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December 20, 2019

Dear Sirs,

Re: Island Regulatory and Appeals Commission
Hurricane Dorian Storm Restoration Costs

Background

On Saturday, September 7, 2019, the Tropical Storm Dorian made landfall on Prince Edward Island ("PEI") and impacted Maritime Electric Company Limited ("MECL" or "the Company") customers Island-wide, as per MECL's Post Tropical Storm Dorian Post-Mortem Report ("Post-Mortem Report"). In the Post-Mortem Report MECL noted that the storm lasted for approximately 15 hours and caused serious damage to much of its infrastructure. The damage resulted in power outages for over 65,000 of MECL's 80,000 plus customers. Overall, MECL has indicated that Storm Dorian caused an average customer outage of 35.82 hours and required replacement of 97 poles, 93 transformers and related conductor. As a result, MECL indicates that they have incurred approximately $3.5 million of storm related costs. MECL submitted an application to the Island Regulatory and Appeals Commission ("IRAC") outlining these costs, which were made up of contractor costs, mutual aid teams, and costs relating to Maritime Electric's own employees; specifically the extra labour which was incurred as they worked around the clock to resolve outages.

On December 17, 2019 MECL requested the following:

- *"…regulatory approval to use 2019 excess revenues to offset the incremental Dorian restoration operating costs. The amount of excess net revenues for 2019 will not be known until year-end. However, Management proposes that any residual restoration operating costs, not offset by 2019 excess net revenues, be deferred and recovered over the years 2020 and 2021 or in a manner to be determined by IRAC."*

- *"…Management proposes that the Commission vary Order UE19-08 and order that any excess net revenues, after offsetting all of the incremental Dorian restoration operating costs in 2019, be applied to reduce any amounts recoverable from customers in the Energy Cost Adjustment Mechanism deferral account."*

- *"…an order from the Commission authorizing the deferral of any net residual post tropical storm Dorian restoration operating costs where the excess net revenues are not sufficient to fully recover these unplanned costs in 2019. Further, should the excess net revenues from 2019 exceed the post tropical storm Dorian restoration operating costs, Maritime Electric requests an order from the Commission to apply the net amount to the accumulated balance in the ECAM* [Energy Cost Adjustment Mechanism] *deferral account."*

Based on this request we have considered the following matters:

1. The total costs incurred related to Storm Dorian in an effort to determine if these costs were supported and directly related to this one-time event;
2. The treatment of the costs as either capital or operating and whether this was in accordance with generally accepted accounting principles;
3. The reasonability of MECL's allocation of the cost between capital and operating based on the nature of the work performed;
4. The impact that the decision to classify as a capital or operating charge would have on rate payers;
5. The amortization period proposed for recovering any deferred Storm Dorian costs; and
6. The use of 2019 excess net revenues and the Energy Cost Adjustment Mechanism.

Information reviewed

Our review included the following:

- Letter from Mr. John Gaudet, President and CEO of MECL regarding Hurricane Dorian Storm Restoration Costs - September 26, 2019;
- Post Tropical Storm Dorian Post-Mortem Report - November 8, 2019;
- Hurricane Dorian Storm Restoration Costs – Response to Interrogatories from Commission Staff - November 8, 2019;
- November 29, 2018 Storm Post Mortem dated January 21, 2019;
- MECL's verbal walkthroughs and written responses to Grant Thornton ("GT");
- Supporting documents noted throughout this letter; and
- Letter from J.C. Roberts, Vice President Finance & Chief Financial Officer of MECL regarding their proposed treatment of the Dorian operating expense costs – December 17, 2019.

Procedures

We have been engaged to review the information filed by MECL as it pertains to Storm Dorian. Our procedures were focused on the verification of the data incorporated in the calculations and the cost methodology used by the Company. Specifically, we performed the following:

1. Performed mathematical and clerical review of the information submitted by MECL (as summarized in the “Information Reviewed” section above) for accuracy and consistency between documents;
2. Performed a walkthrough of the financial model supporting the Post-Mortem Report;
3. Performed mathematical and clerical review of the financial model for accuracy;
4. Agreed costs included in the financial model with the general ledger detail provided;
5. Reviewed the coding of accounts in the general ledger and compared this coding to MECL’s classification of the costs between operating, capital and retirement expenditures in the application;
6. Reviewed supporting documents for mutual aid and contractor expenses for evidence to support the existence and classification of the expense (i.e. capital or operating); and
7. For costs prorated based on a percent allocation for the nature of the work, we performed the following:
    a. Discussed the allocation with MECL during the walkthrough of the financial model;
    b. Reviewed supporting information regarding the allocation; and
    c. Considered evidence regarding the differing impact between the 2018 storm and the impact of Storm Dorian.

