsel, also seeks a formal investigation of the Complaint, penalties for any violations of the Commission's rules and certain specific relief for violations of Chapter 304. In its response, the Company strongly denied the allegations in the WPS Complaint and asked the Commission to dismiss the Complaint and for Summary Judgement in its favor.

On May 1, 2001, the Commission issued its Order in this matter, finding that some counts in the WPS Complaint should be dismissed but that others raised factual issues that could be resolved only through a more formal hearing process. The Commission declined, however, to take initial jurisdiction over the Complaint. Instead the Commission ordered the parties to submit their dispute to the informal dispute resolution process set forth in MPS's Chapter 304 Implementation Plan. Under this Plan, the dispute must be submitted to an independent law firm which must issue its decision within 30 days. Only if the matter is not resolved to both parties' satisfaction will the Commission then take jurisdiction over the dispute.

The Commission also stated that it would open an investigation into the issue of whether MPS's General Counsel's dual role with MPS and EA is inherently problematic and the standards that should govern any

MPS employees who also provide services to EA. A schedule for this investigation has not yet been announced.

The parties submitted the dispute to an independent arbitrator who issued his proposed findings on June 29, 2001. The arbitrator found that MPS did not violate any provisions of Chapter 304, except for the Company's unintentional failure to identify WPS as a Standard Offer Service provider on its March and April 2000 bills to customers. The arbitrator recommended that MPS refund WPS its billing fees for these two months, approximately \$18,000, and the refund was made in July, 2001. On July 5, 2001, the Company and WPS informed the Commission of their acceptance of the arbitrator's findings. As a result, the Commission, in its July 13, 2001 Order, stated that it would not be necessary for it to further address the allegations in the WPD complaint, even though it would continue its investigation into the sharing of employee services.

8. ADOPTION OF SFAS NO. 133

The Company has adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" effective January 1, 2001. The Company has reviewed its business activities and determined that interest rate caps on the three variable rate long-term debt issues qualify as derivatives in accordance with SFAS 133. On June 1, 1998, the

Company purchased an interest rate cap of 7% at a cost of \$172,000, to expire June

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8, 2008 on \$11,540,000 of FAME's Taxable Electric Rate Stabilization Notes, Series 1998A, issued on behalf of the Company. On November 20, 2000, the Company purchased an interest cap of 6% at a cost of \$36,000 to expire November 2003 that applies to the 2000 and 1996 Series of Maine Public Utilities Financing Bank's (MPUFB) bonds issued on behalf of the Company with outstanding balances of \$9.0 million and \$13.6 million, respectively. The Company recorded the cost of the caps as regulatory assets and is amortizing them over their useful lives. SFAS 133 requires companies to record derivatives on their balance sheet at fair value, with the related changes in fair value recorded as either income/expense or as a component of other comprehensive income, depending on the intended use of the derivative. For regulated entities, SFAS 133 allows the amount the fair value is below the carrying value to be recorded as a regulatory asset to the extent the difference is recoverable in the rate base of the Company.

The Company has adopted a policy under regulatory accounting that requires any gain on the sale of these regulatory assets to be recorded as regulatory liabilities and returned to rate payers. The issuers of the caps related to the Company's FAME and MPUFB debt have declared their fair values as of September 30, 2001 to be \$76,000. The corresponding unamortized regulatory assets as of September 30, 2001 are \$140,000.

9. NEW ACCOUNTING PRONOUNCEMENTS

In June of 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 143 "Accounting for Asset Retirement Obligations". This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement is effective for financial statements issued for fiscal years beginning after June 15,

2002. The Company does not expect the adoption of this statement to have a material impact on its financial position or results of operations.

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Form 10-Q

PART 1. FINANCIAL INFORMATION

Item 2. Management's Analysis of Quarterly Income Statements

Forward-Looking Statements

The discussion below may contain "forward-looking statements", as defined in the Private Securities Litigation Reform Act of 1995, related to expected future performance or our plans and objectives. Actual results could potentially differ materially from these statements. Therefore, there can be no assurance that actual results will not materially differ from expectations.

Factors that could cause actual results to differ materially from our projections include, among other matters, electric utility restructuring; future economic conditions; changes in tax rates, interest rates or rates of inflation; developments in our legislative, regulatory, and competitive environment; and the decommissioning cost of Maine Yankee.

