COMMISSION DE RÉGLEMENTATION ET D'APPELS DE L'ÎLE

THE ISLAND REGULATORY AND APPEALS COMMISSION

Prince Edward Island

Île-du-Prince-Édouard

CANADA

Docket UE20934

Order UE06-03

IN THE MATTER of an application by Maritime Electric Company, Limited for approval of proposed amendments to its rates.

BEFORE THE COMMISSION

on Tuesday, the 27th day of June, 2006.

Maurice Rodgerson, Chair

Weston Rose, Commissioner

James Carragher, Commissioner

Anne Petley, Commissioner

Order

Compared and Certified a True Copy

(Sgd) *Donald G. Sutherland*

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Technical and

Regulatory Services Division

IN THE MATTER of an application by Maritime Electric Company, Limited for approval of proposed amendments to its rates.

Contents

IN THE MATTER of an application by Maritime Electric Company, Limited for approval of proposed amendments to its rates.

Reasons for Order

1. Introduction

[1] This is an application under the *Electric Power Act*, R.S.P.E.I. 1988, Cap. E-4 (the "*Act*"), by Maritime Electric Company, Limited (the "Applicant", "Maritime Electric" or the "Company") seeking, among other things, an order or orders of the Island Regulatory and Appeals Commission (the "Commission") approving an increase in the Company's basic rates of 3.35% effective July 1, 2006.

[2] The application in this matter was filed on January 31, 2006 and publicly noticed in the Province's daily newspapers and on the Commission's website. In response to the notice, the Commission received a formal intervention from the Prince Edward Island Power Company Limited ("PEI Power") and also received a comment from a member of the public generally opposing the application and a request from a member of the public to make a presentation. The latter request was granted but a presentation was not forthcoming.

[3] The formal intervention filed by PEI Power concerns itself with an application by Maritime Electric for approval of a wind power purchase agreement with the P.E.I. Energy Corporation and the P.E.I. Government. That application is being dealt with separately by the Commission under docket UE21007. PEI Power has also intervened in that case.

[4] Given that PEI Power's interventions in both cases are virtually identical, the Commission will consider the intervention within the context of docket UE21007.

2. The Application

[5] Maritime Electric seeks an Order or Orders of the Commission:

- confirming Maritime Electric's rate bases for the years ended December 31, 2003- 2005 at $188,526,407, $197, 685,922 and $202,501,831 respectively, for establishment of its projected rate bases at $243,638,600 for the year ended December 31, 2006 and at $258,185,100 for the year ended December 31, 2007;
- setting the return on average rate base for the year ending December 31, 2006 of 8.71% to 8.92% and 8.32% to 8.52% for the year ending December 31, 2007; and
- approving an increase in basic rates of 3.35% for July 1, 2006 together with the general Rules and Regulations which relate to those rates for the period July 1, 2006 to December 31, 2007.

3. Discussion & Findings

3.1 Introduction

[6] The application before the Commission involves an assessment of several issues, including the Company forecast of sales and expenditures as well as other matters directly related to the proposed rate increase. In the discussion that follows, the Commission will review these issues and render its findings.

3.2 Sales Forecast

[7] The sales forecast is critical in determining many of the Company's operating expenses particularly those relating to energy purchases. A sales forecast that underestimates growth can, for example, result in a requirement for rates that is higher than necessary and revenue surplus to the needs of the Company.

[8] Prior to deregulation in 1994, the Company's sales forecast was based on an economic model that used historical sales, customer data, population statistics, provincial economic indicators and other related data. This rate application reintroduces these sales modeling techniques; however only short term sales forecasts are provided. Short term energy sales forecasts are based on a two-year average growth rate calculation and the rate of year-to-date growth over the previous year-to-date growth.

[9] Table 1 shows actual and forecast sales levels, by rate class, from 2004 to 2007.

