



**THE ISLAND REGULATORY AND
APPEALS COMMISSION**
Prince Edward Island
Île-du-Prince-Édouard
CANADA

Docket UE20938
Order UE09-02

IN THE MATTER of an
application by Maritime Electric Company,
Limited for approval of amendments to rates,
tolls and charges.

**BEFORE THE
COMMISSION**

on Thursday, the 5th day of March, 2009.

Maurice Rodgerson, Chair
John Broderick, Commissioner
Anne Petley, Commissioner
Ernest Arsenault, Commissioner

Order

Compared and Certified a True Copy

(Sgd) *Mark Lanigan*

Technical and Regulatory Services

IN THE MATTER of an
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 Limited for approval of amendments to rates,
 tolls and charges.

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Appearances & Witnesses

1. **For Maritime Electric Company, Limited**
Counsel:
Spencer Campbell
Thomas Laughlin

Witnesses:
Fred J. O'Brien, President & Chief Executive Officer
John D. Gaudet, Vice President, Corporate Planning & Energy Supply
J. William Geldert, Vice President, Finance & Administration, Chief
Financial Officer & Corporate Secretary
Steven D. Loggie, Vice President, Customer Service
2. **For the Minister of Environment, Energy & Forestry, Government of Prince
Edward Island**
Counsel:
J. Gordon MacKay
3. **Interveners**
Jamie Fox, Gateway Petroleum
Alexander (Sandy) MacKay
John teRaa
4. **Public Participants**
Eric Hammill and Preston MacLeod, PEI Senior Citizens Federation Inc.
Matthew McCarville, Energy Coalition of Prince Edward Island
5. **For The Island Regulatory and Appeals Commission**
Counsel:
Thomas A. Matheson, Q.C.

Witness (on behalf of Commission staff):
Terry MacDonald, KnAP Energy Consultants

Staff:
J. Mark Lanigan, Senior Analyst, Technical & Regulatory Services
Heather Walker, Recording Secretary

IN THE MATTER of an
application by Maritime Electric Company,
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tolls and charges.

Reasons for Order

1. Introduction & Background

[1] This is an application under the *Electric Power Act*, R.S.P.E.I. 1988, Cap. E-4, 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 amendments to the rates, tolls and charges for electric service for the period beginning April 1, 2009, and certain approvals incidental to such an Order.

[2] The Application was filed pursuant to Section 20(1) of the *Electric Power Act* (the “*Act*”) which reads as follows:

Variation of
rates,
submission for
review and
approval

20. (1) Whenever any public utility wishes to vary any existing rates, tolls or charges, or to establish any new rates, tolls or charges for any service, it shall submit for the review and approval of the Commission a schedule of such proposed rates, tolls and charges together with and appended thereto all rules and regulations which, in any manner, relate to the rates, tolls and charges; the Commission may approve, after reviewing the schedule and rules and regulations submitted, the schedule of rates, tolls and charges and the rules and regulations either in whole or in part, or may determine and fix new rates, tolls and charges, and amend the rules and regulations as it sees fit. 2003,c.3.s.10.

[3] This application seeks to rebase the Energy Cost Adjustment Mechanism (the “ECAM”) which will have the result of increasing monthly customer billings and reducing the monthly energy costs deferred through the operation of the ECAM formula. The Company’s most recent forecast of rural residential annual electricity bills (basic charge and energy costs) indicates that the 2009 average annual rural residential bill will increase by 5.34% over 2008 costs.

[4] The application was received on October 2, 2008 and the notice of application was published in local newspapers in mid-October, 2008. Comments from the general public were to be submitted to the Commission by November 28, 2008. The Commission received a number of letters and telephone calls concerning this application. Approximately 23 letters and emails were received within the time frame allowed, and subsequent emails and telephone calls from customers expressing concern over their rising electric bills continued to be submitted.

[5] Following the significant public interest in this application, in December, 2008, the Commission published a notice in local newspapers inviting parties to participate in a public hearing. Anyone interested in participating as an intervener in the matter was advised to file a Notice of Intervention stating their reason for intervention and inviting interveners to present their evidence. Four (4) parties registered as interveners in this application:

- Government of PEI, as represented by the Minister of Environment, Energy and Forestry
- Mr. Jamie Fox, Gateway Petroleum
- Mr. Alexander (Sandy) MacKay, Private Citizen
- Mr. John teRaa, Private Citizen

[6] The public hearing was held on January 21 and 22, 2009 in the Commission’s main hearing room. The hearing participants included Mr. Spencer Campbell and Mr. Thomas Laughlin, legal counsel for Maritime Electric, Mr. Gordon MacKay, legal counsel for the Government of PEI, Gateway Petroleum, represented by Mr. Jamie Fox, Mr. Alexander (Sandy) MacKay, representing himself, and Mr. John teRaa, representing himself. In addition, two groups – PEI Senior Citizens Federation, as represented by Mr. Eric Hammill and Mr. Preston MacLeod; and ECOPEI, represented by Mr. Matthew McCarville – requested and received permission to speak at the hearing. Mr. Hammill presented a written submission stating the concerns of seniors and the inability of people living on a fixed income to pay escalating electricity rates. Mr. McCarville did not present written evidence but spoke to the Commission Panel outlining his concerns. There were members of the media in attendance, however, few, if any, additional members of the public attended the proceedings.

