Decision Report: 2018-2022 Performance Based Regulation Plans

EXECUTIVE SUMMARY

This report summarizes the Alberta Utility Commission's (AUC) decision on the second generation Performance Based Regulation (PBR) Plans for the 2018-2022 period. This proceeding addressed a number of important issues for the energy distribution utilities as they prepare applications for their 2018-2022 PBR plans. The City's intervention in this proceeding contributed to the outcome which is favourable for limiting future increases in The City's cost of utilities.

ADMINISTRATION RECOMMENDATION(S)

That the Gas, Power and Telecommunications Committee:

1. Receive this report for information.

PREVIOUS COUNCIL DIRECTION / POLICY

This Gas, Power and Telecommunications Committee (GPT) requests that reports be prepared to summarize the decisions made on proceedings where The City has participated as an intervener.

BACKGROUND

The Alberta energy distribution utilities are currently in the first generation of PBR which covers the 2013-2017 period. Under PBR a utility's rates are adjusted annually by a formula, denoted by (I-X), where "I" is the inflation rate and "X" is a factor for productivity gains that the utility is expected to achieve. With revenue that is fixed for each year the utility has an incentive to increase productivity and decrease costs in order to enhance their profitability.

The utilities under PBR will be preparing their plans for the 2018-2022 PBR period. The AUC held this proceeding to consider adjustments to the PBR regulatory structure including:

- Rebasing and the going-in rates for the second PBR term
- The productivity factor (the X factor lowers the annual increase in rates)
- Adjustments to the funding arrangements for capital additions, and
- The calculation of the return on equity (ROE) for reopener purposes.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

These issues are addressed separately below.

Rebasing and the going-in rates

Rebasing refers to the exercise of resetting the utility's revenue requirement and customer rates at the beginning of the new PBR term. Consumers benefit from rebasing when cost efficiencies achieved by the utility in the first PBR term result in a lowering of the going-in rates for the next PBR term.

Most of the utilities in this proceeding argued for a cost of service approach to rebasing whereby operating and capital costs are forecast for 2018, the first year of the second PBR term. Customer rates would then be adjusted such that the utility is expected to make its approved ROE.

Consumers were concerned that the utility proposed prospective cost of service methodology would result in higher rates over the next five year PBR term because utilities would have an incentive to overestimate their expected costs. The City proposed that the rebasing of operating and maintenance (O&M) expenditures should be based on an average of three years of actual costs during the current PBR term so that consumers are able to share the benefit of efficiencies that have been achieved by the utilities. With respect to rebasing capital, The City supported using the 2017 mid-year rate base with the 2017 capital tracker projects trued-up to actual costs.

The AUC decided that rebasing of O&M costs for each utility will be based on the lowest O&M cost year in the current PBR term, restated to 2017 dollars, with adjustments as necessary to reflect material anomalies specific to that year. The capital component is also to be set to actual amounts but the process is a little more complicated. To determine the 2017 capital rate base the utilities are to start with the actual 2016 closing rate base adjusted for asset dispositions, add the actual average capital additions for non-capital tracker capital converted to 2017 dollars and the approved 2017 forecast capital tracker additions.

Administration views this to be a favourable decision on rebasing because determining the going in rates based on actual expenditures rather than a forecast of revenue requirements provides the best opportunity for consumers to share in the benefits of efficiencies achieved under PBR. The AUC decision on rebasing the O&M expenditures was even more favourable than the position advocated by The City in its intervention.

<u>The Productivity Factor (X Factor)</u>
The City did not submit separate expert testimony on determining the X Factor for the next generation of PBR. Instead, The City supported the submissions of Dr. Lowry of Pacific Economics Group (PEG) that were made on behalf of the Consumer Coalition of Alberta (CCA). There were a number of utility growth studies submitted in this proceeding resulting in proposed values for the X Factor ranging from -0.79% to +0.75%. A negative value for the X Factor implies that the energy distribution utilities anticipate declining productivity over the next five year period. The various growth studies were based on different data sets and different assumptions leaving the AUC with a difficult decision. The AUC determined that a reasonable X Factor for the next generation of PBR plans will be 0.3%.

