Alberta Utilities Commission

Revised Regulatory Accounting Treatment for Alberta Electric System Operator Customer Contributions

October 6, 2021

Alberta Utilities Commission
Decision 26521-D01-2021
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Proceeding 26521

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1 Decision summary

1. In this decision, the Alberta Utilities Commission has determined that the revised accounting treatment for Alberta Electric System Operator (AESO) customer contributions will require distribution facility owners (DFOs) to expense the contributions in the year that they occur through use of the Y factor mechanism under performance-based regulation (PBR). This treatment will be consistently applied during the 2023 cost-of-service rebasing and any subsequent PBR term.

2. The Commission approves the establishment of a deferral account for AESO customer contributions if the amounts in a particular year are large enough to contribute to rate shock. Consistent with the treatment of other cost items, the Commission generally expects that carrying costs on the AESO customer contribution amounts included in the Y factor will be calculated using Rule 023: *Rules Respecting Payment of Interest*. However, if a longer-term deferral account is needed, the Commission will determine the carrying costs and the amortization period for such a deferral account on a case-by-case basis based on proposals from DFOs.

2 Background and procedural summary

3. The Commission initiated the current Proceeding 26521 as a result of Decision 26061-D01-2021,[1] where it made the following findings:

> The current DFO tariff recovery mechanism applicable to AESO customer contributions fails to provide effective price signals to incent the end-use customers to choose the most economical connection solution. To better achieve the objectives of the AESO customer contribution policy, (i) DFOs will no longer be permitted to earn a return (i.e., return-on-equity component) on any AESO customer contribution payments; and (ii) to the extent possible, customer contributions are to be flowed through to the DFO customer that is requesting the new connection.

4. In that decision, the Commission directed DFOs to file a proposal or proposals for a revised regulatory accounting treatment for future AESO customer contributions by May 31, 2021.[2]

5. The Commission pre-registered the four electric DFOs for this proceeding: EPCOR Distribution & Transmission Inc., ENMAX Power Corporation, FortisAlberta Inc. and ATCO Electric Ltd. As directed, the four DFOs submitted their proposals on May 31, 2021. The Commission issued notice on June 2, 2021, inviting other interested parties to submit a statement

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[1] Decision 26061-D01-2021: Commission-Directed Examination of Distribution Facility Owner Payments under the Independent System Operator Tariff Customer Contribution Policy, Proceeding 26061, April 23, 2021, paragraph 2.

[2] Decision 26061-D01-2021, paragraph 139.

of intent to participate (SIP) by June 11, 2021. The Commission received SIPs from the Consumers' Coalition of Alberta (CCA), the Office of the Utilities Consumer Advocate (UCA), and AltaLink Management Ltd. On June 11, 2021, AltaLink also filed its submission on the DFOs' proposals.

6. On June 18, 2021, the Commission issued a process schedule setting dates for the CCA and the UCA to make submissions on the DFO proposals, information requests (IRs) and IR responses from all parties, as well as a final submission from all parties, which were filed on August 13, 2021. The Commission considers this to be the closing date for the record of this proceeding.

7. In the process schedule, the Commission asked parties to focus their submission and IRs primarily on the following issues:

(a) Recovery of AESO customer contributions as an expense item in the year they are made, similar to other operating expenses.

(b) The use of a reserve account or similar mechanism including an appropriate amortization period and carrying costs.

(c) The impact of any changes in regulatory accounting treatment on individual utility credit metrics and/or credit ratings and future debt financing rates.

(d) The definition of rate shock as well as appropriate mechanisms to address it both in the context of expensing AESO contributions in the year they are made, or through the use of a reserve account or similar mechanism.[3]

8. In reaching the determinations set out within this decision, the Commission has considered all relevant materials comprising the record of this proceeding. Accordingly, references in this decision to specific parts of the records in this or the aforementioned proceedings are intended to assist the reader in understanding the Commission's reasoning relating to a particular matter and should not be taken as an indication that the Commission did not consider all relevant portions of the record with respect to that matter.