Results of Operations

Earnings per share and the net income available for common stock for the three months ended September 30, 2001 along with the corresponding information for the previous year are as follows:

| | Three Months Ended | |
|-------------------------|--------------------|-------|
| | September 30, | |
| | 2001 | 2000 |
| Earnings per share | \$.44 | \$.53 |
| Net income in thousands | \$703 | \$829 |

For the third quarter of 2001 compared to the same quarter last year, the decrease in consolidated earnings per share (EPS) of \$.09 is attributable to the following:

Change in EPS - Third Quarter of 2001

Compared to Third Quarter of 2000

| | EPS Increase (Decrease) |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------|
| Decrease in Energy Atlantic net income | \$(.21) |
| Net change from decreases in retail revenues and power procurement expenses according to rate stipulation due to deregulation beginning March 1, 2000 | .03 |
| Decrease in amortization of stranded costs | .02 |
| Reduction in net interest costs | .05 |
| Increase in other operation and maintenance expenses | (.01) |
| Other | .03 |
| Total | \$(.09) |

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Form 10-Q

PART 1. FINANCIAL INFORMATION

Item 2. Management's Analysis of Quarterly Income Statements

Results of Operations (Continued)

Consolidated operating revenues for the quarters ended September 30, 2001 and 2000, are as follows:

| (Dollars in Thousands) | 2001 | | 2000 | |
|-----------------------------|-------|-----------|--------|-----------|
| | \$ | MWH | \$ | MWH |
| Maine Public Service (MPS) | | | | |
| - Retail | 6,091 | 125,965 | 5,976 | 126,547 |
| - Other Revenues | 466 | - | 514 | - |
| Energy Atlantic, LLC (EA) | | | | |
| - Competitive Energy Supply | 1,600 | 54,309 | 11,422 | 251,933 |
| - Standard Offer Margin | 891 | 861,111 | 1,218 | 823,265 |
| Totals | 9,048 | 1,041,385 | 19,130 | 1,201,745 |

MPS retail sales decreased by .5% (582 MWH), reflecting small decreases in sales to small and large commercial customers, partially offset by an increase in sales to residential customers of 4.0%.

The Company's wholly-owned marketing subsidiary, Energy Atlantic, LLC's (EA) Competitive Energy Supply revenues decreased by \$9,822,000 due to the termination of two large industrial contracts in February and March of 2001, and the termination of a contract to service a large grocery store chain and most medium non-residential service in the Company's service territory, both in August, 2001. The Standard Offer Service margin decreased \$327,000, reflecting favorable ISO tariff and settlement cost adjustments recognized in September, 2000. The Standard Offer MWH's, which increased by 37,846 MWH's, reflect normal operations, with revenues and expenses recognized on a net basis. See discussion below in "Energy Atlantic Operations".

For the quarters ended September 30, 2001 and 2000, total operating expenses were \$7,977,000 and \$17,957,000 respectively. The changes in operating expenses and energy sources are as follows:

| (Dollars in Thousands) | Increase/(Decrease) | |
|---------------------------------------------------------------------------|---------------------|-----------|
| | \$ | MWH |
| MPS Purchases | (2) | |
| EA Purchases | | |
| - Competitive Energy Supply | (9,581) | (197,624) |
| - Standard Offer Service (costs reported in Standard Offer Margin, above) | | 37,846 |
| Total Energy Supply | (9,583) | (159,778) |
| Operation & Maintenance Expenses | (2) | |
| Depreciation | 39 | |
| Amortization | 39 | |
| Amortization of Stranded Costs | (79) | |
| Income Taxes | (404) | |
| Taxes Other than Income | 10 | |
| Total | (9,980) | (159,778) |

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Form 10-Q

PART 1. FINANCIAL INFORMATION

Item 2. Management's Analysis of Quarterly Income Statements

Results of Operations (Continued)

With the start of retail competition on March 1, 2000, the Company provides transmission and distribution (T&D or delivery) services and no longer purchases or generates energy supply for its customers. CES purchases by EA decreased by 197,624 MWH, \$9,581,000, due to the expired contracts discussed above. MPS continues to purchase power from Wheelabrator-Sherman (W-S) under an agreement that expires in 2006, at prices above current market conditions. Beginning on March 1, 2000, as a result of competitive bidding, the output from W-S is sold to the successful bidder, and the above-market amount, \$2,027,000 for the third quarter of 2001, is included in stranded cost amortization rather than energy supply. The decrease in amortization of stranded costs of \$79,000 reflects a decrease in net W-S costs of \$855,000, offset by a \$526,000 increase in the asset sale gain recognition, and a \$211,000 increase in deferred fuel recognition. Stranded costs include the W-S above-market costs discussed above, less amortization of the deferred gain from the 1999 sale of the Company's generating assets, in accordance with a Stipulation approved by the MPUC.