Table 1

Energy Sales 2005 to 2007

	2004 Actual	**2005 Actual**	**2006 Forecast**	**2007 Forecast**
Energy Sales (MWh)				
Residential	410,672	412,122	414,801	418,949
General Service I	341,517	346,149	350,995	356,085
General Service II	5,003	4,850	4,802	4,807
Large Industrial	145,296	145,514	147,279	149,318
Small Industrial	67,412	73,342	77,119	79,626
Street Lighting/Unmetered	6,865	7,273	7,627	7,825
Total Energy Sales	976,765	989,250	1,002,623	1,016,610
Growth Rate (%)				
Residential	3.4	0.4	0.7	1.0
General Service I	0.5	1.4	1.4	1.4
General Service II	0.5	(3.0)	(1.0)	0.1
Large Industrial	(1.8)	.1	1.2	1.4
Small Industrial	10.4	8.8	5.1	3.2
Street Lighting/Unmetered	3.8	5.9	4.9	2.6
Overall Growth Rate	2.0	1.3	1.4	1.4

[10] To assess the reasonableness of the forecast, the Commission has looked at recent actual-to-forecast results, the modeling approach used and the inputs and assumptions used in the model. Past forecast information was not available to the Commission during the period of deregulation. The 1993 general rate case—the last review of the Company's rates prior to deregulation—concluded that there was a positive trend on the part of the Company's forecasting accuracy.

[11] Table 2 compares the most recent forecast-to-actual results.

Table 2

	2004 Forecast	2004 Actual	Actual to Forecast (%)	2005 Forecast	2005 Actual	Actual to Forecast (%)
Energy Sales (MWh)						
Residential	408,184	410,672	0.61%	418,388	412,122	(1.5%)
General Service I	341,820	341,517	(0.09%)	345,922	346,149	0.07%
General Service II	5,027	5,003	(0.48%)	5,135	4,850	(5.55%)
Large Industrial	147,859	145,296	(1.73%)	149,077	145,514	(2.39%)
Small Industrial	68,969	67,412	(2.26%)	72,590	73,342	1.04%
Street Lighting/Unmetered	6,811	6,865	0.79%	6,924	7,273	5.04%
Total Energy Sales	978,670	976,765	(0.19%)	998,036	989,250	(0.88%)

[12] Historically, forecast results have tended to err on the low side of actual results. In the Commission's view, however, the above shows reasonable accuracy in the Company's recent forecasting techniques and provides the Commission with confidence in the forecasts for 2006 and 2007.

[13] Maritime Electric has filed with the Commission its Demand Side Management Plan, Phase 1 for the period 2006-2010 as required by the *Renewable Energy Act.* This *Act* calls for a 5% reduction, by 2010, in the intensity of peak demand as measured in 2004. The impact of this plan is not expected to impact the revenue forecast contained in this application, but will need consideration in the future.

[14] The Commission finds that the projected growth rate of 1.4% in 2006 and 2007 appears reasonable. Although lower than the forecast general growth in the Canadian economy of 3.1% as reported in April by the Bank of Canada, it is more in line with local P.E.I. economic conditions. The Commission accepts the Company's sales forecast of 1,002,623 mWh for 2006.

3.3 Operating Expenditure Forecast

[15] The operating expenses of Maritime Electric are made up of production, transmission, distribution and administrative costs. Production costs—or costs associated with energy supply—represent the largest component of the Company's expenses and overall revenue requirement. These expenses include energy costs to be procured under pre-negotiated energy purchase contracts as well as expenditures associated with the Company's generation facilities in Charlottetown and Borden. Energy purchases from NB Power fall under three contracts: the Point Lepreau Unit Participation Agreement, the Dalhousie Unit Participation Agreement and an Energy Purchase Agreement. Both unit participation agreements extend for the life of the generating stations while the Energy Purchase Agreement is a short-term supply agreement that expires on October 31, 2006.

[16] A summary of energy supply costs is shown below.

Table 3

Energy Cost by Source 2005 to 2007

Source	2005 Actual	2006 Forecast	2007 Forecast
Point Lepreau	$10,590,075	$11,182,800	$11,204,900
Dalhousie	9,092,354	9,717,700	9,878,700
Firm Energy Purchases	24,104,756	5,465,400	10,492,400
System Energy Purchases	15,014,887	36,421,300	37,865,100
Charlottetown Plant	3,011,124	2,662,900	2,781,500
50 MW Combustine Turbine	-	2,177,500	2,158,500
Borden Plant	219,844	245,600	234,800
Wind	2,162,168	4,876,600	13,946,800
Ancillary Services	988,112	1,123,100	1,142,400
Other Purchases	703,778	3,024,400	3,225,900
Amortization Point Lepreau Writedown	560,000	93,400	93,400
Total	$66,447,098	$76,990,700	$93,024,400

[17] The energy cost per source varies by contract and by the fuel source. While some costs are stable and predictable, many are not.