2. The Application

[7] Pursuant to Commission Order UE08-01, Maritime Electric filed this ECAM rebasing application. The proposed ECAM rebasing calls for an increase in the basic ECAM energy rate as follows:

	Current	April 1 2009	April 1, 2010	April 1, 2011	April 1, 2012
ECAM Base Rate per kWh(\$)	0.0673	0.0770	0.0900	0.1000	0.1100

The initial application indicates that the proposed ECAM rebasing and base energy rate of \$0.0770/kWh—which is currently \$0.0673/kWh as set in 2005—is based on an ECAM monthly amortization rate of 12 months. This results in an outstanding balance recoverable from customers of approximately \$48 million with an average annual increase for residential customers of 7.46% over 2008 annual costs. The application also requests deferral of the replacement energy procured as a result of the Point LePreau refurbishment project, which was calculated to be \$14 million. Maritime Electric proposes to recover these costs over 10 years through the ECAM formula.

- [8] In addition, the application seeks Commission approval of the following:
- a) a return to a 12-month ECAM amortization recovery period contained in the ECAM formula from the current 8-month period;
 - b) a refiling of an ECAM rebasing report by November 15, 2010;
 - c) acceptance of the Company's revenue requirement of \$132,642,300 for 2008 and \$143,747,100 for 2009;
 - d) confirmation of Commission Order UE06-08 regarding the recovery of pre-2004 costs recoverable from customers; and
 - e) a requested return on average common equity of 9.75% in 2009.

3. Discussion

[9] The hearing provided the opportunity for the interveners to present their evidence at the beginning of the deliberations. In advance of the hearing, all parties were provided copies of the application, Commission and Government interrogatories with Maritime Electric's responses, and copies of public comments with Maritime Electric's responses.

[10] Intervener John teRaa presented written evidence which focused on rate design issues for various customer classes and the potential unfairness or subsidization of one rate class by another. Also, he discussed the ECAM result of delaying rate increases which in his view is causing customers to make space heating decisions towards electric sourced heat that could have a potential negative effect on the efficiency of the overall electric system.

[11] Mr. teRaa states that the current rate structure penalizes low consumption customers as the basic service charge is the same regardless of consumption. Mr. teRaa believes that higher consumption customers should pay either a higher service charge and/or a higher price for the extra consumption due to the impact this consumption has on system load.

[12] As well, Mr. teRaa raised the issue of rate fairness between customer rate classes and focused on the results of a 2006 Cost of Service Study prepared for Maritime Electric which reviewed rates and the allocation of costs to support the current rate structure. That study indicated the large industrial and residential rate classes have been subsidized relative to the other rate classes.

[13] Mr. teRaa indicated that the Commission should take a critical view of the assertions by the Government of PEI and ECOPEI regarding electricity being the most environmental friendly method to heat homes. Although there is some wind generation providing energy to the grid, he notes the majority of energy is supplied by coal-fired generation.

[14] Mr. teRaa would also like to see more information provided on customers' monthly bills. For instance, he feels the monthly customer billings should disclose the ECAM portion of the energy used that month which will be billed the following month. He believes this would provide customers with information on the true cost of the energy being consumed and this information would be valuable for customers planning electrical usage into the future.

[15] Finally, Mr. teRaa offered suggestions regarding a reduction of peak intensity, which Maritime Electric must achieve as part of the requirements under the *Renewable Energy Act*. Mr. teRaa suggests that the elimination of electric space heat for the approximately 2,300 homes currently relying on electric space heating or electrically-driven geothermal heat pumps would reduce the peak by 10%. The *Renewable Energy Act* calls for a 5% reduction in the intensity of peak demand by 2010.

[16] Intervener Jamie Fox, representing Gateway Petroleum, expressed concern over the impact electric rates are having on the small business sector on Prince Edward Island. Mr. Fox noted that consumers have no choice in electric utility suppliers as Maritime Electric has a monopoly, and electricity is a necessity for small business and residential home owners. Mr. Fox expressed frustration that, as a small business owner, he must absorb these costs and can't simply pass them on to customers as his business operates within regulated margin limits. He believes Maritime Electric should bear some of the costs of rising electric rates themselves.