The procedures undertaken in the course of our financial analysis do not constitute an audit of the Company’s financial information and consequently, we do not express an opinion on the Company’s financial information.

1. Total costs incurred

In MECL's Post-Mortem Report it indicates that Storm Dorian had a financial impact of approximately $3.5 million, with the largest cost component being internal and external labour. The table below provides MECL's breakdown of the total cost of the storm restoration efforts:

Item	Cost ($)
MECL Labour and Transportation	1,008,696
H-Line (Contractor)	695,739
Atlantic Reach (Contractor)	254,246
GSD (Contractor)	83,105
T&T Line Construction (Contractor)	135,719
Ontario Line Clearing (Contractor)	281,994
City of Summerside EU (Mutual Aid)	5,656
Saint John Energy (Mutual Aid)	38,559
Fortis Ontario (Mutual Aid)	154,640
Newfoundland Power (Mutual Aid)	253,955
PEI Forestry	15,487
Helicopter Inspection	2,340
Go with the Flow Traffic Control	175,072
Materials	183,482
Travel, Accommodations, Meals, Telecommunications, Other	177,100
Total	**3,465,790**

During our review we noted that the balance submitted by MECL was a combination of items recorded in the general ledger, estimates of costs when invoices were not yet available, and the adjustments included in notes 1 and 2 below:

Item	Amount ($)
General ledger	2,967,042
Estimates of costs when invoices were not yet received	639,694
Subtotal	**3,606,736**
Adjustments:	
West Cape costs *(Note 1)*	(91,586)
Normal operations *(Note 2)*	(49,360)
Total	**3,465,790**

Note 1: The West Cape is a wind farm which was out of service for six days as a result of the number of fallen trees on the transmission line and on access routes. These amounts were recorded within MECL's general ledger and then deducted from storm restoration costs as these costs are to be billed to the West Cape wind farm directly.

Note 2: As per discussions with MECL, these costs are related to operations and normal charges from H-Line to the Company.

Cost testing

To review the total expenses included in MECL's Post-Mortem Report we broke the total into two categories; 1) mutual aid and contractor expenses that are supported by invoices, and 2) other charges. This categorization is outlined in the following:

Item	Amount ($)	%
Other charges	1,369,280	40
Mutual aid and contractor expenses tested	2,096,510	60
Total	**3,465,790**	**100**

Test of details

During our review of the Storm Dorian costs we completed the following:

- For internal MECL expenses where invoice support would be not be available, our review was limited to comparing the Post-Mortem Report allocation between capital and operating to the coding in MECL's general ledger;
- For mutual aid and contractor costs we vouched the amounts to supporting invoices and reviewed invoice descriptions and account coding for consistency with MECL's description of the nature of the operating and capital impact of Storm Dorian; and
- Our review of MECL's methodology for allocating costs between capital and operating included:
    - Internal correspondence between the Manager of Transmission and Distribution Operations of MECL and various MECL leadership team members regarding the status of restoration work during the timeframe of Storm Dorian;
    - MECL's memo to file prepared by the Manager of Transmission and Distribution Operations dated December 13, 2019 regarding the Dorian Restoration Cost allocation ("December 13 Cost Allocation Memo");
    - Correspondence between MECL and IRAC regarding the status of restoration efforts during the timeframe of Storm Dorian; and
    - Photos of the damage from the 2018 storm and Storm Dorian provided by MECL to illustrate the differences between the impact of each storm.

