AUC
Alberta Utilities Commission

Bulletin 2019-03

March 12, 2019

Generic proceeding to review rate treatment of distribution system acquisition costs under performance-based regulation

The Alberta Utilities Commission is initiating a generic proceeding, Proceeding 24405, to consider and clarify the rate treatment of amounts paid by a regulated distribution utility for the acquisition of other distribution systems or assets under the 2013-2017 and 2018-2022 performance-based regulation (PBR) plan frameworks (acquisition costs).

The Commission has determined that all interested parties (e.g., municipalities owning distribution systems, rural electrification associations (REAs), gas co-ops) would benefit from clarity regarding the rate treatment of these types of purchases by a distribution utility. The generic proceeding will not re-examine how the acquisition costs should be evaluated for prudency nor will it reconsider the parameters, rate adjustment mechanisms, and capital funding mechanisms established or continued by the Commission for the 2018-2022 PBR plans.

1. Background

1.1. Performance-based regulation overview

In Decision 20414-D01-2016 (Errata),[1] the Commission set out the parameters of the 2018-2022 PBR plans for the six distribution utilities: ATCO Electric Ltd. (distribution), FortisAlberta Inc., AltaGas Utilities Inc., ATCO Gas and Pipelines Ltd. (distribution), ENMAX Power Corporation (distribution), and EPCOR Distribution & Transmission Inc. Many parameters of this PBR framework are the same or similar to the parameters of the prior generation of PBR plans adopted by the Commission in Decision 2012-237[2] for AltaGas, ATCO Gas, ATCO Electric, EPCOR and Fortis for the years 2013-2017 and in Decision 21149-D01-2016 (Errata)[3] for ENMAX for the years 2015-2017.

The PBR framework approved in Decision 2012-237, provided a rate-setting mechanism (price cap for electric distribution utilities and revenue-per-customer cap for gas distribution utilities) based on a formula that adjusted rates annually by means of an indexing mechanism that tracks the rate of inflation (represented as I factor) that is relevant to the prices of inputs the utilities

[1] Decision 20414-D01-2016 (Errata): 2018-2022 Performance-Based Regulation Plans for Alberta Electric and Gas Distribution Utilities, Proceeding 20414, February 6, 2017, amending the decision issued December 16, 2016.

[2] Decision 2012-237: Rate Regulation Initiative, Distribution Performance-Based Regulation, Proceeding 566, Application 1606029-1, September 12, 2012.

[3] Decision 21149-D01-2016 (Errata): ENMAX Power Corporation, Distribution 2015-2017 Performance-Based Regulation – Negotiated Settlement Application and Interim X Factor, Proceeding 21149, October 3, 2016, amending the decision issued August 3, 2016.

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use, less a productivity offset (reflected in the X factor). With the exception of specifically approved adjustments, as discussed further below, a utility's revenues were not linked to its costs during the PBR term in order to provide the utility with the flexibility to manage its business in an environment that fosters incentives to seek out and realize process, operational, capital and financial improvements. These improvements lead to lower costs, while maintaining existing service levels.

Additionally, the Commission approved certain rate adjustments to enable the recovery of specific costs where certain criteria have been satisfied to demonstrate that those costs cannot be managed under the I-X mechanism. These adjustments include an adjustment for certain flow-through costs that should be recovered from, or refunded to, customers directly (represented as Y factor), and an adjustment to account for the effect of exogenous and material events for which the distribution utility has no other reasonable cost recovery or refund mechanism within the PBR plan (represented as a Z factor). The PBR framework approved in Decision 2012-237 also included a supplemental capital funding mechanism, referred to as a capital tracker mechanism. This mechanism was designed to fund certain capital-related costs that the utility was able to demonstrate could not be funded under the I-X mechanism. Approved capital tracker amounts were collected through an annual K factor.

In establishing the 2018-2022 PBR plans for the distribution utilities in Decision 20414-D01-2016 (Errata), the Commission kept the same methodology for the I factor and set the X factor to be 0.3 per cent. Additionally, the Commission approved the continuation of the Y factor and Z factor rate-adjustment mechanisms for the 2018-2022 PBR term. As was the case in previous generation PBR plans, in Decision 20414-D01-2016 (Errata), the Commission determined that a supplemental capital funding mechanism, in addition to revenue provided under I-X, is required for the 2018-2022 PBR plans. However, in place of the capital tracker mechanism employed in previous generation PBR plans, the Commission adopted a capital funding model that it determined would provide the necessary incremental capital funding while significantly enhancing the incentives to pursue lower costs for the distribution utilities when they plan, design and construct capital assets.