[17] Intervener Alexander (Sandy) MacKay expressed concern about consumers' ability to pay the increased energy charges, and stated that the proposed increases are above normal inflationary increases. In addition, Mr. MacKay expressed concern over the requested rate of return of 9.75% indicating that this is also above inflation.

[18] Intervener Government of Prince Edward Island, as represented by legal counsel for the Minister of Environment, Energy and Forestry, Mr. Gordon MacKay, did not present any additional evidence during the hearing. The Minister asked questions of Maritime Electric during the interrogatory stage of the application process.

[19] The Commission acknowledges and thanks all of the participants for their contributions.

4. Findings

Upon completion of the intervener testimony, Maritime Electric provided testimony from Company President, Mr. Fred O'Brien and a Panel of members of Senior Management, Mr. William Geldert, Mr. John Gaudet and Mr. Steve Loggie, in support of the written evidence filed as part of the application. Upon completion of the public hearing and a review of the evidence and closing submissions of the parties, the Commission made the following determinations.

4.1 Point LePreau Replacement Energy

[20] Subsequent to the initial application, Maritime Electric revised its forecast of replacement energy costs associated with the refurbishment of Point LePreau to \$19.3 million for the period January 2009 to September 2009. Maritime Electric estimates non deferral of these costs from ECAM recovery would have the effect of a further increase of 5.5% in the 2009 annual cost to the average residential household. The Company has a 4.72% participation agreement with NB Power Nuclear which entitles the Company to this portion of energy output

from the facility. During the refurbishment outage, Maritime Electric must pay the monthly fixed overhead costs of the facility as per the participation agreement, and also must buy replacement energy under market-based energy purchase contracts with NB Power Generation. Maritime Electric is proposing recovery of these costs from customers when the unit returns to service at which time it is proposed these costs will be recovered through rates over a 10 year period.

[21] The Commission heard from Mr. teRaa that deferring recovery of replacement energy costs is not the appropriate approach. This sends false price signals to consumers about the real cost of energy, and consumers may be making energy decisions without understanding the full cost implications.

[22] The Province of PEI stated, in its closing submission, that in normal circumstances the deferral of current or previous energy costs with recovery over an extended future period of time should not be considered normal practice. Further, if the Commission were to approve this request, it should be considered an exceptional circumstance as it is a one time only event. Given the economic climate, the Province reluctantly agrees with the amortization of these costs over an extended future period, but feels that the amortization should not exceed 10 years.

[23] The Commission was informed during the hearing that NB Power has not made any decisions regarding the recovery of replacement energy costs from customers through rates.

[24] The Commission understands that in selecting a 10-year amortization period for the recovery of Point LePreau replacement energy, Maritime Electric is attempting to balance the additional rate burden of a shorter recovery period with the Company's operating requirements to recover these costs in a timely manner.

[25] At present, the refurbishment of Point LePreau is not complete and there are indications that delays in the project may occur. Any delay in the project will increase replacement energy costs. The Commission accepts Maritime Electric's concerns regarding customer impact of a shorter recovery period. Although concerned about adding more costs to a deferral account that will have future rate impacts, the Commission understands concerns relating to customer rate burden. In addition, the Commission agrees with the concept of deferring replacement energy costs relating to the Point LePreau project. The Commission needs further information and feedback from Maritime Electric and its customers regarding the recovery period of these costs.

[26] The Commission takes the position the refurbishment of Point LePreau is a unique situation and precedent exists for replacement energy costs to be amortized over an extended period. Therefore, the Commission will order the

deferral of replacement energy costs for Point LePreau effective January 1, 2009 and continuing until such time as the LePreau unit returns to production. Maritime Electric is ordered to consult with NB Power regarding its plans to recover replacement energy costs and to file with the Commission further information regarding the appropriate method to recover such costs (ECAM or non-ECAM) and the time period over which such costs should be recovered.

4.2 ECAM Rebasing and Amortization Period

[27] The Company has filed this application pursuant to Commission direction contained in UE08-01 which requested an ECAM rebasing application. The Commission is concerned about the rising level of ECAM account deferral and the implications on rates and customer behaviour. The Commission approved the ECAM approach to energy pricing in 2005. The ECAM was viewed as an efficient and effective approach to setting energy rates. Consumers would not be subject to dramatic monthly fluctuations in energy costs and the Company and consumers would avoid the cost of expensive regulatory hearings. The ECAM was established during a period of relatively stable electricity wholesale pricing.

[28] Maritime Electric procures energy from NB Power Generation by Energy Purchase Agreements (the "EPA"). Beginning in 2005, and unlike previous agreements which were cost-based, these agreements were market-based using ISO-New England commodity prices as a basis for the prices charged by NB Generation Company. Essentially, NB Power Generation has the opportunity to sell electricity into the New England market and, therefore, Maritime Electric must pay a similar price in order to ensure electricity supply for Prince Edward Island.

