

CANADA
PROVINCE OF
PRINCE EDWARD ISLAND

Case No. E21204
Order No. E91-1

THE PUBLIC UTILITIES COMMISSION

IN THE MATTER of the *Public
Utilities Commission Act* and the
Electric Power and Telephone Act;

- and -

IN THE MATTER of a review of the
present CITY-TOWN-RURAL electric
rate differentials of Maritime Electric.

ORDER

Monday, the 18th day of March, 1991

BEFORE

{ Linda Webber, Chairman
{ Anna C. Carr, Commissioner
{ C.C. Hickey, Commissioner

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REASONS FOR ORDER

I. INTRODUCTION AND BACKGROUND

The matter of urban versus rural rate areas came to the public's attention in the fall of 1990 when electricity rates were increased. The increases came into effect on September 1, 1990 and were less for city customers than for rural customers in certain rate categories. While these rates were based on policies that had been consistently applied for a number of years, the rates called attention to these policies. Many people began to question them - why they existed and whether they should be changed.

Two policies are at issue here. One is the policy of applying the "user pay" principle to electric rates. The other is the policy of dividing certain rate categories into rate areas, e.g. city, town and rural.

1. User Pay

Overall, whatever it costs to produce and distribute electricity must be recovered from those using the service. Attempts are made to ensure that individual users pay what it costs to service them. The concept of "user-pay" is fundamental to the present rate structure of the Company and has been a primary objective in rate determination in Prince Edward Island for many years. A notable exception to the user-pay principle is where government becomes involved in the direct subsidy of certain electricity users or groups of users.

The application of the user pay principle went through some changes in the mid-1980s. As Maritime Electric Company, Limited (the "Company") prepared and presented cost allocation studies to the Commission through the public hearing process, the Commission questioned why some groups of customers (city) consistently paid more than the cost to provide service to them while other groups (rural) consistently paid less than the cost.

While the Company continually maintained that its cost allocation studies were reasonably accurate, it argued that cost allocation studies were not an exact measure of costs and that rates should not be amended to produce revenue precisely equal to an allocated cost. The Company felt that, while these studies should provide guidance in the determination of an appropriate level of rates, the ultimate determination of a proposed rate should, to a large extent, be left to the discretion of the Company subject, of course, to Commission review. **Following extensive discussion, the Commission decided against the Company on this point and an order was issued mandating that rates move toward allocated costs.**

During the late 1980s as well as at the rate hearing in 1990, the Company argued against this decision. The Company's position was, however, not supported by any party to the review process - not even the Government of Prince Edward Island. **During that time, the Town of Summerside vigorously supported the decision, apparently because it resulted in reduced rates to the Town. The Commission ultimately did not change its initial decision.**

2. Rate Areas

In the mid-1980s, the Commission commenced a review of the rate area boundaries of the Company. The review was initially prompted over concerns expressed by the Bunbury-Southport Joint Planning Board that the boundaries of the city rate area were inappropriate given urban development in the provincial capital region in the last several years. This, combined with the fact that the rate area boundary structure had not been the subject of a review for some time, prompted the Commission in 1986 to hold a public hearing into the matter of rate area boundaries.

While a few municipalities wrote to say that they supported the existing rate structure, only Bunbury-Southport appeared at the hearing.

The Commission did not, at the time, make any final decision on the matter but did order the Company to prepare a study of rate area boundaries - what we do in Prince Edward Island, what should be done, and what is done elsewhere in Canada.

That study was completed in 1988 and in it the Company recommended that the existing structure be maintained. In the Company's view, it seemed the best way to implement the user pay principle in P.E.I.

That study was distributed widely - to the Government of Prince Edward Island, the Federation of Municipalities and anyone else interested - and another public hearing was called for in July of 1989. However, while a few municipalities wrote the Commission and most of the letters supported the continuation of the existing boundary structure, no one showed up at the hearing.

