



One Island Community
One Island Future



PEI Energy Accord *Backgrounder*



What is the PEI Energy Accord?

The *PEI Energy Accord* is an agreement developed by the Province of Prince Edward Island in close collaboration and partnership with Maritime Electric Company Limited (MECL). The Accord draws on a number of instruments available to Government including legislative powers, lower cost financing, alternative programming, long term planning and Government to Government relations.

The Accord is formed and shaped by the following goals:

1. Lowering electricity rates.
2. Stabilizing electricity rates.
3. Increasing PEI's reliance on locally owned wind power.

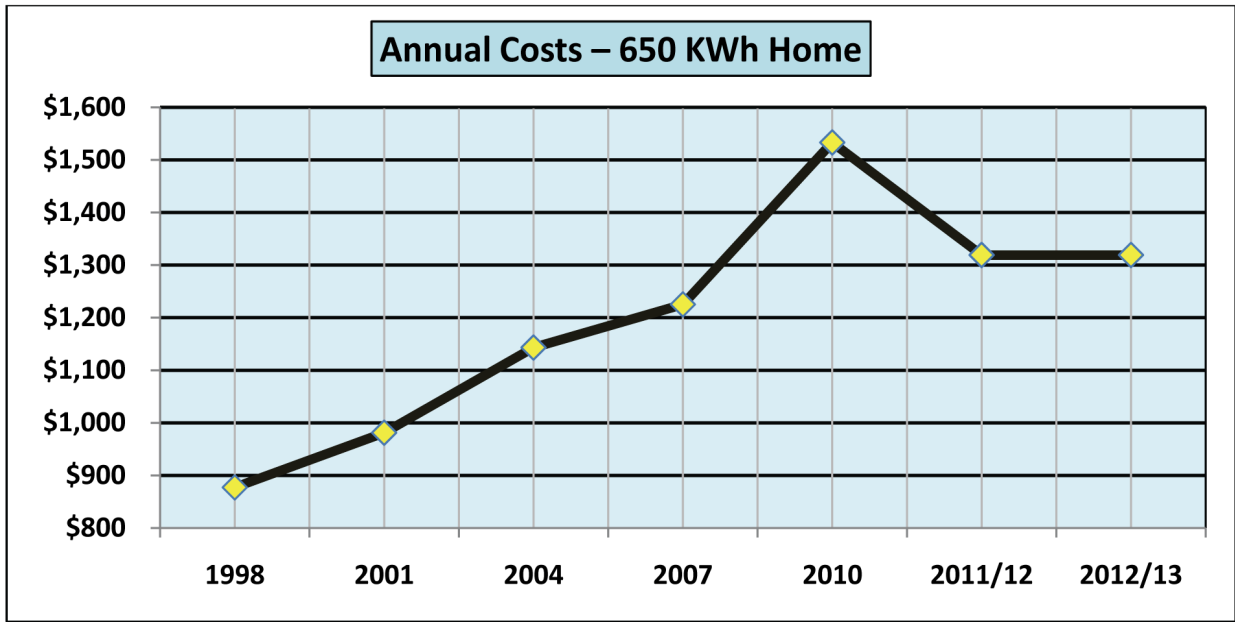
The Accord will take effect on March 1, 2011 to coincide with the start of a new Power Purchase Agreement (PPA) supplying over half of PEI's energy requirements.

High Electricity Costs

Over the past thirty years successive Governments have focused on the high cost of electricity. A Commission has been called; new PPA's negotiated; price cap models implemented and price cap models ended. Renewable energy has been pursued and multiple alternative models explored.

Because of our undue reliance on imported energy, Islanders have often been subjected to increasing costs of electricity and price spikes. Since 1998, electricity costs have risen by close to an average of 5% annually, almost double historic inflation levels.

Under the Accord, rates will drop by 14% in the first year and be frozen in the second year.