[29] The ECAM formula originally contained an 18-month amortization period, which means that the monthly real cost of electricity is collected over this 18-month period. ECAM had the effect of smoothing electricity rates to consumers when commodity market electric prices fluctuated temporarily. Since the fall of 2007, electricity commodity market prices have trended very high due to a variety of factors such as increased oil and natural gas prices, reduced generation capabilities (e.g. Point LePreau refurbishment), and ever-increasing electricity demand in the New England market. The ECAM formula, with an 18-month amortization, did not increase rates to consumers in a

responsive time frame with significant build up of deferred energy costs. Taking this into consideration, the Commission reduced the amortization period to 12 months and then 8 months. However, the commodity price of electricity continued to escalate leaving Maritime Electric with a continued large deferred energy account of \$33 million at the end of 2008. Consumers' bills are now showing the effects of rising energy prices which began in 2007. These will continue as the ECAM formula adjusts rates to reflect the current electric commodity prices. The following table shows the average residential energy costs for a typical month of consumption (defined at 650 kWh usage):

Average Residential Household (650 kWh)	Annual Cost 2007	Annual Cost 2008	Estimated Annual Cost 2009*
Service Charge	\$292.68	\$296.64	\$316.77
Base Energy Rate	\$833.04	\$844.16	\$901.10
ECAM Energy Rate	\$41.15	\$251.88	\$249.02
Total (EX TAX)	\$1,166.87	\$1,392.67	\$1,466.88
Annual % Change	9.9%	19.35%	5.33%

*The estimated 2009 cost assumes deferral of the Point LePreau replacement energy and amortization recovery over 10 years beginning in October 2009. In addition, it assumes a 12 month ECAM amortization formula period.

[30] The Commission heard from Mr. teRaa who testified that the delay in electricity price increases caused by the ECAM is harmful in that consumers are making decisions to switch to electric space heating which is not environmentally friendly and not cost effective. Mr. teRaa believes that it leads to an inefficient utility system load and ultimately results in higher costs to all customers. Mr. teRaa suggested removal of the ECAM and an immediate dramatic price increase as he feels this is the true cost of electricity and customers should be informed. At the least, Mr. teRaa suggests that the monthly electric billings should inform the customer of both the current month's bill and the cost in subsequent months for the unbilled ECAM charge that is to come. Mr. teRaa states this would provide valuable information to consumers of the actual monthly electricity costs and could influence electricity consumers' behaviour.

[31] The Commission heard from the Province of PEI which expressed concerns to the Commission over an 18-month ECAM amortization period and the inability of the ECAM to react to record-high energy prices. The Province believes the current ECAM debt should be paid off as quickly as possible and should not be repeated. The Province suggested setting minimum and maximum ECAM thresholds that would trigger ECAM base rate adjustments and minimize the "downloading" of current electricity costs onto future ratepayers. The Province would like Maritime Electric to provide more information on the monthly customer bills regarding true energy costs.

[32] The Commission's decision regarding the rebasing of ECAM essentially involves the degree which rates should be increased in a reasonable manner both to the consumer and Maritime Electric. Maritime Electric has applied for a rebasing which results in a 5.33% annual cost increase in 2009 over 2008, based upon a 12-month ECAM amortization period. This would leave a further \$55 million to be recovered from customers, which will result in additional rate increases. The Commission received feedback from several interveners indicating that delaying price increases by extending the ECAM amortization period does not benefit the consumer and potentially causes them to make erroneous energy decisions. In addition, The Commission received submissions that rates were too high and were a hardship on seniors, small business and residential consumers.

[33] The Commission was informed by Maritime Electric that a shorter ECAM amortization period such as the present 8-month amortization period would result in a net annual residential increase of 9.45% for 2009 as opposed to the requested 5.34%. The 8-month amortization will collect an additional \$60.19 per household in 2009 and an additional \$7.8 million in energy costs overall, and results in \$47.2 million remaining in the ECAM deferral account at the end of 2009. The Commission accepts the comments by some interveners that longer delays in the collection of past energy costs is not in the best interests of consumers or Maritime Electric.

[34] The Commission's decision regarding amortization periods is ultimately a balance between the interests of Maritime Electric and its consumers. The return to a 12-month amortization period further delays the recovery of electricity costs even though it results in a 5.34% residential increase in 2009 over 2008. With a 12-month amortization, consumers will still owe \$55 million for electricity already used. Combine this with the Point Lepreau replacement energy costs of at least \$19 million and the pre-2004 energy costs recoverable of \$10 million, and the forecasted total amount owed by consumers at the end of 2009 for previously-used electricity is \$84 million. This is a significant liability which at some point must be repaid.