Specifically, the Commission determined that incremental capital funding would be divided into two categories: Type 1 and Type 2 capital. For Type 1 capital, the Commission approved a modified capital tracker mechanism with narrow eligibility criteria, with the revenue requirement associated with approved amounts to be collected from ratepayers by way of a "K factor" adjustment to the annual PBR rate-setting formula. The Commission's approach to defining the Type 1 capital tracker criteria was to determine whether it is a type of capital that does not meet the criteria for Z factor treatment, but is not a type of capital that the distribution utilities have deployed in the past. These types of capital additions might include capital additions required by new government programs, but would not include expenditures required by governments in the normal course, such as moves required to accommodate road or interchange reconfigurations.

For Type 2 capital, the Commission approved a K-bar mechanism that provides an amount of capital funding for each year of the 2018-2022 PBR plans based, in part, on capital additions made during the previous PBR term. Generally, this category would include all or most other capital that is not Type 1 and does not qualify for either Y factor or Z factor treatment.

This capital funding, collected from ratepayers by way of a "K-bar factor" adjustment to the annual PBR rate-setting formula, is in addition to the revenue generated under the I-X mechanism, affords distribution utilities the ability to carry out necessary capital additions and concentrate on the unique circumstances of each utility with respect to its capital program and business cycle.

1.2. Related proceedings

On June 5, 2018, the Commission issued Decision 21785-D01-2018[4] with respect to Fortis's acquisition of electric distribution system assets from the Municipality of Crowsnest Pass (Crowsnest Pass). The Commission found the transfer of the Crowsnest Pass electric distribution system operations and related assets to Fortis to be in the public interest and found the use of the replacement cost new less depreciation (RCN-D) methodology to be reasonable for the purposes of determining the purchase price. However, the Commission did not find the applied-for depreciation amount, used in RCN-D methodology, to be prudent. The Commission permitted Fortis to reapply in a compliance filing to that decision for approval of a revised purchase price. Fortis did so and this matter is under consideration in Proceeding 23961, which has been suspended pending a decision in this generic proceeding.

Notwithstanding the above, the Commission indicated its preparedness to grant the necessary approvals concerning the transfer, should the parties agree to proceed with the sale and transfer of assets, despite the Commission's purchase price denial. In correspondence dated June 21, 2018, Crowsnest Pass and Fortis confirmed their intention to complete the sale and purchase of the assets in accordance with the terms of the purchase and sale agreement and the prescribed purchase amount therein. This transaction was subsequently completed by both parties on July 24, 2018.

Analogous to the above transaction, on June 28, 2018, the Town of Fort Macleod filed an application requesting approvals to cease to operate in its service area, to discontinue its electric distribution system, to transfer the service area of Fort Macleod to Fortis and rescind Approval No. HE 9405 concurrent with the closing of the transfer of the electric distribution system and related assets. On the same date, Fortis applied to alter its service area to include that of Fort Macleod. These applications are jointly under consideration in Proceeding 23702. On October 12, 2018, Fortis filed an application with the Commission requesting approval of the transfer and sale of the electric distribution system currently owned by Fort Macleod and the associated RCN-D purchase price. This application is before the Commission's consideration in Proceeding 23972. The Commission has also suspended proceedings 23972 and 23702 pending the decision in the present generic proceeding.

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[4] Decision 21785-D01-2018: FortisAlberta Inc., Sale and Transfer of the Municipality of Crowsnest Pass Electric Distribution Assets; Municipality of Crowsnest Pass Permission to Cease and Discontinue Operations, Proceeding 21785, June 5, 2018.

2. Common issues of potentially broad application

On December 21, 2018, the Commission issued a letter on the records of proceedings 23961,[5] 23972[6] and 23702[7] (the proceedings) highlighting the similarity of issues among them. In the proceedings, Fortis did not indicate the method by which it would seek recovery from Fortis ratepayers of the purchase price paid by Fortis to acquire the municipal electric distribution systems. The Commission considered that the parties to the proceedings should be provided with the opportunity to comment on the rate treatment of the acquisition price prior to proceeding further with the above applications. The Commission also considered that these issues may have broader application beyond the immediate parties to the proceedings and determined that the commencement of a generic proceeding is necessary to consider the rate treatment of amounts paid by electric and gas distribution utilities to acquire municipal electric distribution systems, REAs and gas co-operatives. More specifically, the generic proceeding would consider rate treatment of acquisition costs for REAs, gas co-operatives and municipal electric distribution systems under the 2018-2022 PBR plan and the treatment of such costs for municipal electric distribution systems under the 2013-2017 PBR framework.