Forecasts for years 3-5 of the Accord project rate increases at approximate inflation levels of 2.5% annually (well below the 5% annual increases between 1998 and 2010). Almost all of these future increases can be attributed to long term financing of Pt. Lepreau when it returns to service in late 2012. In short, this forecast model accounts for the fully amortized costs of repayment of Lepreau.

A new rate structure will be developed for regulatory consideration in late 2012 which will have up to date information respecting Lepreau and can draw on the expertise of the Commission on the Future of Electricity on PEI.

Future Trends and Issues

Electricity pricing is highly complex. Not only must Islanders contend with current and historic factors that have resulted in rising costs (not the least of which were the oil price shocks of 2008-09), but there are emerging factors that need to be planned in a careful and thoughtful manner. These include:

1. Planning for a New Cable

The two submarine Cables, which are the lifeline of electricity for Islanders, are coming to the end of their useful life. A new 200 MW Cable is required to ensure Islanders have a continuous supply of energy for generations to come.

Current estimates place the capital cost of this Cable and its interconnections at \$90 million. While there are ways in which these costs can be mitigated, significant planning and consultation with Islanders is required before long term commitments are made.

2. Delays At Pt. Lepreau

MECL receives approximately 20% of its energy from Pt. Lepreau. Over the past 25 years, Lepreau has provided Islanders with cheap, dependable energy and base load supply.

To ensure these benefits continue, the plant required a major refurbishment.

The refurbishment of Lepreau was scheduled to take 18 months to complete with a return to service in 2009. During the construction phase, ratepayers would have to absorb the incremental costs associated with replacement energy and continue to make monthly operations and related payments.

The project has been plagued with delays and will not return to service before the fall of 2012: three years behind schedule. These delays have resulted in mounting deferred costs which have not yet been reflected in current rate structures.

Compounding this has been the manner in which these deferred costs have been financed. With IRAC approval, MECL has financed the deferred costs using acceptable private sector debt/equity models. The effective financing rate has been approximately 7% annually.

3. **Planned Exit From Dalhousie Power Agreement**

MECL receives approximately 15% of its energy supply from the Dalhousie plant in New Brunswick. This is now expensive energy for Island ratepayers and there are long term structural benefits in severing our ties to this supply. Under current plans this \$9 to \$13 million exit cost would have been absorbed in one year resulting in a short term price shock. The Accord will address this matter.

4. **Managing Electricity on PEI**

As previously noted, electricity pricing is highly complex. The current regulatory models, financing structures and operating practices can all impact future rates positively or negatively.

Government does not believe it has sufficient and informed information to conclude whether the current structure best serves Islanders. And more to the point, Government is firmly convinced that Islanders have not been afforded an adequate opportunity to weigh in on these matters.

Any deliberations on matters of such complexity and importance need to be considered in the context of informed research, objective analysis, transparency and inclusiveness. This Accord will speak to these principles.

Elements of the Accord

The Accord is a series of inter-related actions comprised of:

1. **New Power Purchase Agreement (PPA) with NB Power**

For the past year, the Province and MECL have been actively seeking a new PPA to supply more than half of PEI's energy supply over the next five years. This search has involved ongoing discussions with multiple suppliers, including Hydro Quebec.

The timing for a new PPA is opportune given the expiry of the current PPA, excess supply in the marketplace, natural gas prices being delinked from oil prices and a strong dollar.

By securing a new PPA with NB Power, there are two particularly significant features:

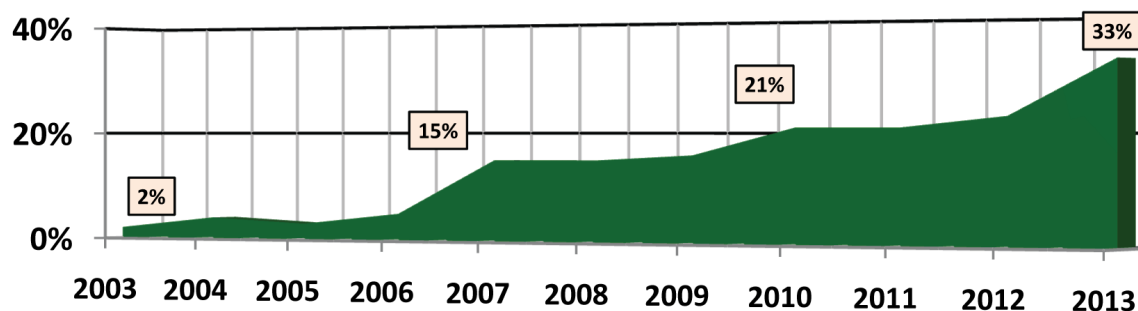
- The base line cost of PPA energy is approximately 14% lower than in 2010, thus providing Islanders an opportunity to have their rates reduced.
- The annual increase in energy supply costs will be 1%, well below projected inflation increases in the 2.5% range. This stabilizing nature of the PPA will assist Islanders in being able to achieve better rate predictability over the next five years.

2. **Increasing Publicly Owned Wind Power**

Islanders have a rich resource in their wind capacity. Over the past decade, PEI has not only reduced its reliance on expensive and volatile fossil based fuels, but it has done so in an environmentally and economically responsible manner. More can and will be done.

Under the provisions of the Accord, and in keeping with the 10 Point Plan on Renewable Energy, Government will double its reliance on locally owned and produced wind energy.

Through a new PPA, Government will add 30 MWs of publicly owned wind power which will be in operation by 2013. In addition WEICan will add 10 MWs of wind power by 2012. This will ensure that the rural based WEICan is sustainable well into the future.



The PEI Energy Corporation has considerable expertise in wind farms. Through PPA's with the PEI Energy Corporation, the base price for this new wind power will be \$78.00 per MWh with annual increases (0.5% annually) well below projected inflation levels. Not only do these prices compare favourably with other energy sources, but these measures will reduce PEI's carbon footprint on a go forward basis.

And perhaps most importantly, PEI will take a major step forward in reducing its reliance on imported energy. This measure will increase locally produced and owned wind power from approximately 16% in 2008 to 33% in 2013. This increase will make PEI a world leader in the integration of wind power for domestic use.

3. *A Commission on the Future of Electricity on PEI*

While there are a number of measures Government and its partners can introduce to bring life to the objects of this Accord, there are many other complex issues which need to be examined and addressed in a thoughtful, careful manner.

The Accord will call for the establishment of a new *Commission* which be **expert, nonpartisan and inclusive** of Islanders' views. This *Commission* will examine and consult with Islanders on the following key items:

- Provide specific advice and analysis on long term financing of Pt. Lepreau deferral costs.
- Provide advice and recommendations with respect to a new Cable.
- Review all aspects of the structural considerations that impact on the cost of electric energy sold and delivered to Island consumers.
- Taking into account the above, provide recommendations to IRAC on future rate issues beginning in March, 2013.

Details of the *Commission* will be announced at a later date.

4. **Pt. Lepreau Financing – Short Term**

While deferral costs for Pt. Lepreau will continue to grow by approximately \$2 million per month, rather than follow the traditional and more expensive path of financing future deferred Lepreau costs using private sector based debt/equity instruments (approximately 7%), under the Accord beginning in March, 2011 Government will use its preferred financing ability to underwrite these costs.

By drawing on lower interest costs, ratepayers will save approximately \$2.9 million over the shorter term.

Government will look to the *Commission* to provide advice on the most effective way in which total Lepreau costs will be financed over the longer term (25 – 30 years); but when Lepreau returns to service, through legislation, all costs borne by Government will be fully absorbed through electricity bills. Again, these forecasted costs are built into the projected 2.5% annual increases for years 3 – 5.

5. **Planning for a New Cable**

While work has begun to plan for a new 200 MW Cable to ensure PEI has energy security for years to come, more work is required. To assist the *Commission* in its mandate, a Federal-Provincial-Utilities Planning Committee will be established to examine ways and means by which a new Cable can be added without causing undue impact on the future rate structure for Islanders. The *Commission* process will ensure Islanders have direct input on this matter.