[35] Maritime Electric has requested that an updated report on ECAM rebasing be filed by November 15, 2010. The Commission orders this report be filed by December 15, 2009. The Commission requires that the report incorporate a return to the 8-month amortization period, and a projection of 2010 electricity price increases.

[36] In the interests of reducing the rate impact on customers, the Commission accepts Maritime Electric's request to return to a 12-month ECAM amortization period beginning April 1, 2009. However, beginning in 2010, the Commission expects the utility to return to an 8-month amortization period and to file an updated ECAM report by December 15, 2009. The Commission heard testimony from members of the public concerning both the impact of higher electricity costs on rate payers and the distorted price signal caused by deferred energy costs through the Energy Cost Adjustment Mechanism. These competing interests represent a challenge for Maritime Electric and the Commission. Efforts to lessen the impact—or rate shock—for customers are commendable, but they must also be balanced with an understanding that the costs have been incurred and must be recovered.

[37] In an effort to enhance public understanding, the Commission believes it would be ignoring its responsibility if it did not highlight the fact that, while electricity costs have increased, substantial costs are also being deferred through the Energy Cost Adjustment Mechanism. If nothing else, the consuming public should take from this Order the warning that deferred costs represent expenditures already made to purchase energy already consumed. Those costs must be paid and that objective can only be achieved by charging those costs to the customers.

[38] For a jurisdiction our size, the figures are substantial. For example, in the month of January 2009, Maritime Electric paid \$11.8 million for purchased energy, however, \$4.5 million of those energy costs (38%) were deferred through the Energy Cost Adjustment Mechanism. That means it cost the company \$4.5 million more to purchase the energy Islanders consumed in that one month than was recovered through bills to customers for that month. Through the operation of the ECAM, that \$4.5 million will be recovered over the next 12-month period thereby impacting every bill for the next year. Already more than \$33 million in deferred costs are booked to be recovered through the ECAM.

[39] While accepting Maritime Electric's desire to balance actual energy costs with the challenges represented by significant increases in customer bills, consumers of electricity must be aware they cannot avoid responsibility for the full cost of energy used.

4.3 Power Purchase Agreements

[40] In assessing the reasonableness and fairness of the energy costs charged to customers, the Commission engaged the services of KnAP Energy Consultants and principal consultant, Mr. Terry MacDonald, P.Eng. (the

“Consultant”). Mr. MacDonald was engaged to review the Energy Purchase Agreement process undertaken by Maritime Electric for reasonableness and appropriateness, given the electricity commodity market in which Maritime Electric must participate. The Commission learned that Maritime Electric solicited energy supply from 12 potential suppliers. Three suppliers responded with NB Power Generation ultimately being decided as the least-cost supplier. The other two suppliers either had significant shortcomings in their offerings or were not cost competitive. Mr. MacDonald advised that Maritime Electric has three options for electricity supply:

Options:	Mr. MacDonald's Comments:
Self-Generation	Cost would be prohibitive
Spot Market Purchases	Market and supply risk too high for essential service
Contract for Supply Market Rates	Most reasonable approach

[41] The Consultant advised the Commission that the NB Power Generation contract supply options provided the best pricing based upon the risk level accepted by Maritime Electric. This risk assessment appeared reasonable to the Consultant. The Consultant compared the pricing obtained by Maritime Electric with the prices as observed in the Maine market (Maine Standard Offer Rates) and the Independent System Operator (ISO)-New England commodity prices. The Consultant concluded that Maritime Electric received prices which are comparable to the competitive prices of the New England energy pool market. The Consultant also reviewed Maritime Electric's decision to lock in prices for electricity in October 2008. After reviewing the market information available in October 2008, the Consultant concluded that this decision was reasonable given the circumstances at the time.

[42] During the hearing, the Consultant informed the Commission that other Canadian jurisdictions which export electricity are under no obligation to sell electricity to Prince Edward Island at prices below market rates. The Commission frequently hears complaints from customers who compare Prince Edward Island electricity rates to the rest of Canada. For instance, NB Power rates are significantly below Maritime Electric rates even though NB Power Generation supplies 85% of Maritime Electric's energy requirements. NB Power domestic rates are not market-based and, therefore, not comparable to Prince Edward Island rates. The Commission also notes that Prince Edward Island electric rates are unique in Canada as they are market-based and the market prices are established in markets outside of Canada. Most other jurisdictions in Canada have hybrid/market-cost based rates, and these jurisdictions have natural resources such as hydro or coal as generation sources which help reduce energy costs.