Category	Total	Support Vouched	Difference
Maritime Electric Labour & Transportation	1,008,696	NA	
Materials	183,485	NA	
Travel, Accommodations, Meals, Telecommunications & Other	177,099	NA	
Subtotal	**1,369,280**		
H-Line (Contractor) *(Note 1)*	695,739	674,346	21,393
Atlantic Reach Electric Ltd (Contractor)	254,245	254,245	-

Category	Total	Support Vouched	Difference
GSD Utility Services Inc. (Contractor)	83,105	83,105	-
Fortis Ontario (Mutual Aid) *(Note 2)*	154,640	170,769	(16,129)
Newfoundland Power (Mutual Aid) *(Note 2)*	253,955	259,895	(5,940)
T & T Line Construction (Contractor)	135,718	135,718	-
Ontario Line Clearing & Tree Experts (Contractor)	281,994	281,994	-
City of Summerside Electric Utility (Mutual Aid)	5,656	5,656	-
Saint John Energy (Mutual Aid)	38,559	38,559	-
PEI Forestry	15,487	15,487	-
Green Isle Air Ltd - Helicopter Inspection	2,340	2,340	-
Go With the Flow Traffic Control	175,072	175,072	-
Subtotal	**2,096,510**	**2,097,186**	**(676)**
Total	**3,465,790**		

Note 1: *There was one H-Line invoice which did not directly tie to the Dorian Cost allocation in the general ledger. We were unable to reconcile the difference prior to the release of this report.*

Note 2: *Total costs reported in the Storm Dorian Post-Mortem Report included estimates for invoices that had not been received at the time of filing. The final invoice was greater than was originally estimated.*

Findings and observations – total costs incurred

- Nothing has come to our attention that would suggest that the total costs incurred by MECL regarding their response to Storm Dorian are unreasonable. Therefore, based on the tests outlined above nothing has come to our attention that would suggest the expenditures incurred by MECL were not incurred during the timeframe of the Storm Dorian event.

2. Treatment of costs – capital vs operating

MECL discusses allocating a portion of the Storm Dorian costs between capital and operating.

Test of cost allocation details

During our review of the mutual aid and contractor invoices we noted the following errors with respect to the allocation of the invoices between capital and operating:

Item	Capital ($)			Operating ($)		
	MECL	GT	Difference	MECL	GT	Difference
Atlantic Reach Electric Ltd	4,570	-	4,570	249,675	254,245	(4,570)
GSD Utility Services Inc.	83,105	-	83,105	-	83,105	(83,105)
Go With the Flow Traffic Control	26,344	17,509	8,835	148,730	157,565	(8,835)
Total	**114,019**	**17,509**	**96,510**	**398,405**	**494,915**	**(96,510)**

We identified invoices that were coded to capital which were inconsistent with their described methodology. We discussed these items with MECL and determined that the allocation was an error and the balances were operating in nature. As a result, the operating costs for deferral are understated by $96,510 and capital costs are overstated by $96,510 as summarized in the table above.

Findings and observations – treatment of costs – capital vs operating

- Nothing has come to our attention that would suggest MECL's classification of Storm Dorian costs between capital and operating expenses is inappropriate with the exception of the $96,510 error noted above.

3. Cost allocation methodology

The allocation of costs such as those incurred to address the impact of Storm Dorian between capital and operating would not be standard across all weather events. The cost allocation would be judgementally determined based upon the nature of work which is required during the restoration process, either operating or capital in nature.

MECL has explained in their December 13 Cost Allocation Memo that *"…the rationale for this allocation was based on the type of system damage that occurred and restoration approach that was required to safely re-energize lines…The system impact of Dorian was predominately power outages due to trees on lines and lines taken down by trees."* Furthermore, *"the tree damage resulting from Dorian however was extraordinary, as were the resource requirements for clearing lines before any restoration work could begin....[and] as tree removal is an operational expense, it factored materially into the overall storm cost allocation."*

MECL's December 13 Cost Allocation Memo explains that *"capital costs from the storm were associated with broken poles, damaged transformers and where necessary, main line and service wire replacement. Storm related capital costs such as these can vary considerably depending upon the conditions of the work. Dorian was a later summer storm….a similar event in winter conditions could increase labour cost to complete the same amount of work…* [therefore] *a 10% allocation for capital costs is reasonable."*

We have considered MECL's explanation of their allocation in the context of the nature of the work that was described on invoices and in updates from the MECL operations team to MECL leadership. Specifically, we reviewed the following supporting documents regarding cost allocation of MECL being 90% operating and 10% capital:

- Daily email correspondence between the Manager of Transmission and Distribution Operations and the MECL leadership team throughout the storm restoration, which highlighted specific references to the damage caused by downed trees on line;

- Similar emails provided by the Company to the Commission throughout the restoration;

- The December 13 Cost Allocation Memo discussing the rationale for the cost allocations; and

- Photos comparing storm damage that was experienced in the 2018 storm to the Storm Dorian as a visual aid in assessing the allocation of the restoration costs.