Energy Atlantic Operations

In January, 1999, Energy Atlantic, the Company's wholly-owned unregulated marketing subsidiary, formally began operations. This marketing subsidiary was involved in wholesale energy transactions during 1999 and the first two months of 2000, and began selling to retail customers on March 1, 2000, the commencement of retail competition in

the State of Maine. EA's net income for the third quarter of 2001 was \$411,000 compared to \$742,000 for the third quarter of last year. The decrease primarily reflects the expiration of several large competitive retail contracts in Central Maine Power's (CMP) service territory, as well as the expiration of most medium non-residential service in the Company's service territory.

Energy Atlantic provides standard offer service (SOS) and competitive energy supply (CES) to retail customers, both of which utilize power provided via a Wholesale Power Sales Agreement with Engage Energy America, LLC (Engage). Revenues are received and expenses are paid directly by an escrow agent pursuant to instruction from Engage. EA receives a percentage of the net profit from the sale of energy. EA is the SOS provider for approximately 525,000 residential and small non-residential customers in CMP's service territory and was awarded 20% of the medium non-residential customer base in the Company's service territory. Under the original SOS terms, EA had furnished a performance bond of approximately \$33,000,000 issued by Frontier Insurance Company. The utility (in this case CMP) bears the SOS account collection risk, as it is required to remit the amounts billed 26 days after the billing date to the escrow account mentioned above and maintain the billing and customer service relationship.

EA records the accrued net margin of the SOS activity as revenue in the financial statements. EA's CES activity currently consists of industrial and commercial customers in Maine. CES activity is recorded on a gross basis to include the related revenues and purchased power expenses.

On December 5, 2000, the Federal Energy Regulatory Commission (FERC) issued an order requiring an increase in the Installed Capacity (ICAP) Deficiency Charge in the New England market from \$0.17 to \$8.75 per kw/month. Engage sent EA a letter giving notice that it was invoking certain contract renegotiation rights and setting forth its position that an increase of this magnitude would give it grounds to cancel its contract with EA. EA responded by stating its view that the contract requires Engage to sustain the market risks of increases in the cost of supplying power and that the notice was in breach of the contract. Without agreeing with EA's position, Engage withdrew its notice letter. Subsequently, Engage alleged that EA previously breached the contract in certain respects. EA denied these allegations.

On May 24, 2001, the Maine Public Utilities Commission (MPUC) issued an Order authorizing a comprehensive settlement of the dispute between EA and Engage. In connection with the MPUC Order, EA, Engage, CMP, and other parties entered into a comprehensive settlement which includes the following:

PART 1. FINANCIAL INFORMATION

Item 2. Management's Analysis of Quarterly Income Statements

Results of Operations (Continued)

- (i) Engage will continue to supply EA with all energy required to perform outstanding retail contracts and the SOS commitments.
- (ii) Engage and EA released one another from liabilities arising on or before May 24, 2001, with limited exceptions.
- (iii) EA is no longer required to purchase power exclusively from Engage.
- (iv) Before its expiration on February 28, 2002, the Wholesale Agreement cannot be terminated by EA or Engage except upon the willful and material misconduct of the other party.
- (v) The order waives the requirement that EA provide a performance bond. Frontier Insurance Company (Frontier) was released from liability under its bond and Frontier released EA and the Company from any and all claims for indemnification, subrogation or contribution under the bond and associated indemnification agreement.
- (vi) Westcoast Energy, Inc. (Engage's current parent company) has provided CMP a \$33 million guarantee of Engage's performance, and Coastal Corporation (a former affiliate of Engage) was released from its prior guarantee of Engage's performance.
- (vii) Engage will receive \$8 million over the remaining term of the Wholesale Power Agreement consisting of the following: \$1 million received from Frontier; a \$4.5 million offset from amounts Engage was otherwise obligated to pay to CMP for entitlements; a total of \$1.0 million of payments from EA in monthly increments through March, 2002; and a \$1.5 million payment from EA in April, 2002. Under the Order, CMP will be allowed to recover the \$4.5 million from ratepayers instead of from Engage.

In connection with this settlement, EA recognized a charge against second quarter 2001 earnings (after-tax) of approximately \$1.08 million, or \$.69 per share.