6. **Greater Focus on Intergovernmental Collaboration**

Intergovernmental relations greatly assisted in landing a much improved PPA. More can be done. Over the next two years, Government will step up its intergovernmental efforts in addressing short and long term issues affecting electricity costs on PEI. This will include:

- Relief associated with delays at Lepreau.
- Supporting and actively participating in Atlantic energy strategies.
- The previously noted Cable planning process.
- Intergovernmental collaboration with respect to Demand Side Management (DSM) and other energy efficiency matters.

7. **Dalhousie Financing**

Ending our arrangements with Dalhousie will structurally benefit ratepayers over the longer term. Applying these costs over a one year period does not reflect the long term nature of this benefit. Under the Accord, Government will finance these costs over a ten year period and recover all of its cost through rates. Subject to further negotiations with NB Power and MECL, the estimated one time cost is expected to be in the \$9 million to \$13 million range. The financing costs will be offset by purchasing lower priced energy through the PPA, wind and nuclear sources.

8. Stabilizing In-Year Rate Increases

Not only have Islanders had to deal with rate spikes from year-to-year, but many times the unit price of electricity has jumped from month to month. All MECL ratepayers experienced this in-year monthly adjustment this past August.

To mitigate this matter and advance the Accord's goal of rate stability, beginning March, 2011 Island ratepayers will receive monthly bills that are consistent throughout the year. This means that an Island ratepayer who consumes the same amount of electricity each month will receive a bill in the same amount each month. At the end of each year, there will be a 'true-up' to adjust for any under/over charges in that particular year; however, it is projected that this adjustment will be minor in nature.

9. Integrating Demand Side Management (DSM) Programs

Economies of scale can be realized by integrating MECL's \$600,000 DSM program into Government's \$1.8 million Office of Energy Efficiency. Any incremental costs to Government will be more than offset by overall savings to Government under the Accord.

10. Legislating Two Year Rates

MECL recently completed a detailed IRAC rate hearing. These hearings are expensive and the costs are borne by ratepayers (normally in excess of \$500,000 per application). Legislating rates over two years will assist ratepayers by avoiding the costs of another expensive rate hearing.

Through the *Electricity Rate Reduction Act*, electricity costs across rate categories will be reduced by 14% in March, 2011 and frozen for a one year period, beginning in March, 2012.

With the benefit of the work of the *Commission* and the other tools available to Government and Island utilities, over the next two years all options will be examined to reduce any future increases. The parties to this Accord are committed to rate reduction and rate stability.

11. Equitable Distribution of Benefits

All rate classes, be it residential, general service or industrial are more or less equally impacted by rate disparity measures with other provinces. For this reason, the benefits of this Accord will be equally distributed amongst all rate classes.

Benefits of the Accord

Measured against the objectives of this undertaking, the Accord will achieve the following:

1. **Rate Reduction**

- A 14% electricity cost reduction across all rate categories beginning March, 2011.
- Overall rates paid by Islanders will be approximately \$25 million a year lower than in 2010.
- Government's electricity costs will be reduced by \$1.2 million annually.
- Islanders on fixed incomes, notably seniors will benefit from this immediate rate reduction.

2. **Price Stability**

- Rates remain frozen from March, 2012 to March, 2013.
- Outer year rates will be within projected inflation levels of 2.5% (including Lepreau).
- In-year (month to month) rate increases are stabilized under provisions of the Accord.
- Increased reliance on non fossil based energy (wind power and nuclear) will stabilize prices in the longer term.

3. **Increased Domestic Production of Wind Power**

- By doubling wind power to 33% of supply, Islanders will reduce their reliance on imports.
- Publicly owned wind energy is now price competitive with other sources of supply.
- Greater reliance of clean renewable energy is environmentally responsible.
- Island wind farms normally generate a profit for Government.