Once again, the Commission reserved decision on the issue. As a result, when the Company applied for a rate increase in 1990, the rules that applied to the rate proposals of the Company had not changed. Within the context of the defined rate areas, rates were to reflect the cost of service with a movement towards allocated costs.

When members of the public and the government expressed surprise about the rate increases in the fall of 1990, the Commission pointed out that these concerns had never before been raised by anyone at the two public hearings called for this purpose. However, after consideration, the Commission decided to reopen once again the public hearing into rate area boundaries begun in 1986 and continued in 1989. This time, the response was favorable and many individuals and groups made submissions. A list of those making submissions is appended to this Order.

The Commission notes that there are costs associated with the three hearings into this matter that must, in the end, be borne by consumers. While the Commission will try to continue to improve its public notices, there is an obligation on the public - all who may wish to be heard - to note the matters being dealt with by the Commission. Regrettably, all too often there is no public input even after extraordinary efforts on the part of the Commission and, indeed, the media, to publicize a hearing. In the absence of public input, the Commission must make the best decision it can and move on to other pressing items.

II. ISSUES

The Commission considers the following to be the issues raised at the hearing and in submissions:

1. Is the user pay policy appropriate?
2. Are the rate area classifications of city, town and rural appropriate within the general rate classes of residential, street lighting and general service?
3. If rate area classifications are appropriate, should geographical boundaries be used in developing these areas?
4. Are the current geographical boundaries reasonable?
5. If rate area classifications are inappropriate, how should change be implemented?
6. Do these matters have an impact on the Town of Summerside?

III. DISCUSSION

1. Is the user pay policy appropriate?

In a broad sense the answer to this question must be "yes." What it costs to produce, purchase and distribute electricity to consumers must be recovered from consumers on this basis. Anything less would mean that rates would be subsidized by someone else.

In fundamental terms, the method by which rates are set is based on an initial determination of what it costs to produce, transmit and distribute electricity to different classes of customers. In this sense, the user class - for example residential, street lighting or general service - pays for the service to it.

We heard no argument against this basic principle of classification during the public hearing. There appears to be an acceptance that it is appropriate in the broad sense for the residential class of customer to pay for what it costs to supply energy to residential customers, for street lighting customers to pay for what it costs to supply energy to street lighting customers and for small general service customers to pay for what it costs to supply energy to small general service customers.

The contentious issue appears to be restricted to the matter of area classification (city, town, rural) as opposed to customer classification (residential, street lighting, etc.).

2. Are the rate area classifications of city, town and rural appropriate within the general rate classes of residential, street lighting and general service customers?

This is the question most focused upon by those who intervened at the public hearing.

(a) *Social Issues*

A large number of the submissions we received dealt with social issues, such as

- the need to encourage farming in P.E.I.
- the need to support growth in rural P.E.I.
- the possible tax consequences on the City of Charlottetown if rates are increased for the City
- the number of government benefits received by rural P.E.I. but not by the City of Charlottetown.

These are not matters which we feel are appropriate for us to take into consideration in this hearing.

The mandate of a regulatory board in dealing with a public utility is to ensure that safe and adequate service is provided by the utility and that rates are fair and reasonable. In our view, a rate must be fair considering the service a customer

receives and the cost of providing that service. A customer should be confident that a rate set by a regulatory board is not determined so as to subsidize one group at the expense of another. Fair, objective criteria are in order.

Opposition Leader Leone Bagnall appears to support our view on social considerations:

It may well be that the issue we are discussing today relates more to public policy than to utility regulation. If that is the case, public policy should be established by the Legislative Assembly of the Province. Government should not encourage the P.U.C. to do what may more appropriately be accomplished by legislative action.

(Brief to the Commission, p.3)

In our opinion, it is clear that public policy issues must be addressed by the Legislature, not by the Commission. To do otherwise is to turn the Commission into a political rather than a regulatory body. We believe it is in the best interests of the public that the Commission be independent of political decision-making.