In September, 2001, after examining competitive bids including EA's, the MPUC awarded the SOS contract for residential and small commercial customers in CMP's territory to a different marketer effective when the current contract with EA expires February 28, 2002. With the elimination of the requirement to purchase power exclusively from Engage, EA began seeking other sources of supply in June, 2001. Although unsuccessful in its bid for the SOS in CMP's territory, EA was able to negotiate a competitive arrangement with a New England supplier for purposes of its bid. In July, 2001, EA began purchasing power from ISO-New England for CES sales to a paper company in Central Maine. EA also began purchasing from NB Power in late September, 2001 to begin serving commercial customers in the Company's service territory. In November, 2001, the MPUC staff has recommended that EA be awarded 40% of the output of the Wheelabrator-Sherman energy facility for two years, beginning March 1, 2002. The MPUC is expected to approve this award. This award amounts to approximately 55,000 MWH's annually and will be used to support additional CES sales in the Company's service territory. The NB Power and Wheelabrator-Sherman supply is only available for sales in the Company's service territory. EA is actively seeking a wholesale supplier in order to begin marketing for sales in Southern and Central Maine. Liquidity

Net cash flows from operating activities were \$9,650,000 for the first nine months of 2001. For the period, the Company paid \$1,510,000 in dividends and drew down \$1,498,000 from the trustee of the tax-exempt revenue bond proceeds based on qualifying property. The Company received \$1,050,000 resulting from a settlement related to the June, 1999 sale of its ownership in the Wyman Unit No. 4 generating facility. The Company also paid scheduled sinking fund payments of \$525,000 on long-term debt and decreased short-term borrowings by \$900,000. For the period, the Company invested \$3,485,000 in electric plant.

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PART 1. FINANCIAL INFORMATION

Item 2. Management's Analysis of Quarterly Income Statements

Results of Operations (Continued)

Net cash flows from operating activities were \$545,000 for the first nine months of 2000. For the period,

the Company paid \$1,445,000 in dividends, deposited \$211,000 of proceeds from the sale of land into the trustee account and drew down \$18,957,000 of the asset sale proceeds from the trustee. The proceeds were used to reduce short-term borrowings, and provide \$15,000,000 of principal, and the \$2,105,000

premium on the early retirement of the 9.775% series of First Mortgage Bonds. The Company also paid a scheduled sinking fund payment of \$25,000 on long-term debt and repurchased 45,000 shares of common

stock for \$922,000 in order to manage its capital structure to limit common equity to 51%, and increased short-term borrowings by \$5,300,000. For the period, the Company invested \$3,639,000 in electric plant, paid \$7,853,000 in Canadian income taxes on the generating asset sale, and received proceeds of \$208,000 from the sale of land.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

(a) The Company has interest rate risk with three variable rate debt issues of the regulated business as of September 30, 2001 for purposes other than trading. These issues are discussed in detail in the Company's 2000 Annual Report, which is Exhibit 13 of the Company's 2000 Form 10-K. The discussion occurs in Note 9, "Long-Term Debt", of the Notes to Consolidated Financial Statements. See Note 8, "Adoption of SFAS 133" of this Form 10-Q for required disclosure of interest rate caps that qualify as derivative instruments.

(b) The Company's unregulated marketing subsidiary, Energy Atlantic, LLC (EA) is engaged in retail and wholesale energy transactions for purposes other than trading. This activity exposes EA to a number of risks such as market liquidity, forecasting, deliverability and credit risk. EA seeks to assure that risks are identified, evaluated and actively managed.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

(a) WPS Energy Services, Inc., Complaint against Maine Public Service Company, and Petition to Alter or Amend the MPUC's Order Authorizing the Formation of Energy Atlantic, LLC, MPUC Docket Nos. 98-138 and 00-894

On October 30, 2000, WPS Energy Services (WPS), a Competitive Electricity Provider (CEP) offering retail sales of electricity in the Company's service territory, filed a Complaint (Docket No. 00-894) against the Company as well as a Petition to Alter or Amend the MPUC's September 2, 1998 Order in Docket No. 98-138.

The Complaint alleges that the Company has violated various provisions of Chapter 304 of the MPUC's Regulations governing relations between the Company and all CEPs, including the Company's own marketing subsidiary, Energy Atlantic, LLC (EA). According to the Complaint, various of the Company's employees have engaged in conduct that either awards EA a competitive advantage over other CEPs or has burdened WPS with an unfair disadvantage relative to EA. These allegations include such practices as denying WPS information made available to EA, or providing EA with information about WPS's customers that is not available publicly. The Company does not believe it has in any way violated any provisions of Chapter 304 and has so argued to the MPUC.