3. Generic proceeding process and participation

In light of the Commission's suspension of the proceedings pending the outcome of the present proceeding, the Commission is concerned to ensure that this generic proceeding is conducted in an expeditious and efficient manner. To that end, the Commission has prepared a preliminary issues list, attached as Appendix A to this bulletin, detailing those specific issues the Commission wants the parties to address in this proceeding. Parties may offer submissions concerning any additional issues relevant to scope of this proceeding, not captured in Appendix A, in accordance with the process schedule established below. The Commission also requests parties' comments with respect to the process, specifically, if the filing of evidence and a round of information requests and responses is required, or if this matter can proceed directly to argument and reply argument. Following its consideration of any submissions received, the Commission will release a confirmed issues list and a further process schedule. It is the Commission's expectation that this approach will result in a considered and comprehensive issues list that will serve to focus the proceeding, enhance the quality of the record and promote regulatory efficiency.

The Commission has pre-registered the six distribution utilities under the 2018-2022 PBR plans, ATCO Electric, Fortis, AltaGas, ATCO Gas, ENMAX, and EPCOR, as participants in this proceeding. The Commission has also pre-registered intervening parties that actively participated in proceedings 23702 and 23972; namely, the Consumers' Coalition of Alberta and the Office of the Utilities Consumer Advocate. The Commission requests that all parties confirm their contact information for Proceeding 24405 in the Commission's eFiling System and update it if required.

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5 Proceeding 23961, FortisAlberta Inc., Compliance Filing to Decision 21785-D01-2018, Exhibit 23961-X0018.

6 Proceeding 23972, FortisAlberta Inc., Transfer and Sale of the Town of Fort Macleod Electric Distribution System to Fortis, Exhibit 23972-X0015.

7 Proceeding 23702, Town of Fort Macleod Service Area Transfer Application, Exhibit 23702-X0042.

If any pre-registered party does not wish to participate, it may change its status to an “Inactive” in the eFiling System to this proceeding.

Concurrently with the release of this bulletin, the Commission is issuing a notice of application inviting any other interested parties to participate. The statements of intent to participate (SIPs) are due March 19, 2019. Parties who are pre-registered in this proceeding are not required to file SIPs.

The Commission has established the proceeding process schedule as follows:

Process step	**Due date***
SIPs from non pre-registered parties	March 19, 2019
Comments from registered parties on preliminary issues list and further process	March 26, 2019
Commission to issue confirmed issues list and further process schedule	April 2, 2019

*Note: all submissions are due by 4 p.m. on the date indicated.

Any further correspondence with respect to the generic proceeding and matters under consideration must be submitted on the record of the current proceeding, Proceeding 24405.

Any questions or comments with respect to the matters considered in the generic proceeding should be directed to the lead application officer for Proceeding 24405, Artyom Jukov, by email at artyom.jukov@auc.ab.ca or by telephone at 403-592-4507.

Robert D. Heggie
Chief Executive

Appendix A to Bulletin 2019-03

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Proceeding 24405

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Preliminary issues list

1. Under the previous PBR framework, amounts paid by a regulated distribution utility for the acquisition of an REA may be treated by way of a Y factor when the acquisition was directed by the Commission. For the purposes of funding under the previous PBR framework, should the purchase of a municipally owned electric or gas distribution system be treated differently than the purchase of an REA?

2. For the purposes of funding under the 2018-2022 PBR plans, should the purchase of a distribution system (such as an REA or municipally owned electric or gas distribution system) be treated differently than the purchase of an REA under the previous PBR framework and should different types of distribution systems require different rate treatment?

3. In light of the established 2018-2022 PBR plan framework and the five PBR principles,[8] how should the amounts paid by a regulated distribution utility for the acquisition of an electric or gas distribution system from an REA, municipality or gas co-op be treated under that framework? In particular:
   (a) Should these costs be considered for funding through a supplemental funding mechanism such as a Z factor or a Y factor?
   (b) Alternatively, should the supplemental funding mechanisms such as a Z factor or a Y factor be unavailable to a distribution utility, given the presence of the capital funding mechanism under the 2018-2022 PBR plan?

   Please discuss the rate treatment options referenced in parts (a) and (b) above.

4. With respect to the purchase of an REA, a specific Commission direction to the utility to acquire the subject assets is required to allow for Y factor treatment of the acquisition costs.[9] What should the treatment be for the acquisition costs absent a Commission direction?

5. Consistent with the Commission's prior correspondence in Proceeding 23961, Fortis and other interested parties may make submissions in this proceeding with respect to "the rate treatment of the acquisition costs of the Crowsnest Pass electric distribution system in light of the service area and transfer approvals received to date."[10]

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[8] Decision 20414-D01-2016 (Errata), paragraph 22.
[9] Decision 2013-296, paragraph 99.
[10] Exhibit 23961-X0018, paragraph 9.