[18] Energy supply constraints with ever increasing demand for energy are causing rising energy costs throughout the marketplace. The rising price of crude oil is a good example of the affects of supply constraints with increasing consumer demand. This is a concern as it may have an impact on new energy supply contracts that will take effect in the fall of 2006.

[19] Transmission expenses relate to those facilities that make up the Company's bulk energy delivery system, from the submarine cables to the inputs in the Company's distribution system. Distribution expenses cover the day to day operating costs of the Company's distribution system and include expenses such as planned maintenance, breakdown and forced outages and equipment failure. General expenses include internal and external costs associated with the overall operation and management of the Company.

[20] A summary of these expenditures, by major category, follows:

Table 4

Maritime Electric Company Limited
Expenses
2005 to 2007

Description of Expenses	Expenditures 2005 Actual	2006 Forecast	2007 Forecast	% Increase 2006 Forecast	2007 Forecast
General and Administrative	9,668,500	9,952,500	10,227,100	2.94%	2.76%
Transmission	354,259	363,700	374,100	2.66%	2.86%
Distribution	2,512,277	2,584,900	2,684,300	2.89%	3.85%
Total	12,535,036	12,901,100	13,285,500	2.92%	2.98%

[21] Table 4 shows overall cost increases of 2.92% in 2006 and 2.98% in 2007.

[22] Within the context of published economic forecasts for 2006 and 2007, the Company's forecast appears reasonable. The Commission has, as well, spent considerable time reviewing detailed budget data submitted in response to staff interrogatories and has satisfied itself that forecast expenditure levels are reasonable and prudent.

3.4 Rate of Return

[23] The Commission is guided in determining the allowable return on average common equity rates by the *Electric Power Act* which requires that the return be just and reasonable. Considerable jurisprudence in this area clearly directs that the return must be fair to both the consumer and the shareholder.

[24] Maritime Electric maintains that the rate of return must:

- Earn a return on the value of its property commensurate with that of comparable risk enterprises;
- Maintain its financial integrity; and
- Attract capital on reasonable terms.

[25] Maritime Electric is proposing a return on average common equity in the range of 10.0% to 10.5%. The Company states it will continue to strengthen its capital structure by increasing its common equity ratio to 45% from 42.69% in 2006 by the retention of earnings.

[26] A major input factor in the selection of return on common equity rates is business risk. As described in the rate application, business risk comes in the form of :

- The marketplace under which the utility operates;
- The nature of the utilities operations and energy supply;
- The regulatory risk faced by the utility; and
- The forecasting risk.

[27] The Company concludes that it is a higher risk utility than the other two investor-owned Atlantic Province electric utilities, Newfoundland Power and Nova Scotia Power. The Company provided the following actual return information for both investor-owned electric utilities:

Table 5

Earned Returns 2002 to 2004(%)

Year	Newfoundland Power	Nova Scotia Power
2002	10.7%	9.8%
2003	10.2%	10.4%
2004	10.3%	10.0%
2005	9.24%	9.8%
Average	10.11%	10.0%

[28] The Commission has reviewed the Company's submissions on this matter and agrees that the Company operates with a higher degree of business risk than other investor owned utilities in Atlantic Canada. This is due, in part, to the relative small size of the Company. In our view, this risk is, however, mitigated somewhat through the operation of the Energy Cost Adjustment Mechanism, which is discussed in more detail below.

[29] The Commission finds that a rate of return on average common equity of 10.25% is just and reasonable. This is viewed by the Commission as an upper limit or the maximum allowable return.

