Decision Report – The 2018-2022 Performance Based Regulation Plans

EXECUTIVE SUMMARY

The Alberta Utilities Commission (AUC) has issued a decision that will determine the utility rates for the Alberta’s gas and electric distribution utilities over the 2018 to 2022 Performance Based Regulation (PBR) term. The decision sets out how the 2017 revenue requirement is to be determined for each utility to set the going-in rates for 2018. This report summarizes the positions taken by The City in its intervention and the outcomes as set out in the AUC decision.

ADMINISTRATION RECOMMENDATION:

That the Gas, Power and Telecommunications Committee:

1. Receive this report for information.

PREVIOUS COUNCIL DIRECTION / POLICY

The City has participated in, and reported on, all of the previous AUC proceedings related to the development of the Performance Based Regulation regime. In GP2010-25, GPT directed Administration to participate in the PBR proceedings. The main PBR proceedings were the initial 2012 Rate Regulation Initiative, reported in GP2012-0711, and 2013 PBR Capital Trackers, reported in GP2014-0050.

BACKGROUND

The AUC decision on the Rebasing and Going-in Rates for the 2018-2022 PBR proceeding will determine the rates from 2018-2022 for AltaGas Utilities, ATCO Electric (distribution), ATCO Gas, Enmax Power, EPCOR Distribution and FortisAlberta.

In PBR, rates are set by determining the revenue requirement (total operating and maintenance costs plus the funding needed to support capital expenditures) for the initial year. For every other year of the PBR 5-year term, rates are increased according to a formula. While there are a number of allowed adjustments, the formula for increasing rates is basically inflation minus a productivity factor (I-X). With the revenue fixed for each year the utilities are incented to lower their costs so that they can increase their profitability. This incentive to develop efficiencies is designed to make the regulated utilities behave more like firms in a competitive market.

The utilities are able to keep any additional profits they are able to achieve through productivity gains over the 5-year PBR term. At the beginning of the next PBR term the utility rates are lowered theoretically to the point where the utilities are expected to achieve their approved return on equity. The benefit of productivity gains achieved by the utilities over the previous PBR term are transferred to ratepayers through a lowering of the rates. This is why the rebasing and determination of the going-in rates are so important to ratepayers.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Rebasing and Going-in Rates

In this proceeding, the utilities made compliance filings to an earlier AUC initiated proceeding that established parameters for the second generation of performance-based regulation plans. For operating and maintenance costs, each utility determined which year in the first PBR term had the least cost. The AUC provided the opportunity for each utility to apply for adjustments to the lowest cost year because of special circumstances, called anomalies, that made the operating and maintenance costs unusual for that year.

The utilities were directed to average the last three years of capital expenditures to arrive at a notional amount for annual capital additions. The annual capital additions are added to the adjusted rate base to calculate each utility's annual requirement for capital funding. Experience has shown that the annual capital funding component provided by the PBR formula is insufficient to support the actual capital expenditure programs of the utilities. Therefore a mechanism has been developed to provide additional capital funding.

Additional Funding for Capital – the K-bar Mechanism

In the first PBR term, additional funding for capital was managed through capital trackers. Capital trackers were a cost of service process where a capital funding shortfall was identified and additional funding was provided as needed. Capital projects were reviewed after completion and the additional amount of funding provided was adjusted with a true up proceeding. This process did not provide the PBR style incentive where the utilities were rewarded for finding efficiencies in their capital expenditures.

For the second PBR term the AUC wanted to bring funding for capital expenditures into the PBR framework. This required the determination of a base amount of additional funding required for capital in the initial year of the PBR term that would be increased annually by the PBR I-X formula. Epcor proposed the K-bar mechanism for providing additional capital funding and this was broadly accepted by the AUC.

The City evaluated the originally proposed K-bar mechanism and determined that it was too generous because the K-bar mechanism did not account for the declining value of the annual capital additions as they are adjusted for depreciation. In their decision, the AUC adjusted the K-bar mechanism to account for the annual application of depreciation to the rate base.

Anomalies – Adjustments to the Going in Rate

The anomalies applied for by the utilities became a hotly contested issue in this proceeding. The utilities offered a variety of interpretations for the definition of an anomaly leading to an inconsistency in the applications.

In coming to terms with what would qualify as an anomaly the AUC provided clarification by adding the requirement that an anomaly "must not be costs that each distribution utility, operating under the incentives of the PBR mechanism, unencumbered by incentives inconsistent with the PBR incentives, would have incurred in 2017". Following this clarification, the AUC denied all of the anomalies applied for by the utilities. Several utilities took exception to this treatment of their anomalies believing that it does not give them a reasonable opportunity to earn a fair rate of return and have filed applications at the Alberta Court of Appeal.

The City, which focussed its intervention on the ATCO PBR plan, submitted that ATCO should have its information technology costs treated as placeholders until the AUC decides on the ATCO Utilities IT Common Matters proceeding. The City was concerned that any adjustment to ATCO IT costs, including potentially a refund to ratepayers, should be made to ATCO's going in rates. The AUC decided in favour of The City's position on this issue.

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Stakeholder Engagement, Research and Communication

This report provides a summary of The City's regulatory intervention and the AUC decision on the rebasing and going-in rates for the Alberta distribution utilities' 2018-2022 PBR plans. There was no stakeholder engagement, research or communications required.

Strategic Alignment

This report, and The City's intervention in this regulatory proceeding, is in alignment with the mandate of the Gas, Power and Telecommunications Committee.

Social, Environmental, Economic (External)

This report has been reviewed for alignment with The City's Triple Bottom Line Policy Framework. No implications were identified.

Financial Capacity

Current and Future Operating Budget:

As the report does not propose a decision or course of action, there are no budget or business plan impacts.

Current and Future Capital Budget:

As the report does not propose a decision or course of action, there are no budget or business plan impacts.

Risk Assessment

There are no specific risks identified with this report. When regulatory applications are made that may affect The City's interests then participation by The City in a regulatory intervention is necessary to mitigate the risk of a decision contrary to The City's interests.

REASON(S) FOR RECOMMENDATION(S):

This report informs the GPT of the outcome of a regulatory proceeding in which The City intervened.

ATTACHMENT(S)

None