[43] The Commission accepts the evidence of Mr. MacDonald that Maritime Electric followed the most appropriate course in obtaining energy supply from off-Island sources, and obtained the best deal available from the supply offers received.

4.4 Revenue Requirement

[44] The rates of a public utility are designed to generate, in a fiscal year, what is known as the revenue requirement. The revenue requirement is the sum of all operating expenses, amortization or depreciation of capital assets, interest on debt, income tax and return on equity. Under traditional rate regulation, the revenue requirement approval is required to establish customer rates.

[45] With the establishment and approval of the ECAM approach to rate setting, the energy cost component of the revenue requirement is essentially established each month as the energy rates are set based on actual costs incurred by the company, plus or minus the net ECAM adjustment.

[46] The remaining costs comprising the revenue requirement are assessed by the Commission for reasonableness. The *Electric Power Act* provides guidance to the Commission in Section 21(3) which reads:

Rate base, determination and fixing for each utility	21. (1) The Commission may . . . (3) (a) include all or any of (i) an allowance for necessary working capital, and (ii) any other fair and reasonable expenditure which the Commission thinks proper and basic to the public utility's operation;
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[47] Expenditures of Maritime Electric are reviewed monthly with the Company's filing of monthly financial statements and rate schedules. In addition, the rate application includes details of annual expenditure plans. The Commission has considered these estimates of expenditures which consist of analysis of past expenditures and inquiries into proposed plans for future expenditures. In addition, the public hearing provided an opportunity for further public input into the reasonableness of expenditures.

[48] During the public hearing, Commission counsel asked several questions concerning the nature of general and administrative transactions with Fortis Inc., identified as part of Maritime Electric's response to Government of PEI interrogatory 4.a.(ii). Subsequent to the hearing, Maritime Electric provided additional detail concerning the nature of these transactions.

[49] Maritime Electric informed the Commission that Fortis subsidiaries pay a proportionate share of the Fortis general and administrative costs. The proportionate share is determined based on the asset value each subsidiary contributes to the overall asset value of Fortis Inc. Maritime Electric indicates that these costs represent various securities and exchange charges incurred by Fortis Inc. These costs were once incurred by Maritime Electric when it was a publicly traded company. The Applicant's position is that since it is now a wholly owned subsidiary of Fortis Inc., these costs are incurred by Fortis Inc. on its behalf and are rightly chargeable back to Maritime Electric.

[50] The Commission reviewed the schedule of these costs, which are general and administrative, such as insurance, directors' fees, audit and professional fees, etc. Based on the evidence before us, the Commission considers these costs to be more in the nature of the cost of running Fortis Inc. The Commission believes that the approved return on average common equity provides fair and reasonable return to Fortis Inc. to cover the payment of these expenditures. Therefore, the Commission will deny inclusion of these expenditures (approximately \$300,000) in the revenue requirement for Maritime Electric.

4.5 Rate of Return Approval

[51] Maritime Electric is requesting approval of a 9.75% return on average common equity. The application contains 11 pages of evidence supporting the rate of return request. Maritime Electric states that it faces higher business risk than other Atlantic Canada investor-owned electric utilities as it operates on a small island with an undiversified economy. The inability to spread risk throughout a diversified customer base means investors are more cautious on the outlook for Maritime Electric. Maritime Electric states this is evidenced by the Standard and Poor's BBB+ credit rating which indicates a stable outlook, but this rating is lower than other investor owned utilities such as Emera's, Nova Scotia Power, and Newfoundland Power. In fact, Maritime Electric notes the bond rating agency expressed concern about Maritime Electric's relative poor cash flow position which is caused by the ECAM and delayed recovery of energy costs. The bond raters expressed concern about the relatively low earnings as a percentage of debt ("Interest Coverage Ratio").

[52] The *Electric Power Act* Section 24(1) states return on investment shall be set by the Commission and reads as follows:

Return on investment, utility authorized to earn certain, computation of

24. (1) Every public utility shall be entitled to earn annually such return as the Commission considers just and reasonable, computed by using the rate base as fixed and determined by the Commission for each type of service furnished, rendered or supplied by such public utility, and the return shall be in addition to the expenses as the Commission may allow as reasonable and prudent and properly chargeable to operating account, and to all just allowances made by the Commission according to this Act and the rules and regulations made by the Commission hereunder.

[53] During the hearing the Province of Prince Edward Island and Commission staff asked interrogatories relating to rate of return. The Province specifically asked Maritime Electric to comment on evidence provided by interrogatory from Professor Lawrence Booth. In response Maritime Electric provided comments by Kathleen McShane of Foster Associates. Neither Mr. Booth nor Ms. McShane was called by the parties to testify directly at the hearing.