These comments are not, however, to be taken as a suggestion that political decision-making is unimportant or inappropriate - for the government and the Legislature. The elected representatives of the province have an obligation to respond to concerns about public-policy matters. However, when those representatives appear before the Commission, it should be to argue why the Commission as a regulatory body and within its terms of reference should render a particular decision.

(b) *Regulatory Principles: Fairness and Equity, Simplicity*

While social policy issues are not usually appropriate ones for the Commission to consider, fairness is. In some ways, it may seem like the two are similar, but there is a difference. A rate designed for a social policy reason would attempt to achieve a specific goal - for example, assistance to family farmers. This is inappropriate. A fair rate might end up appearing to help some groups, but that would be incidental to the rate, not the reason for it.

In some way or other, most of the briefs that were presented raised the fairness issue from the viewpoint that, in a province the size of Prince Edward Island, it is unfair to distinguish among city, town and rural customers.

This view emphasized the difficulty in making any truly fair distinction among city, town and rural customers. Whether a distinction is made on the basis of geography or by population density, in a province this small, relatively close neighbors would often find themselves with different rates. As well, it was argued, it is unfair to set rates because of an accident of geography.

On the other side, the City of Charlottetown presents the view that it is unfair to charge urban customers the same rate as rural customers when it is clearly less expensive - on a per person basis - to provide service where the population density is greater. The City argues that this would, in effect, be subsidizing rural rates - a social issue.

In the Commission's view, population density as a criterion creates a problem. In order to be completely fair, the consistent monitoring of a constantly changing situation would be needed. Given the size of P.E.I., we believe that any benefits of this approach would be outweighed by the costs. Moreover, in our view, equity and fairness suggest that it is inappropriate to look at how close one lives to a source of generation. This can, and has, changed over time and will no doubt keep changing.

The complexity added by any rate design or classification plan is, of course, of relevance. Complexity adds to cost. As several submissions pointed out, a simplified classification system would likely cost less to administer.

As for the City's argument that equal rates would represent a subsidy to rural P.E.I., we must note that rates never precisely track costs. In our view, it would not be fair, equitable or reasonable to attempt to identify costs for each and every person when trying to ensure a universal level of safe and adequate service. Yet, it could be argued that any variation from this concept would result in rate subsidization. We cannot accept this as a valid argument against uniform rates given the size of Prince Edward Island.

In this area, the submission of Robert D. Knecht, the regulatory economics consultant hired by the Minister of Energy and Forestry, was particularly helpful. His brief approached the issue from the regulatory perspective using what we consider to be sound ratemaking principles. He concluded that uniform rates would be appropriate for residential, street lighting and small general service customers.

The Commission found the analyses of Mr. Knecht objective. His comments on the Company's cost allocation studies were also of interest:

Due primarily to the limited availability of load data, the level of uncertainty in Monenco's cost allocation study is high. Monenco recognizes the uncertainties inherent in the analysis, and emphasizes that the costs be used only as a guide.
(submission p.4)

While there is intuitively a basis for believing that it is less expensive to serve people living more closely together, we find it difficult to judge, with any degree of precision, the extent of the difference. The Monenco study admits its own limitations. Robert O'Rourke, presenter for the City, stated that such studies were a combination of economics, accounting and, to a large extent, judgment. Given these comments and those of Mr. Knecht, it would seem unreasonable to base a decision justifying different rates solely on such information, especially in light of factors such as the size of the province and the difficulty of administering and monitoring either density or geographic distinctions.

We also note that the *Rate Areas Study 1988* reviewed the following matters:

- matching revenue to cost
- ease of administration
- in keeping with the trend in the rest of Canada
- understandable and acceptable to customers
- appropriateness to the Prince Edward Island situation.

The study concluded that:

Uniform rates are the preferred alternative in regard to all of the above criteria except for the matching of revenue and cost.

(Study, pp. 1-2)

On balance, the Commission finds that the issue of fairness and equity is better

served with uniform rates for each rate group. We believe this conclusion is supported by sound regulatory principles. Rate area classifications are therefore not appropriate.