In its September 2, 1998 Order in Docket No. 98-138 authorizing the formation of EA, the Commission allowed the Company and EA to share the services of certain employees under certain conditions on the ground that such sharing was in the public interest and would not have any anti-competitive effect on the retail market for electricity. WPS claims that the sharing does not conform to the conditions set forth in the Order and that, in any event, the Commission should now find such sharing not in the public interest, thereby amending its original September 2, 1998 Order.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings (Continued)

The Complaint and Petition to Amend the September 2, 1998 Order, in addition to requesting a

prohibition on the sharing of certain employees, particularly Maine Public Service Company's General Counsel, also seeks a formal investigation of the Complaint, penalties for any violations of the Commission's rules and certain specific relief for violations of Chapter 304.

In its response, the Company strongly denied the allegations in the WPS Complaint and asked the Commission to dismiss the Complaint and for Summary Judgment in its favor.

On May 1, 2001, the Commission issued its Order in this matter, finding that some counts in the WPS Complaint should be dismissed but that others raised factual issues that could be resolved only through a more formal hearing process. The Commission declined, however, to take initial jurisdiction over the Complaint. Instead, the Commission ordered the parties to submit their dispute to the informal dispute resolution process set forth in MPS's Chapter 304 Implementation Plan. Under this Plan, the dispute must be submitted to an independent law firm which must issue its decision within 30 days. Only if the matter is not resolved to both parties' satisfaction would the

Commission then take jurisdiction over the dispute. The Commission also stated that it would open

an investigation into the issues of whether MPS's General Counsel's dual role with MPS and EA is inherently problematic and the standards that should govern any MPS employees who also provide services to EA. A schedule for this investigation has not yet been announced.

The parties submitted the dispute to an independent arbitrator who issued his proposed findings on June 29, 2001. The arbitrator found that MPS did not violate any provisions of Chapter 304, except for the Company's unintentional failure to identify WPS as a Standard Offer Service provider on its March and April 2000 bills to customers. The arbitrator recommended that MPS refund to WPS its billing fees for these two months, approximately \$18,000. On July 5, 2001, the Company and WPS informed the Commission of their acceptance of the arbitrator's findings. As a result, the Commission, in its July 13, 2001 Order, stated that it would not be necessary for it to further address the allegations in the WPS complaint, even though it would continue its investigation into the sharing of employee services.

(b) Maine Public Utilities Commission Investigation of Maine Public Service Company's Stranded Cost Revenue Requirement in MPUC Docket No. 01-240.

Reference is made to the Company's 1999 Annual Report in which the Company noted that the MPUC had allowed it to begin an annual recovery of \$12.5 million in stranded investment beginning on March 1, 2000. On May 8, 2001, the MPUC issued a notice of investigation in the above docket for the purpose of determining whether the Company's rates must be changed, effective March 1, 2002, to reflect any changes in its stranded costs. On July 12, 2001, the Company filed its proposal in which it advocated continuing the \$12.5 million annual recovery of stranded costs and also proposed to begin the recovery of deferred amounts associated with the discounted rates it had made available to certain industrial customers. Also at issue in the proceeding is an insurance refund associated with Maine Yankee, of which the Company's share is \$1,005,000. The MPUC Staff is proposing to reduce the Company's stranded cost by this amount, while the Company believes the refund is the property of its shareholders. Currently, the Company reflects the refund as a miscellaneous deferred credit.

Discussions with the MPUC on this matter are underway, but the Company cannot predict the nature or timing of any decision.

(c) Maine Public Utilities Commission, Investigation of Rate Design of Transmission and Distribution Utilities, MPUC Docket No. 01-245.

On May 8, 2001, the MPUC issued a Notice of Investigation into certain common fundamental issues regarding the rates for the State's three major electric utilities - the Company, Central Maine Power Company (CMP) and Bangor Hydro-Electric Company (BHE). These issues have been defined by the MPUC as follows:

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings (Continued)

- (i) The extent to which stranded cost recovery should be shifted from variable kwh and kw charges to a fixed charge;
- (ii) The redefinition of time of use periods for rate design; and
- (iii) The elimination or reduction of seasonal rates.

The Company believes that at least a substantial portion of its stranded costs should be recovered through fixed charges that its customers cannot avoid by reducing or eliminating their usage. Such a fixed charge would reduce the risk of the Company's ability to recover its stranded costs from customers. The Company, together with CMP and BHE, will be filing testimony in support of its position in early January, 2002.

The Company cannot predict the nature or the outcome of any decision in this proceeding.

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

None.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MAINE PUBLIC SERVICE COMPANY

(Registrant)

Date: November 9, 2001

By: /s/ Kurt A. Tornquist

Kurt A. Tornquist

Controller, Assistant Secretary and Assistant Treasurer