[54] The evidence of Mr. Booth is a paper titled “Cost of Capital for Ontario’s Electricity Distributors” which was evidence before the Ontario Energy Board in 2006. The Province of PEI makes reference to Professor Booth’s statement “As I have indicated to regulatory boards before it should be a concern to see Canadian regulated assets being flipped for twice book value. This is incontrovertible evidence that the allowed financial parameters for Canadian utilities are too generous.”

[55] Ms. Kathleen McShane of Foster and Associates in responding on behalf of MECL to Mr. Booth’s position states “I disagree strongly with this conclusion....While this argument has some theoretical appeal, it is flawed for various reasons...I would also point out that in 2006, the year the Booth evidence was prepared, another analyst came to a diametrically different conclusion regarding the reasonableness of allowed returns for Canadian utilities. In a report in Pipelines/Gas & Electric Utilities, December 7, 2006, Karen Taylor, highly regarded equity analyst for BMO Capital Markets, concluded, “We believe on a collective basis , that the allowed returns as established by formulas highlighted above [referring to the NEB, EUB, BCUC and OEB formulas] are confiscatory and likely violate the Fair Return Standard.”

[56] In its closing submission filed after the hearing dates, the Province of Prince Edward Island stated that the return on equity requested was too high given present financial market conditions and suggested the Commission consult an external expert to determine an appropriate rate of return.

[57] Both Maritime Electric and the Province of Prince Edward Island referred to the Northwestern Utilities case ([1929] S.C.R.186) in their evidence or submissions. This decision of the Supreme Court of Canada is the most often cited source to assist regulatory commissions in deciding a “fair rate of return”. Specifically, the following quote provides direction:

“The duty of the Board was to fix fair and reasonable rates; rates which under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company’s enterprise. In fixing this net return the Board should take into consideration the rate of interest which the company is obliged to pay upon its bonds as a result of having to sell them at a time when the rate of interest payable thereon exceeded that payable on bonds issued at the time of the hearing. To properly fix a fair return the Board must necessarily be informed of the rate of return which money would yield in other fields of investment.

[58] The evidence before the Commission on rate of return was that filed by Maritime Electric in its original application and in its responses to interrogatories from Commission Staff and the Province of Prince Edward Island. There was no further independent evidence presented by any party on an alternative rate of return, although as stated there was some cross examination by legal counsel for the Province and the Commission.

[59] The Commission in determining a fair return must try to assess the risk associated with the capital invested and the comments provided in the Northwestern Utilities case. Those comments make reference to the fact that the company will be allowed as large a return on the capital invested in its enterprise as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company’s enterprise.

[60] Regulators and courts have evolved a “fair return standard” in which returns have been set to help utilities provide safe and adequate services to the public at reasonable prices, while ensuring that the utilities involved remain a going concern with sufficient credit worthiness to attract capital needed to maintain and expand their facilities. A utility’s duty to serve and the acceptance of the risk associated with this obligation cannot be discounted.

[61] The application makes note of the return on equity rates for other Atlantic Canadian owned utilities which have averaged between 9.35% and 9.53% in the past 4 years. The British Columbia Utilities Commission (“the BCUC”) has instituted a formula-based approach in setting equity return rates. This formula uses the forecast 10-year Canada Bond Yield, average spread between 10-year and 30-year bonds reported by the Bank of Canada, and a sliding scale adjustment factor. The BCUC has set the low risk benchmark utility return on equity rate for 2009 at 8.47% (8.62% in 2008). Returns on equity for individual utilities are then adjusted for their specific risk profile. For instance, the regulator approved 2008 risk adjusted return on equity of Fortis BC was 9.02%.

[62] The Commission is aware that current economic conditions are volatile and rates of return throughout the investment marketplace is in significant decline as can be seen in the dramatic declines in stock exchange values. However, the Commission must decide this case based on the evidence placed before it during this application and hearing process. No party has presented evidence of rate of return that takes into account the current financial market conditions and how it affects the fair return standard which regulators have followed for many years.

[63] Therefore, the Commission grants the requested 9.75% return on average common equity as requested by Maritime Electric. The Commission orders Maritime Electric file their 2010 rate of return application with the 2010 application for ECAM rebasing and Point LePreau Replacement Energy report.

4.6 Other Matters

[64] The Commission notes the Cost of Service study reference by Mr. teRaa was completed in 2006 after 10-plus years of deregulation wherein the New Brunswick rate structure was adopted. Historically, New Brunswick rates are not based on a cost of service by rate class methodology. Therefore, it is not unrealistic to find discrepancies as found in the 2006 Cost of Service Study. The Commission intends to review rates by customer class and will be requiring Maritime Electric to re-file a cost of service study with a report which outlines rate class rate implications. The Commission would like to have this study reflect changes which may occur as a result of Maritime Electric financial statement conversion to International Financial Reporting.