3.5 Deferred Costs Recoverable from Customers

[30] Section 47 of the *Electric Power Act* reads, in part, as follows:

> *47. (1) On and after January 1, 2004, Maritime Electric Company, Limited shall provide service in the province at the rates, tolls and charges, and on the terms and conditions of service, that were established and in effect under the former Act and the former regulations immediately before January 1, 2004 until such time as those rates, tolls and charges, and those terms and conditions of service, are altered or modified under this Act. 2003,c.3,s.23.*
>
> Annual report
>
> *(2) Prior to March 1, 2004, Maritime Electric Company, Limited shall provide an annual report to the Commission for the calendar year beginning January 1, 2003 that complies with the requirements of section 15. 2003,c.3,s.23.*
>
> Submission of proposed rates, tolls and charges
>
> *(3) Prior to May 1, 2004, Maritime Electric Company, Limited shall make a submission to the Commission under section 20 for the review and approval of its rates, tolls and charges. 2003,c.3,s.23.*
>
> Recovery of deferred costs, interest and unamortized expenses
>
> *(4) When approving or determining and fixing the rates, tolls and charges of Maritime Electric Company, Limited pursuant to a submission made under section 20 in accordance with subsection (3), or in accordance with any later application made in accordance with section 20, the Commission shall allow Maritime Electric Company, Limited*
>
> *(a) to recover, over such period of time and on such terms and conditions as the Commission considers just and reasonable,*
>
> *(i) the deferred costs that Maritime Electric Company, Limited would have been able to recover under the former Act and the former regulations,*
>
> *(ii) the unamortized portion of any deferred cost incurred before January 1, 2004 by Maritime Electric Company, Limited in respect of any power purchase agreement, and*
>
> *(iii) a reasonable return on the unrecovered deferred costs referred to in subclauses (i) and (ii); and*
>
> *(b) to recover, as an annual expense, the amounts payable by Maritime Electric Company, Limited pursuant to any power purchase agreement Maritime Electric Company, Limited has entered into before January 1, 2004 that continues in force on and after that date. 2003,c.3,s.23.*

[31] Commission Order UE05-01 approved the recovery of deferred costs in the amount of $1,500,000 in 2004 and $2,500,000 in 2005. This leaves $16,783,600 yet to be recovered from rates. Maritime Electric is requesting that a further $1,500,000 be recovered in 2006 and $1,300,000 in 2007. These are the amounts included in the proposed rates.

[32] Although the Commission has not, to date, defined the time period over which the remainder of the deferred account must be amortized or recovered through rates, the Commission believes that it is time to do so. We will, however, give the Company an opportunity to make a submission before doing

so. The Commission will order the filing of such a submission before the end of 2006. The proposed amount for 2006 will, however, be allowed. A decision on the 2007 amount will be deferred pending the filing of the above submission.

3.6 Proposed Rates

[33] A summary of current and proposed basic rates is summarized in Table 6.

Table 6

Basic Rates	Present Rates	Proposed Rates July 1, 2006
Residential Service Rate Schedule		
Residential Urban	$21.55	$22.27
Residential Rural	$23.60	$24.39
Residential Energy Charge for first 1200kWh/billing period	$0.1033/kWh	$0.1068/kWh
General Service Rate Schedule		
General Service 1	$21.55	$22.27
General Service Energy Charge		
Demand Charge (first 20kW no charge)	$11.78/kW	$12.17/kW
Energy Charge – first 5000kWh	$0.1291/kWh	$0.1334/kWh
Energy Charge – balance of kWh	$0.0813/kWh	$0.0840/kWh

[34] Maritime Electric states that the proposed 3.35% basic rate increase will be largely offset on July 1, 2006 due to the effects of the Energy Cost Adjustment Mechanism ("ECAM"). The Company states that the overall impact on a Rural Residential customer on July 1, 2006 using 650kWh per month (including GST) is a total increase of 1.6%. The following table illustrates the proposed rate increase for the average rural residential customer.

Table 7

Rural Residential Billing Comparison **Base charge and Energy charge**	July 1, 2005	July 1, 2006	July 1, 2007	Dec.31/07
Basic Service Charge	$23.60	$24.39	$24.39	$24.39
Energy charge (650KWh)	67.15	69.42	69.42	69.42
Subtotal	90.75	93.81	93.81	93.81
GST(7% & 6%)	6.35	5.63	5.63	5.63
Total	97.10	99.44	99.44	99.44
Base service charge and energy rate increase	3.35%		0.00%	

[35] In 2004, the Company applied for, and received Commission approval of, the present ECAM. The ECAM provides a mechanism that automatically adjusts monthly billings to customers to reflect changes in defined energy related costs.

