Prince Edward Island CANADA

Energy Corporation

Société de l'énergie

Île-du-Prince-Édouard CANADA

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October 16, 2015

Mr. Mark Lanigan, CA
Island Regulatory and Appeals Commission
PO Box 577
Charlottetown, PE C1A 7L1

Dear Mr. Lanigan,

Please find enclosed Government's comments on Maritime Electric's 2016 Depreciation Study.

Sincerely,

Kim Horrelt

Kim Horrelt

cc: Steve Loggie, CA
Maritime Electric Company, Limited

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PEI ENERGY CORPORATION

CANADA

PROVINCE OF PRINCE EDWARD ISLAND

BEFORE THE ISLAND REGULATORY

AND APPEALS COMMISSION

IN THE MATTER of Section 26 of the Electric Power Act (R.S.P.E.I. 1988, Cap. E-4) and Section 12 of the Island Regulatory and Appeals Commission Act (R.S.P.E.I. 1988, Cap. I-11) and **IN THE MATTER** of the Application of Maritime Electric Company, Limited for an order of the Commission with respect to input factors for the period between January 1, 2016 and February 29, 2016 and to establish rates of depreciation with respect to the Company's several classes of property for the period beginning January 1, 2016 and for certain approvals incidental to such an order.

COMMENTS OF THE PEI ENERGY CORPORATION

Filing Docket UE21603

The PEI Energy Corporation has reviewed Maritime Electric Company, Limited's (MECL) Responses to Interrogatories filed by our office and has the following comments.

1. According to MECL's response, "a principle in the historic cost of service regulatory framework throughout North America allows for prudently incurred costs to be fully recoverable by the utility." However, ignoring the results and recommendations of an external specialist's study, as was the case with the 2005 Depreciation Study, and thereby deferring costs for an extended period of time could be viewed as imprudent management and/or regulatory oversight. This deferral of costs increases the risk that ratepayers will face more drastic rate increases in the future as the costs will be depreciated over a significantly shorter remaining useful life. This is especially true in the case of the CTGS which is expected to be retired in 2021. In addition, excessive cost deferral creates an intergenerational customer fairness issue whereby future ratepayers are forced to bear a disproportionate amount of cost vis-à-vis the value they receive from a given asset. Should ratepayers be responsible for more dramatic rate increases that could have been avoided had the external specialist's recommendations been adopted?

   If ratepayers are forced to bear the risk of imprudent cost management and/or regulatory oversight, then, contrary to Ms. McShane's testimony, what risk do shareholders actually face in terms of impaired ability to fully recover their invested capital? If shareholders do not assume this risk, then what justification is there for MECL to earn a higher return than its Atlantic Canadian peers?

2. An issue now exists whereby the deferred depreciation will need to be recognized over a condensed time period. This will place increased upward pressure on customer rates which could have been avoided. Should ratepayers bear all the responsibility?

3. The PEI Energy Corporation acknowledges that the CTGS depreciation is the most pressing issue given that it has the shortest remaining useful life. Therefore, how can ignoring the 2015 gap for the CTGS until 2019 be justified as prudent? At that time, there will be only 2 years of remaining useful life left until its expected retirement in 2021.

   It is understood that the 2015 gap in respect of the CTGS consists of $1.239 million of depreciation based on the new rate plus $2.117 million of accumulated reserve variance amortization for a total of $3.356 million of expense that MECL is proposing to defer until the next depreciation study. Spreading this expense over the 6 years of remaining useful life from 2016 to 2021 would increase annual depreciation expense by $0.559 million, which would equate to approximately 0.3% in rate impact (based on a $195 million pre-adjusted revenue requirement).

   However, ignoring the expense until 2019 will cause the $3.356 million to be spread over 2 years, result in increased annual depreciation expense of $1.678, equating to an approximate 0.9% rate impact at that time. If rate stability is a goal, then wouldn't a more modest increase now spanning a longer period of time be more palatable than a future rate hike that is three times as large? As well, what other upward pressures might there be on rates at that time that may also need to be addressed?

In summary, there are three issues pertaining to deferral of depreciation expense which should be considered:

- To what degree will the deferral of depreciation expense to future periods limit MECL's ability to address other future cost pressures without significantly impacting ratepayers?
- What is the appropriate balance between current ratepayer impacts and the risk of more aggressive ratepayer impacts in the future?
- How important is it to maintain intergenerational customer fairness to prevent costs from being borne by ratepayers who obtain little to no benefit from a given asset?