While the X Factor will decline from the current rate of 1.16%, the interveners' arguments for a positive X factor due to the expectation of positive productivity growth were recognized in the AUC decision.

<u>Treatment of Capital Additions</u>
In the initial PBR term, the AUC incorporated a "capital tracker" mechanism to provide the utilities with additional funding for capital projects where the (I-X) formula was shown to be insufficient. The capital tracker mechanism proved to be very generous and contributed to utility profits that exceeded the approved rate of return.

The utilities and their expert witnesses argued that an incremental funding mechanism is still required in the next generation of PBR plans. The City's position, which was directed to the proposed PBR plan for ATCO Gas, was that ATCO did not demonstrate a need for additional capital funding and that to do so would provide ATCO with revenue that was not necessary to achieve the approved rate of return. Therefore, The City advocated for the removal of the capital tracker mechanism for ATCO Gas and to rely on the reopener clause to provide a safety net for the utility should they achieve significantly less than the approved rate of return.

New Approach to Capital Funding
In its decision, the AUC found that there is a continuing need for incremental capital funding but made significant changes to the funding mechanism. Capital programs are to be divided into Type 1 and Type 2 capital. Type 1 capital is characterized by expenditures outside of management's control, are very difficult to forecast or have a high degree of variability from year to year. Type 1 capital would be treated in a similar manner to capital tracker projects in the current PBR plans.

Type 2 capital are those projects that are typically under management planning and control and these will be under a new regulatory approach where the utilities will be given a predetermined annual amount of funding. All assets currently in the rate base will be treated as Type 2 capital, so initially there will be no Type 1 capital programs included in the going-in rates for the next generation of PBR. Furthermore, the accounting test that calculated whether additional funding was required for each capital project in the rate base is to be amended such that the rate base will be evaluated comprehensively and additional funding for Type 2 capital will only be provided if there is a funding deficit for the rate base as a whole at the point of rebasing.

The changes made to the capital funding mechanism will likely result in a decrease in the additional capital funding provided to the utilities, and will therefore restrain future rate increases. The new funding mechanism for Type 2 capital does not require true up proceedings and there will likely be a decrease in the overall regulatory burden. Furthermore, the setting of the annual additional capital funding during the determination of the going-in rates will limit the ability of the utilities to increase rates by purposely accumulating similar capital expenditures in the same year with the intent of maximizing capital tracker funding.

Reopener Provision Tied to Return on Equity
There is a return on equity (ROE) based reopener provision in the PBR plans that are triggered if a utility's ROE exceeds 500 basis points over the approved ROE in a single year or by 300 basis points in two consecutive years. The AUC addressed the question as to whether the utilities were required to adjust their financial filings from previous years to reflect changes such as regulatory decisions or true-ups. The AUC directed the utilities to file annually a schedule that details the effects of regulatory decisions on the ROE of previous years. This is a change that The City has been requesting.

Stakeholder Engagement, Research, and Communication
As this is an information report to GPT, no stakeholder engagement or communication is required.

Strategic Alignment
The City's involvement in regulatory proceedings is in alignment with the mandate of the Gas, Power, and Telecommunications Committee.

Social, Environmental, Economic (External)
No implications were identified.

Financial Capacity
Current and Future Operating Budget:
Successful intervention in this AUC proceeding will lower The City's cost of utility service from that which would have resulted had the AUC accepted the utility's proposals for their 2017-2022 PBR plans.
Current and Future Capital Budget:
No implications were identified.

Risk Assessment
No risks to The City from this proceeding were identified.

REASON(S) FOR RECOMMENDATION(S):
The Gas, Power and Telecommunications Committee requests that a report be prepared on decisions taken by the Alberta Utilities Commission on proceedings where The City participated as an intervener. There are no decisions required and it is therefore recommended that the report be received for information.

ATTACHMENT(S)
None