3. If rate area classifications are appropriate, should geographical boundaries be used in developing these areas?

Since we have found that rate area boundaries are not appropriate, this question need not be answered.

4. Are the current geographical boundaries reasonable?

There was little comment on this issue by most intervenors, but comments generally were of the view that the current geographical boundaries are not reasonable. The Commission agrees. If boundaries were to be used, the reasons put forward by the Company (in the Rate Areas Study) justifying the existing boundaries would not be accepted.

5. If rate area classifications are inappropriate, how should changes be implemented?

Any change in rate design should be implemented gradually to enable those people affected to adjust to the change. Customers whose rates will increase because of the change are of concern because, as the City of Charlottetown noted, there are obvious budgetary implications to such a change. A number of the submissions recognized the need to avoid so-called rate shock.

The Commission will therefore implement the change to uniform rates on a gradual basis. The Company will be ordered to submit proposals in this respect that will see rate uniformity in Prince Edward Island phased in in four steps over a three-year period. The first step of the phase-in is to occur on July 1, 1991. The Company will be expected to submit an initial proposal for our review prior to or during the upcoming general rate hearing which is to commence on April 16, 1991.

6. Do these matters have an impact on the Town of Summerside?

The Town of Summerside became an issue at these hearing because of a position taken by the Company. The Company's submission in this respect states:

3. Maritime Electric is not necessarily opposed to the establishment of uniform rates, but has the following areas of concern that must be addressed before uniform rates can be fairly implemented:

(i) The move to uniformity ought to be phased in over a period sufficiently long to minimize the impact on customers now on city rates.

(ii) Any change in rates that sees the customers in the urban Charlottetown area paying rates higher than costs under a uniform rate structure must be carried out in a manner that sees all urban islanders participating in the costs of such a scheme. Currently, rates for the Town of Summerside are set based on cost. If service in one urban area is to be set above cost to support the costs of service to rural areas, the same conditions must apply to all urban rates across the province, including electric consumers located within the area served by the Town of Summerside. Without participation of the Town, equity in sharing in the costs of social objectives cannot be achieved.

(Company's submission, p.2)

In making this submission, Company witness James Lea stated that, in the Company's view, while the range of revenue-to-cost ratios for urban and rural customers was not so far apart as to require different rates, it was significant enough to suggest that uniform rates could only be justified based on perceived social benefits.

The Commission disagrees. For the reasons stated earlier, one need not look at social objectives to decide in favor of uniform rates. In this case, sound regulatory principles are sufficient.

In addition, we note that the Town of Summerside Electric Utility is exempt from regulation by the Commission except insofar as that utility furnishes electricity to customers beyond its corporate limits. This means that the rate structure for the

Summerside Utility is a decision made by that utility - not the Commission - except insofar as those rates may affect customers beyond the corporate limits of the Town.

The Commission's decision in this matter relates only to Maritime Electric's customers who are currently classified by rate area. Anyone believing that the Town of Summerside Utility should be affected will have to raise the issue in a separate application and hearing.

Finally, the Commission wishes to thank all who participated in this hearing, either through their appearance at the hearing itself, submissions, or letters. Every submission and letter has been read and considered. Each has made a contribution.

The issue of fairness is always important in regulatory decision-making. The people who are affected by a decision are the ones who can explain most clearly the consequences of that decision upon them. The better the Commission understands the concerns of the public, the better its decisions will be. Even if the Commission cannot give the public what it wants, if the Commission is aware of the concerns, its decisions can better explain what must be done, and why.

In this particular case, virtually all of the submissions were well thought out, clearly presented and showed a thoughtful concern for fairness in its broadest sense. The differences of opinion that were expressed were voiced reasonably and fairly and we believe our decision-making benefited from these contributions.

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THE PUBLIC UTILITIES COMMISSION

IN THE MATTER of the *Public Utilities Commission Act* and the *Electric Power and Telephone Act*;

- and -

IN THE MATTER of a review of the present CITY-TOWN-RURAL electric rate differentials of Maritime Electric.