[36] Without a mechanism to adjust for variations in energy supply costs, the Company's earnings would, in theory, fluctuate beyond reasonable ranges, resulting in the need for frequent Commission hearings. Maritime Electric

maintains that the ECAM, in its present form, provides stability to the Company resulting in reduced basic rates. For example, an increase or decrease in energy costs of $2,000,000—or approximately 3%—would see a variation of approximately 15% in the Company earnings. According to the Company, debt holders and shareholders would demand higher returns to offset this volatility. Maritime Electric maintains that the stability associated with this adjustment mechanism eliminates the need for frequent and costly rate hearings.

[37] Commission Order UE05-05, dated March 16, 2005, approved the interim and transitional ECAM currently in effect. Order UE05-06, dated June 24, 2005, ordered the replacement of the current ECAM with one containing fewer accounts. The transition to a new ECAM was to take effect on July 1, 2006.

[38] During 2004 and 2005, the ECAM was the subject of an independent study carried by consultant John Murphy. The Murphy study recommended a number of changes to the ECAM which were commented upon by the Company. In summary, Murphy recommended:

(1) That certain expense classifications that should be excluded from the ECAM; and
(2) that volume level changes in total purchased power should be excluded from the ECAM.

[39] Maritime Electric now requests that the Commission delay any changes to the ECAM pending receipt and review:

(1) of a depreciation study and cost allocation study ordered by the Commission, by Order UE06-02, to be filed in the summer-fall of 2006;
(2) of new energy supply agreements; and
(3) of the refurbishment costs associated with the Point Lepreau nuclear generating station.

[40] The Commission agrees with Maritime Electric that the pending studies will have implications on the ECAM. As a result, the Commission will, for now, order the continuation of the interim and transitional ECAM currently in effect.

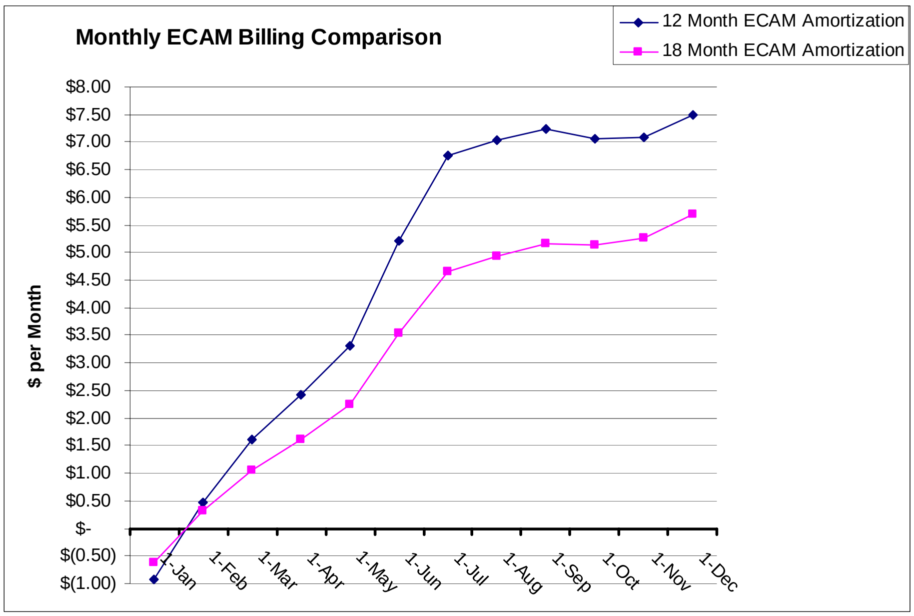
[41] The Commission has reviewed the forecasted impact the monthly ECAM charges will have on consumer electricity charges for 2006 and 2007. Currently, customers are enjoying the benefits of an ECAM adjustment that reduces monthly customer bills. The main reason for this lies in the present energy supply contracts negotiated several years ago when energy was less expensive and denominated in US dollars. The appreciating Canadian dollar has assisted in reducing the costs of purchased energy.

[42] It is unlikely that Maritime Electric will, in future, be immune from rising energy costs experienced by all jurisdictions. New energy supply contracts will

no doubt be more expensive than current agreements and will be based on a higher valued Canadian dollar.

[43] The Commission is concerned about the impact of rising ECAM adjustments and the rising balance of the ECAM account due to the 18 month amortization of energy costs. Deferring energy costs to a future period when costs are rising will place further burden on customers. The Commission is of the view that utility energy costs should be recovered within the year the energy is used. As an alternative, the Commission has considered an ongoing 12 month amortization period. This results in a higher recovery of ECAM charges as shown by the following figure which compares amortizations periods of 18 months and 12 months, commencing in January of 2007. The figure depicts the change in the bill of a residential customer who consumes 650 kWh per month.