Comparison to impact of the 2018 storm

Additionally, we considered how MECL has allocated costs between capital and operating expenses in the recent past. Specifically, we considered MECL's treatment of the 2018 winter storm and noted the following:

Item	2018 Storm		2019 Storm	
	Costs ($)	%	Costs ($)	%
Capital	861,296	75	388,110	11
Retirement	149,475	13	74,796	2
Operating	133,729	12	3,002,884	87
Total	**1,144,500**	**100**	**3,465,790**	**100**

We compared the impact of Storm Dorian to the impact of the 2018 storm for illustrative purposes. There is a significant difference between the two storms in terms of the allocation of costs between capital and operating. However, according to MECL's response to IR-4 *"the damage experienced by Dorian was different in that the costs incurred substantially related to removing downed trees from lines and repairing the existing conductor and lines. Such costs are considered operating in nature …"* This resulted in 87% of the costs incurred being recorded as operating with the remaining costs of replacing the poles and conductor broken during the storm representing in 11% of total costs as capital and 2% as asset retirement.

Findings and observations – cost allocation methodology

- Nothing has come to our attention which would suggest that MECL's position of allocating invoices between capital or operating based on the vendors description of the services provided, and allocating internal expenses 90% operating and 10% capital based on the nature of the work performed on the overall Storm Dorian work was unreasonable.

4. Impact on rate payers for cost classification

We have provided some background information on the impact to rate payers when deciding the appropriate allocation of one-time costs between capital and operating classification:

- **Capital assets** – the balance that is capitalized as a result of Storm Dorian would ultimately be added to MECL's rate base upon which future returns on rate base are calculated and included revenue requirement. In addition, depreciation expense is calculated on the balance each year based on the useful life of the capital asset. This depreciation is included in the calculation of the revenue requirement to recover the cost of the asset over time.

- **Deferred operating expenses** – operating expenses that are deferred through the setup of a regulatory asset are recovered from rate payers through annual amortization of the balance and the rate of return calculated on the regulatory assets as it is included in rate base. For example, in this case the Storm Dorian costs are amortized over 2020 and 2021 then the full balance is recovered by MECL through rates in each of those years. The deferred balance is taken into annual operating expenses in each of the years over which it is amortized increasing the operating expense that year and thereby increasing the revenue requirement that is used in the rate setting process. At this time, MECL has not quantified the impact to rates however, we understand that this would be a matter that the Commission would consider during the March 1, 2020 rate setting process.

Findings and observations – impact on rate payers for cost classification

- Given that the majority of the costs incurred from Storm Dorian are operating in nature, the bulk of the impact to rate payers will be in the form of an increased revenue requirement for 2020 and 2021. At this time, MECL has not quantified this impact but we recommend that this issue be specifically addressed in the March 1, 2020 rate setting process.

5. Deferral and amortization period

MECL's requests regarding the treatment of the Storm Dorian costs has evolved from their original letter dated September 26, 2019 and their letter dated December 17, 2019. We have considered both requests in our review of the deferral and amortization of the operating costs associated with Storm Dorian.

In the September 26, 2019 letter MECL requested *"…approval to defer the operating costs related to Hurricane Dorian and amortize these costs over a three-year period. The Company also proposes to recover amortization from customers as a rate rider on the customer's monthly bill over the three-year period."*

The proposed three-year amortization was intended to provide a reasonable balance between the rate impact on customers and the need to maintain good utility practice of collecting costs from customers within a reasonable and prudent period of time, as per Interrogatory response number 4 ("IR-4").

Furthermore, IR-4 states that the Commission may consider offsetting any Rate of Return Adjustment ("RORA") amounts that may be incurred in 2019 or future years by expensing Dorian related costs up to that amount in the year realized.