ORDER

WHEREAS the Commission has conducted a public review of the present rate area boundary structure of Maritime Electric Company, Limited (the "Company");

AND WHEREAS, for the reasons given in the annexed reasons for order, the Commission has determined that a uniform structure for all rate categories of the Company should be implemented and phased in over a three-year period;

IT IS ORDERED THAT:

1. The present city, town and rural rate area boundaries of the Company shall be phased out in four steps over a three-year period, commencing on July 1, 1991;
2. The Company shall submit to the Commission, prior to or during the upcoming general rate case (Docket E20907), a proposal that will see the elimination of rate area boundaries in the manner described in 1. above; and
3. This docket is concluded.

DATED at Charlottetown, this 18th day of March, 1991.

BY THE COMMISSION:

Yvonne Webber
Chairman

Anna C. Carr
Commissioner

G. G. Mickey
Commissioner

APPENDIX 1
ORDER E91-1

Presenters in Attendance

- 1) P.E.I. Department of Energy & Forestry
Mr. J. Charles Campbell, Deputy Minister &
Mr. Robert D. Knecht, Consultant
- 2) City of Charlottetown
Mr. Richard Brown &
Mr. Robert O'Rourke
- 3) Leader of the Opposition
Ms. Leone Bagnall
- 4) Prince Edward Island Federation of Labour
Mr. Dave Darlington &
Mr. Earl Affleck
- 5) Three Rivers Industrial Commission
Mr. John M. Beck
- 6) Ms. Beverley A. Johnston
Brudenell Resident
- 7) Prince Edward Island Federation of Agriculture
Mr. Fred Martens
- 8) Kensington Area Tourism Association
Mr. Austin Pendergast
- 9) M.L.A.'s for 2nd Kings
Mr. Claude Matheson &
Mr. Walter Bradley
(Including a petition from residents in the areas of Savage Harbour, St.
Andrews, Canavoy and West St. Peters)
- 10) Mrs. Justin MacLellan
Indian River, Kensington RR5, P.E.I.

NOTE: Mr. Ben Taylor was in attendance on behalf of the Town of Summerside but did not make a presentation.

Submissions Received (No presentations made)

- 1) P.E.I. Potato Board
Charlottetown, P.E.I.
- 2) Mr. Alan Toombs
Bunbury, P.E.I.
- 3) Mrs. Claretta MacWilliams, President
West Prince Branch Women in Support of Agriculture
O'Leary, P.E.I.
- 4) Ms. Marion Murphy, M.L.A.
1st Queens
- 5) Mr. Stanley Bruce, Chairman
Valleyfield Community Council
- 6) Mr. Eddie Trail, General Manager
West Prince Industrial Commission
Alberton, P.E.I.
- 7) Mr. J. Frank McAulay, Mayor
Town of Parkdale
- 8) Mr. Dave Gallie, Chairman
Community of East Royalty
- 9) Evangeline Regional Services Centre
Community Advisory Board
Wellington, P.E.I.
- 10) Mr. Phil Babineau, Vice-President
Babineau Fisheries Ltd.
Morell, P.E.I.
- 11) Ms. Vivian Aho, Chairperson
Southern Kings and Queens Community Advisory Board
Montague, P.E.I.
- 12) Community of Southport
- 13) Rev. Arthur J. Pendergast
Stella Maris Parish
North Rustico, P.E.I.
- 14) Ms. Catherine Callbeck, M.P.
Malpeque, P.E.I.
- 15) Mr. Joseph E. Coady, Administrator
Community of Sherwood
- 16) Mr. Leonce Bernard, Chairman
Rural Development Board

- 17) Mr. Alex Dixon, President
P.E.I. Cattlemen's Association
- 18) Ms. Margaret Fogarty, Administrator
Village of Cardigan
- 19) Mr. Keith Paugh, Chairman
West Prince Ventures Limited
- 20) Mrs. Beth McRae, Mayor
Alberton Town Council
- 21) Mr. Robert Stringer
North Granville, P.E.I.