Figure 1



[44] The ECAM balance to be recovered from customers using the currently authorized 18 month amortization period spreads the ECAM recovery over a longer period of time. The Company is owed this money and it appears as an account receivable on year-end financial statements. A 12 month amortization period, commencing on January 1, 2007, would recover these energy charges from customers faster and the Company is owed less money at year end. The following table shows the comparison.

Table 8

Unrecovered post 2003 costs recoverable	Actual 2004	Actual 2005	Forecast 2006	Forecast 2007
18 month amortization	$2,725,400	($3,343,488)	$1,675,800	$14,832,200
12 month amortization	n/a	n/a	$1,675,800	$12,305,781

[45] Thus, an additional $2,526,419 would be collected from customers with the 12 month amortization period. The impact to customer monthly billing for the average residential customer using 650kWh of electricity monthly is shown on Table 9.

Table 9

Residential Billing Comparison Forecast ECAM adjustment	July 1, 2005	July 1, 2006	July 1, 2007	Dec.31, 2007
Forecast monthly ECAM adjustment (650kWh)	0.98	-2.51	5.21	7.50
GST(7% & 6%)	0.07	-0.15	0.31	0.45
ECAM adjustment plus GST	1.05	-2.66	5.52	7.95

[46] The Commission finds that a 12-month amortization period better represents the true costs to the consumer. The Commission will order an amendment to the ECAM to reflect the implementation of 12-month amortization period effective in January, 2007.

4. Disposition

[47] An order will therefore issue implementing the findings and conclusions contained in these reasons.

IN THE MATTER of an application by Maritime Electric Company, Limited for approval of proposed amendments to its rates.

Order

UPON receiving an application by Maritime Electric Company, Limited (the "Company") for approval of proposed amendments to its rates;

AND UPON considering the application as well as the evidence of the Company and responses to staff interrogatories;

NOW THEREFORE, for the reasons given in the annexed Reasons for Order;

IT IS ORDERED THAT

1. the requested increase in basic rates and charges is approved in accordance with Appendix 1 contained in the application for effect with meter readings taken on and after July 1, 2006;
2. the current interim and transitional Energy Cost Adjustment Mechanism ("ECAM") shall continue in effect pending receipt and review of certain studies and filings described in the within Reasons for Order;
3. the amortization period of 18 months contained in the ECAM shall be changed to 12 months, effective January 1, 2007;
4. the maximum allowed return on average common equity is set at 10.25 percent;
5. the Company shall continue the amortization of the December 31, 2003 deferred costs recoverable from customers in the amount of $1,500,000 in 2006 with the balance to be recovered over such time and in such annual amounts as the Commission will further order; and

6. the Company shall prepare a report setting out options for the full recovery of the remaining deferred costs in equal annual amounts with the said report to be filed with the Commission by December 31, 2006.

DATED at Charlottetown, Prince Edward Island, this 27th day of June, 2006.

BY THE COMMISSION:

(Sgd) *Maurice Rodgerson*

Maurice Rodgerson, Chair

(Sgd) *Weston Rose*

Weston Rose, Commissioner

(Sgd) *James Carragher*

James Carragher, Commissioner

(Sgd) *Anne Petley*

Anne Petley, Commissioner

NOTICE

Section 12 of the *Island Regulatory and Appeals Commission Act* reads as follows:

> *12. The Commission may, in its absolute discretion, review, rescind or vary any order or decision made by it or rehear any application before deciding it.*

Parties to this proceeding seeking a review of the Commission's decision or order in this matter may do so by filing with the Commission, at the earliest date, a written Request for Review, which clearly states the reasons for the review and the nature of the relief sought.

Sections 13.(1) and 13(2) of the *Act* provide as follows:

> *13.(1) An appeal lies from a decision or order of the Commission to the Appeal Division of the Supreme Court upon a question of law or jurisdiction.*
>
> *(2) The appeal shall be made by filing a notice of appeal in the Supreme Court within twenty days after the decision or order appealed from and the Civil Procedure Rules respecting appeals apply with the necessary changes.*

IRAC140A(04/07)