Regulated Rate Initiative - PBR Principles

1 Introduction

On February 26, 2010 the Alberta Utilities Commission (AUC or Commission) began an initiative to reform utility rate regulation in Alberta and invited interested parties to assist the Commission in determining scheduling and the scope of issues for the first stages of the initiative. The Commission stated:

This initiative proceeds from the assumption that rate-base rate of return regulation offers few incentives to improve efficiency, and produces incentives for regulated companies to maximize costs and inefficiently allocate resources. In addition, rate-base rate of return regulation is increasingly cumbersome in an environment where some companies offer both regulated and unregulated services and where operations that were formerly integrated have been separated into operating companies, some of which require their own rate and revenue requirement proceedings. These changes in the structure of the industry, occasioned by the introduction of competition in the retail and generation/production segments of the electricity and natural gas industries, have resulted in additional negative economic incentives for companies regulated under rate-base rate of return regulation. These conditions complicate the task for regulators who must critically analyze in detail management judgments and decisions that, in competitive markets and under other forms of regulation, are made in response to market signals and economic incentives. The role of the regulator in this environment is limited to second guessing. Traditional rate-base rate of return regulation provides few opportunities to create meaningful positive economic incentives which would benefit both the companies and the customers. The Commission is seeking a better way to carry out its mandate so that the legitimate expectations of the regulated utilities and of customers are respected.

The Commission held a roundtable with 18 interested parties on March 25, 2010 to discuss the Commission’s letter and further process steps. During the roundtable participants agreed that the Commission should conduct a workshop so that participants could become more familiar with the theory of and experience with performance-based regulation (PBR). Participants also agreed that the Commission should initiate a short proceeding to establish common principles to guide and assess PBR proposals to be subsequently filed by Alberta distribution utilities within the Commission’s jurisdiction.

In its April 9, 2010 letter the Commission announced that in response to requests by participants, it had engaged the Van Horne Institute to conduct an independent PBR workshop on May 26 -

1 See Attachment 1, Exhibit 6.01 for list of participants.
27, 2010 in order to educate participants about the issues, terminology and concepts raised by performance-based regulation. Participants were informed that the information provided and views expressed at the workshop did not necessarily represent the views of the Commission.

Also, in its letter of April 9, 2010, the Commission initiated a short proceeding to solicit comments on the principles that should guide the development of PBR in Alberta. The proceeding commenced on June 10, 2010 with submissions from parties and closed on June 24, 2010 with the submission of reply comments. The Commission reviewed these submissions and developed the principles for PBR that are set out in this Bulletin.

In its letter of April 9, 2010, the Commission reserved its decision on the question of whether to circulate a bulletin in draft form for comment. After reviewing the material submitted, the Commission has determined that there is a high degree of consensus on the principles that should be used to evaluate specific performance-based regulation proposals and therefore has concluded that circulation of a draft bulletin is not necessary.

2 Commission objectives for PBR

A number of parties suggested that PBR should be based upon a clear statement of objectives. The Commission stated the following objectives for PBR in its February 26, 2010 letter and reaffirms these objectives:

The first is to develop a regulatory framework that creates incentives for the regulated companies to improve their efficiency while ensuring that the gains from those improved efficiencies are shared with customers. The second purpose is to improve the efficiency of the regulatory framework and allow the Commission to focus more of its attention on both prices and quality of service important to customers.

3 Principles

The Commission has reviewed the submissions and reply submissions and finds there is general agreement on the following five principles:

Principle 1. A PBR plan should, to the greatest extent possible, create the same efficiency incentives as those experienced in a competitive market while maintaining service quality.

This principle recognizes that in a competitive market companies have incentives both to increase efficiency and to maintain service quality. Where PBR plans are introduced for monopoly utility services, creating efficiency incentives that seek to mimic those in competitive markets, regulation must also ensure that service quality is maintained. The Commission’s reference to service quality includes a broad range of indicators, including those discussed by the parties.

Appendix 1 lists the parties who made submission and the associated exhibit numbers.

The following parties suggested clear objectives before instituting PBR: AltaLink, page 1; ATCO, page 1; Calgary, Principle 1, page 3; UCA, page 1; IPCAA, Principle 1, page 1.


Appendix 2 lists parties who suggested a similar principle in their submissions.

The following parties suggested service quality related principles in their submissions: First Nations, Principle 1, page 1; EPCOR, Principle 10, page 8; Fortis, Principle 3, page 1; ATCO, Principle 4, page 3; AltaLink, Principle...
Principle 2. A PBR plan must provide the company with a reasonable opportunity to recover its prudently incurred costs including a fair rate of return.\textsuperscript{7}

Principle 3. A PBR plan should be easy to understand, implement and administer and should reduce the regulatory burden over time.\textsuperscript{8}

Principle 4. A PBR plan should recognize the unique circumstances of each regulated company that are relevant to a PBR design.\textsuperscript{9}

Principle 5. Customers and the regulated companies should share the benefits of a PBR plan.\textsuperscript{10}

4 PBR proposals

As noted by the Commission in its letter of April 9, 2010, the distribution companies present at the March 25 roundtable agreed that they could each file a PBR proposal by the end of the first quarter of 2011. Therefore, the Commission directs the Alberta gas and electric utility distribution companies to file their PBR proposals by March 31, 2011. Those distribution companies that are also transmission facility owners may choose to include their transmission components in the PBR plan if that is their preference. Parties are required to explain how their PBR proposals are consistent with the principles set out above and how their proposals satisfy the Commission’s objectives for PBR. After receiving the proposals the Commission will establish a review process.