[65] The Commission heard from Mr. teRaa, who stated his concerns about the impact increased heating from electricity will have on the system load factor and ultimately rates we all pay. Maritime Electric responded by indicating that our peak load still occurs in December and is not caused by electric heat. Maritime Electric did indicate that electric heat is increasing and the peak may shift. The Commission will continue to monitor the changing consumer patterns but ultimately these decisions are consumers. The Commission will be reviewing rates to assess equity within rate classes taking into consideration the result of the Cost of Service study to be filed.

[66] There are unprecedented pressures faced by Maritime Electric in meeting its legislated obligation to Island consumers. Numerous external factors have greatly impacted the price at which the utility purchases energy for resale to consumers. While effectively communicating these factors to the Commission, Maritime Electric has not been as effective in communicating with its customers.

[67] The public hearing and public notice process afforded the opportunity for customers to comment on the application and the Commission appreciates the input offered by the written comments received and from those who appeared at the public hearing. These comments have led the Commission to conclude that Maritime Electric must do a better job of informing customers of the price components of the energy used and the reasons for the fluctuation in energy costs reflected in monthly billings. While those with some direct knowledge of the energy sector could predict price escalation, many consumers appear to have been caught off guard by the significant rise in monthly billings. Some comments appear to assume that the desire for utility profits rather than the cost to purchase energy is responsible for higher rates. Many customers know little about the complex planning and detailed work required to ensure a continuous supply for electricity. However, complexity is not a reason to avoid efforts at explanation.

[68] The Commission believes a well developed and executed education and engagement process would mitigate much confusion over rates and billings. The Commission notes the use of an open house concept greatly assisted Maritime Electric in presenting its case for a new generator at the Charlottetown plant. Partnerships with some community groups have facilitated understanding of consumption rates for various appliances and the Maritime Electric website contains valuable information on some of the challenges associated with purchased energy. The Commission believes a more proactive communication approach is needed.

[69] The Commission orders Maritime Electric to prepare and file a detailed communications plan by May 29, 2009, which focuses on improving understanding of the utilities operations and the impact of external factors on customer billings. These include energy supply contracts, commodity based pricing of electricity, cost of wind energy, implications of currency valuations, ECAM account formula approach, transmission and distribution costs, consumption patterns, appliance electricity usage, and steps that can be taken by customers to reduce electricity costs. The plan should seek to enhance customer knowledge of the factors associated with the purchase and supply of electricity.

5. Disposition

[70] 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 amendments to rates,
tolls and charges.

Order

UPON receiving an application by Maritime Electric Company, Limited for approval of proposed amendments to its rates, tolls and charges;

AND UPON considering the application, as well as evidence provided at a public hearing and intervener comments;

AND UPON reviewing the additional evidence received in response to staff interrogatories and intervener interrogatories;

AND UPON reviewing and taking into consideration the evidence and recommendations provided by KnAP Energy Consultants concerning the Energy Supply Contracts;

AND UPON review of previous Commission Orders concerning the Energy Cost Adjustment Mechanism (ECAM), Energy Supply Contracts and Rate of Return;

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

IT IS ORDERED THAT

1. the Company shall defer collection from customers of 2009 Point Lepreau replacement energy costs and file a report by December 15, 2009 to the Commission outlining all options for the recovery of this replacement energy, including incorporation into basic rates outside of the ECAM account;

2. the Company shall rebase the base rate of energy effective with meter readings taken on and after April 1, 2009 as follows:

	Current	Apr. 1, 2009
ECAM Base Rate (\$/kWh)	0.0673	0.0770

3. the Company shall return to a 12-month amortization period in the ECAM formula effective with meter billings taken on and after April 1, 2009;
4. the Company shall re-file an ECAM rebasing report by December 15, 2009 with projections on the electricity rates for 2010, and any recommendations requiring Commission consideration;
5. the maximum allowed return on average common equity is set at 9.75% and the Commission denies the recovery of Fortis Inc. head office costs from the rate base of Maritime Electric;
6. the pre-2004 costs recoverable from customers' recovery of \$2 million annually shall continue at the same rate until otherwise directed by the Commission;
7. the cost of energy associated with the Energy Supply Contracts is reasonable and prudent and recoverable from the Energy Cost Adjustment Mechanism; and
8. the Company shall file with the Commission a communications plan by May 29, 2009;

DATED at Charlottetown, Prince Edward Island, this 5th day of March, 2009.

BY THE COMMISSION:

(Sgd) Maurice Rodgerson

Maurice Rodgerson, Chair

(Sgd) John Broderick

John Broderick, Commissioner

(Sgd) Anne Petley

Anne Petley, Commissioner

(Sgd) Ernest Arsenault

Ernest Arsenault, 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)