In the December 17, 2019 letter MECL requested *"…regulatory approval to use 2019 excess revenues to offset the incremental Dorian restoration operating costs. The amount of excess net revenues for 2019 will not be known until year-end. However, Management proposes that any residual restoration operating costs, not offset by 2019 excess net revenues, be deferred and recovered over the years 2020 and 2021 or in a manner to be determined by IRAC."*

Findings and observations – deferral and amortization period

- Storm Dorian was an extreme weather event resulting in an over $3 million impact to operating expense for MECL. Therefore, MECL's September 26, 2019 request for "*…approval to defer the operating costs related to Hurricane Dorian…*" does not appear unreasonable. Grant Thornton has reviewed the deferral of one-time operating expenses in other jurisdictions when the utility is attempting to minimize the fluctuation in customer rates from one period to the next. MECL's request to defer and amortize these costs is consistent with the treatment of operating costs arising from extreme weather events by other utilities.

- MECL's request to defer the Storm Dorian costs over the remaining term of this rate setting period does not appear unreasonable as it balances their objective of smoothing the impact to rate payers with their objective of recovering costs of providing electrical service from the customers that are using the service in the current rate setting period.

6. Use of 2019 excess net revenues and the Energy Cost Adjustment Mechanism

MECL has requested "…regulatory approval to use 2019 excess revenues to offset the incremental Dorian restoration operating costs. The amount of excess net revenues for 2019 will not be known until year-end…"

Based upon our scope of review to date we are unable to comment on whether or not this treatment is appropriate. While MECL's request does not appear unreasonable, without a complete picture of the total 2019 excess earnings and the options for applying those earnings to other outstanding issues associated with the December 31, 2019 information scheduled to be filed by MECL on January 31, 2020, we are unable to determine what other options may exist for the use of these funds and the overall impact to rate payers in 2020.

Furthermore, at the time of this report we have not reviewed the ECAM and therefore we are not in a position to comment on whether or not MECL's request regarding *"…should the excess net revenues from 2019 exceed the post tropical storm Dorian restoration operating costs, Maritime Electric requests an order from the Commission to apply the net amount to the accumulated balance in the ECAM deferral account"* is reasonable. There are several open items on-going in the 2020-2021 rate setting process and as a result the Commission may want to consider delaying a decision on the 2019 excess earnings, any RORA balance as of December 31, 2019 and the ECAM balance until they have completed their review of all of the outstanding items in preparation for their decision regarding March 1, 2020 rates.

7. Overall conclusion

In summary, on December 17, 2019 MECL requested the following:

- *"…an order from the Commission authorizing the deferral of any net residual post tropical storm Dorian restoration operating costs where the excess net revenues are not sufficient to fully recover these unplanned costs in 2019. Further, should the excess net revenues from 2019 exceed the post tropical storm Dorian restoration operating costs, Maritime Electric requests an order from the Commission to apply the net amount to the accumulated balance in the ECAM [Energy Cost Adjustment Mechanism] deferral account."*

Based on the results of the work outlined throughout this document we have concluded the following:

- Nothing has come to our attention that would suggest that: 1) the total costs are unreasonable; 2) the expenditures incurred by MECL were not incurred during the timeframe of the Storm Dorian event; 3) MECL's classification of Storm Dorian costs between capital and operating expenses is inappropriate with the exception of the $96,510 error noted above; 4) MECL's position of allocating invoices between capital or operating based on the vendors description of the services provided was unreasonable; and 5) the request for "…approval to defer the operating costs related to Hurricane Dorian…" is unreasonable.
- MECL's request to defer the Storm Dorian costs over the remaining term of this rate setting period does not appear unreasonable.
- Without a complete picture of the total 2019 excess earnings and the options for applying those earnings to other outstanding issues associated with the December 31, 2019 information, we are unable to determine what other options may exist for the use of these funds and the overall impact to rate payers in 2020.
- We have not reviewed the ECAM and therefore we are not in a position to comment on whether or not MECL's request regarding "…should the excess net revenues from 2019 exceed the post tropical storm Dorian restoration operating costs, Maritime Electric requests an order from the Commission to apply the net amount to the accumulated balance in the ECAM deferral account" is reasonable.

I trust this is the information you require. If you have any questions or require further clarification, please contact the undersigned.

Yours sincerely,

Grant Thornton LLP

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