All our energy.
All the time.

MARITIME ELECTRIC
A FORTIS COMPANY

June 29, 2018

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The Island Regulatory
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Island Regulatory and Appeals Commission
PO Box 577
Charlottetown PE C1A 7L1

Dear Commissioners:

***2017 Cost Allocation Study***

Under Order UE16-04, Maritime Electric Company, Limited was directed by the Island Regulatory and Appeals Commission to file with the Commission an updated Cost Allocation Study based on financial results ending on December 31, 2017. Please find attached a copy of Maritime Electric's 2017 Cost Allocation Study. The Company retained the services of Chymko Consulting Limited to provide a technical update to the 2014 Cost Allocation Study. The study was based on Maritime Electric's Statement of Earnings for the twelve months ending on December 31, 2017 as well as recommendations from the Point Lepreau Cost Allocation Classification Study filed on April 27, 2017 with the Commission.

The 2017 Cost Allocation Study followed the same three step methodology as previous Cost Allocation Studies with respect to functionalizing revenue requirement, classification, and allocation of expenses to the different rate classes. The functionalized revenue requirement was $182.6 million and is summarized in Table 1 below:

| **Table 1**<br>**Functionalized Revenue Requirement ($ million)** | |
|---|---|
| Power Supply Costs | $126.1 |
| Transmission Costs | $12.3 |
| Distribution Costs | $33.2 |
| Services and Metering Costs | $9.1 |
| Customer Care Costs | $1.2 |
| Lighting Costs | $0.7 |
| **Total Functionalized Revenue Requirement** | **$182.6** |

The above functionalized revenue requirement was then classified as demand, energy or site related based on cost drivers that are measured in terms of how customers use the system. Table 2 includes a comparison of the ratio of demand, energy and site related revenue requirement in the 2014 and 2017 Cost Allocation Studies. The difference is primarily due to the impact of the reclassification of Point Lepreau costs from demand related costs to energy related as recommended in the Point Lepreau Allocation Classification Study.

**Table 2**
**Classified Revenue Requirement**

| | **Demand** | **Energy** | **Site** | **Total** |
|---|---|---|---|---|
| 2017 Revenue Requirement | 32% | 55% | 14% | 100% |
| 2014 Revenue Requirement | 37% | 50% | 13% | 100% |

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The revenue to cost ("RTC") ratios, which compares the revenue collected from each rate class with the allocated cost of providing service to each rate class, are consistent with the 2014 Cost Allocation Study with the exception of Small Industrial, Large Industrial and Lights. Table 3 includes a comparison of the RTCs for each Rate Classification from the 2008, 2014 and 2017 Cost Allocation Studies.

**Table 3**
**Comparison of Revenue to Cost ("RTC") Ratios**

| Rate Classification | 2017 RTC | 2014 RTC | 2008 RTC |
|---|---|---|---|
| Residential | 91% | 92% | 91% |
| Residential (Seasonal) | 96% | 97% | 122% |
| Farm | 82% | 81% | N/A |
| General Service | 121% | 117% | 114% |
| General Service (Seasonal) | 113% | 115% | 132% |
| Small Industrial | 102% | 96% | 109% |
| Large Industrial | 94% | 100% | 86% |
| Lights | 91% | 103% | 119% |
| Unmetered | 104% | 103% | 98% |
| **Total** | **100%** | **100%** | **100%** |

The change in Small and Large Industrial RTCs from 2014 to 2017 is due in part to the loss of one Large Industrial customer in October 2014 and the migration of three Small Industrial customers to the Large Industrial rate in 2017. In addition, changes to the classification of Point Lepreau costs for demand and energy, as detailed in the Point Lepreau Cost Allocation Classification Study has impacted RTCs for the Industrial rate classes. The reduction in the Lights Classification RTC is attributable to a reduction in both sales and demand for this rate class resulting from the conversion from high pressure sodium streetlights to LED streetlights. What would otherwise result in lower costs allocated to this rate class is offset by increased capital costs associated with the conversion to LED streetlights.

One of the objectives of the cost allocation study is to allocate the costs of providing a service to rate classes on a cost causation basis; therefore, an RTC ratio below or above 100% indicates revenue should be increased or decreased respectively. The Residential rate class has consistently been below 100%, while the General Service rate classes have consistently been above 100%. RTCs between 90% and 110% are considered in the Industry to be reasonable in balancing rate class cross subsidization with the rate shock associated with implementing changes. The RTC for the Farm rate class continues to be substantially lower than the recommended industry standard of 90%. Proposals with respect to the cost allocation results and rate design recommendations will be presented in the Company's General Rate Application to be filed later this Fall.

If you have any questions, please do not hesitate to contact me at 902-629-3696.

Yours truly,

MARITIME ELECTRIC

Jason C. Roberts
Vice President,
Finance & Chief Financial Officer

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Enclosure