3 Discussion of issues and Commission findings

3.1 Types of AESO contributions

9. In its submission, ATCO Electric highlighted the two contribution scenarios that must be considered independently when assessing whether the current accounting policy meets the intent of the Commission directions in Decision 26061-D01-2021. In the first scenario, there are customer to distribution to transmission contributions (C to D to T contributions) that can be assigned to a specific customer. In the second scenario, there are distribution to transmission contributions (D to T contributions) that cannot be assigned to a specific customer and are for system upgrades to serve multiple customers, required under the obligation to serve by the DFO.[4] No parties raised concerns with this distinction.

[3] Exhibit 26521-X0021, AUC letter – Process and schedule, paragraph 4.
[4] Exhibit 26521-X0016, ATCO Electric's submission, paragraph 7.

10. ATCO Electric explained that in the case of C to D to T contributions, the transmission facility owner (TFO) would only hold the investment in accordance with the AESO investment policy, net of customer contributions, and the DFO would not record any investment related to the upgrades on the transmission system. As a result, ATCO Electric submitted that the current process fully complies with the Commission direction because an identifiable customer pays the contribution, the DFO does not add the contribution to rate base, and as such, no revisions to the existing accounting mechanism are needed.[5]

11. In the case of the D to T contributions, ATCO Electric stated that the current accounting practice is appropriate as the request for a transmission facility is for a non-identifiable group of customers where the utility must invest to fulfill its obligation to serve, and in return is given the opportunity to earn a fair return on the investment. ATCO Electric explained that if the Commission directions apply to D to T contributions, the only available accounting treatment is to immediately expense and collect the contribution.[6] In its submission, ENMAX referred to the same scenario as distribution-driven transmission projects (DDTPs) and similarly to ATCO Electric stated that the revised accounting treatment should not apply as these projects cannot be attributed to a specific customer or readily identifiable group of customers. Alternatively, if revised accounting treatment must be applied to DDTPs and their related contributions, the contributions should be flowed through to all distribution customers immediately.[7]

12. The Commission agrees with ATCO Electric that for the C to D to T contributions, the current process complies with the Commission direction as the contribution is flowed through to an identifiable customer and a DFO is not adding the contribution to rate base and is, therefore, not earning a return.

13. With regard to the D to T contributions, the Commission generally accepts that in some cases these projects cannot be attributed to a specific customer or readily identifiable group of customers. However, in several decisions (most recently in Decision 26061-D01-2021) the Commission stated its concerns that due to the incentives created under the previous DFO tariff recovery mechanism applicable to AESO customer contributions, generally the AESO customer contributions were not being flowed through to the end-use customers that trigger the need for new connection assets even in instances where such customers could be identified. Rather, these contributions were socialized across all DFO customers and treated as D to T contributions on which DFOs earned a return as these contributions were added to rate base.[8] For the D to T contributions, the accounting treatment must change to accord with the Commission direction from Decision 26061-D01-2021 that a DFO is no longer permitted to earn a return on AESO customer contributions. The current accounting practice for D to T contributions outlined by ATCO Electric and ENMAX does not comply with this direction.

3.2 Revised regulatory accounting treatment

14. With respect to the revised accounting treatment, the DFOs generally expressed their preference to treat the AESO customer contributions as an expense item in the year that they occur. The DFOs suggested that AESO customer contributions can be flowed through to

[5] Exhibit 26521-X0016, ATCO Electric's submission, paragraphs 15-17.
[6] Exhibit 26521-X0016, ATCO Electric's submission, paragraphs 28-31.
[7] Exhibit 26521-X0012, ENMAX submission, paragraphs 108-109.
[8] Decision 26061-D01-2021, paragraphs 124-127.

customers using the Y factor mechanism under PBR.[9] Under the DFOs' proposal, the annual AESO customer contributions Y factor amount would be based on a forecast subject to true-up in a subsequent annual rate filing, with the application of carrying charges as discussed in Section 3.2.1 of this decision. Consistent treatment would be applied during the 2023 cost-of-service rebasing and any subsequent PBR term.