In the Commission’s opinion, a PBR plan consisting only of an I - X formula would, to the greatest extent possible, mimic the efficiency incentives of competitive markets provided that the X factor requires the company to achieve annual productivity improvements at least equivalent to those of the relevant industry. Therefore, the Commission expects each proposal to include I - X as part of the PBR plan. Some parties proposed principles that dealt with certain aspects of various PBR plans such as exogenous adjustments, earnings sharing, the term of the plan, capital adjustments, reporting requirements and rate structure changes, among others. In the Commission’s opinion, these are more properly considered as potential elements of a PBR plan and are not principles. In making their proposals, companies may choose to include these or other elements in order to address circumstances resulting from Alberta’s market structure, the industries in which the companies operate, unique company-specific circumstances or other circumstances that may be relevant. Companies are expected to fully explain the circumstances that give rise to the need for each element, how each element addresses that need and how each element is justified by the principles and objectives of PBR.

\textsuperscript{7} See Appendix 2 for references.
\textsuperscript{8} See Appendix 2 for references.
\textsuperscript{9} See Appendix 2 for references.
\textsuperscript{10} See Appendix 2 for references.
In their submissions parties raised earnings carryover and plan rebasing issues. The Commission stated in its February 26, 2010 letter that it would consider these factors during the term of the PBR plans. However, given the submissions by several parties, the Commission is willing to consider these issues as part of the companies’ proposed PBR plans.

(Original signed by)

Robert D. Heggie
Chief Executive
## APPENDIX 1

### Rate Regulation Initiative
Submission and Reply Exhibit Numbers

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APPENDIX 2

**Principle 1.** A PBR plan should, to the greatest extent possible, create the same efficiency incentives as those experienced in a competitive market while maintaining service quality.

The following parties suggested a similar principle:

AltaLink Principle 1, page 2; ATCO Principle 1, page 2; Calgary Principles 2, 7, 9, and 10, pages 3-4; Enmax Principles 3 and 8, page 2; Epcor Principle 1, pages 1-2 (and citing James C. Bonbright, Principles of Public Utility Rates, New York: Columbia University Press, 1961, page107), and Principle 9, pages 7-8; Fortis Principles 3 and 6, pages 1-2; CAREA Principles 1 and 2, pages 1-2; UCA Principle 3, page 3; First Nations Principle 1, page 1; IPCAA Principles 8, 12, and 13, pages 1-2; AltaGas, paragraph 12.

**Principle 2.** A PBR plan must provide the company with a reasonable opportunity to recover its prudently incurred costs including a fair rate of return.

The following parties suggested a similar principle in their submissions:

AltaLink Principles 4 and 5, page 2; ATCO Principles 4 and 5, page 3; Calgary Principle 11, pages 4-5; Enmax Principle 2, pages 1-2; UCA Principle 2, page 2.

**Principle 3.** A PBR plan should be easy to understand, implement and administer and should reduce the regulatory burden over time.

The following parties suggested a similar principle in their submissions:

AltaLink Principles 2 and 3, page 2; ATCO Principles 2 and 9, pages 2 and 4; Calgary Principles 4, 13, 16, and 17, pages 3, 5, and 6; Enmax Principles 4, 5, and 9, pages 2-3; Epcor Principles 4 and 5, pages 4-5; Fortis Principles 1 and 2, page 1; UCA Principles 2 and 5, pages 2-3; IPCAA Principles 7, 15, and 16, pages 1-2; AltaGas, paragraph 19.

**Principle 4.** A PBR plan should recognize the unique circumstances of each regulated company that are relevant to a PBR design.

The following parties suggested a similar principle:

AltaLink Principle 6, page 2; ATCO Principle 3, page 2; Calgary Principles 18 and 19, page 6-7; Epcor Principle 7, pages 6-7; Fortis Principle 9, page 3; UCA Principle 1, page 2; IPCAA Principle 17, page 2; AltaGas, paragraph 23.

**Principle 5.** Customers and the regulated companies should share the benefits of a PBR plan.

The following parties suggested a similar principle:

AltaLink Principle 1, page 2; ATCO Principle 6, page 3; Calgary Principles 2, 3 and 6, pages 3-4; Epcor Principle 3, page 4; Fortis Principle 7, pages 2-3; IPCAA Principle 9, page 2; AltaGas, paragraph 14.

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11 All pages numbers are references to the party’s initial submission unless otherwise noted.