15. At the same time, all DFOs highlighted that this approach could cause rate instability due to the lumpy nature of AESO customer contributions. Fortis proposed that, should the annual AESO contributions Y factor amount be large enough to contribute to or cause rate shock, the use of a deferral account that is amortized over a longer period may be necessary. Fortis recommended that deferral accounts only be used is cases where other means to mitigate rate shock are not available. In such case, Fortis suggested that the amortization period should be as short as possible. Fortis also proposed that the DFO have the discretion to recommend the appropriate recovery period, which would take into account the circumstances at the time, including the potential effect on credit metrics and customer rate impacts.[10]

16. In its IRs, the Commission asked other DFOs to comment on Fortis's proposal. EPCOR stated that while it does not consider the use of a deferral account to be appropriate, it is not aware of any workable alternative to Fortis's proposal if the Y factor amount is large enough to contribute to rate shock. Also, EPCOR stated that the major benefit of Fortis's proposal is that it is relatively simple to implement.[11] ENMAX responded that while it does not support the use of a deferral account financed entirely through debt because it may impact its credit metrics, the only benefit of a deferral account, as proposed by Fortis, would be to mitigate rate shock.[12] ATCO Electric responded that Fortis's deferral proposal may work in theory and that if a deferral account is implemented, the balance should be cleared up within a short time frame with any carrying costs awarded using the weighted average cost of capital (WACC).[13]

17. In its submission, the UCA expressed concerns with the recovery of AESO customer contributions as an expense item in the year they are made, similar to other operating expenses. The UCA stated that this expense treatment violates the regulatory principle of cost causation as customers who have not caused the requirement for the contribution will be asked to pay for it through a Y factor adjustment. Also, the recovery of AESO contributions as an expense item causes intergenerational inequity as these costs relate to long-lived assets and under the current AUC ruling, a customer today will pay for its portion of the entire contribution through a Y factor while a future customer that will benefit from the asset will pay nothing for them.

18. To address these concerns, the UCA suggested examining the use of a reserve account. Under the UCA's proposal, the costs in such a reserve account would be recovered within a relatively short period of time (one or two years). This is because the longer the amortization period, the more this mechanism looks like the prior process of including the contributions in the

9 Exhibit 26521-X0011, EPCOR submission, paragraph 3; Exhibit 26521-X0015, Fortis submission, paragraph 5; Exhibit 26521-X0016, ATCO Electric submission, paragraph 32; Exhibit 26521-X0012, ENMAX submission, paragraph 29.
10 Exhibit 26521-X0071, Fortis final submission, paragraph 8.
11 Exhibit 26521-X0060, EDTI-AUC-2021JUL16-002(a), pages 1-2.
12 Exhibit 26521-X0035, EPC-AUC-2021JUL16-002(a), pages 1-2.
13 Exhibit 26521-X0055, ATCO-AUC-2021JUL16-002(a), pages 1-4.

DFO rate base.[14] AltaLink commented that if the amortization period cannot be limited to a short period, the reserve account could become very large.[15]

19. In its submission, the CCA stated that in Decision 26061-D01-2021, the Commission contemplated the potential for AESO customer contributions to be flowed through as an operating cost. The CCA supported this approach where the aggregate contributions in a year are immaterial to the revenue requirement but stated that it should not be permitted if it results in rate shock or volatility. As a result, the CCA submitted that it is appropriate for immaterial amounts to be flowed through to ratepayers as they occur. The CCA suggested that contributions should be flowed through as they are incurred if they are less than $1 million annually, and that anything over $1 million should be deferred through the establishment of a reserve account.[16] The CCA proposed the use of a reserve account that has funding set at one per cent of the applied-for revenue requirement in a given year, which would include funding of operating expenses and amortization on deferred AESO customer contributions.[17]

20. In response, EPCOR stated that the CCA's reserve account proposal is unnecessarily complicated and maintained that the decision of whether to expense AESO customer contributions in the year they are incurred or to amortize them over a specific period of time should be determined on a case-by-case basis.[18] ENMAX asserted that the CCA's $1 million threshold to determine whether a contribution would be flowed through as an expense is arbitrary as the revenue requirements differ among the DFOs. In ENMAX's view, the proper criteria for determining whether AESO customer contributions can be flowed through in the year incurred is whether doing so would contribute to rate shock.[19]

21. The Commission agrees with the DFOs that expensing the AESO customer contributions in the year they occur is consistent with the Commission's direction in Decision 26061-D01-2021 to remove the equity component earned by the DFOs on AESO customer contributions. The Commission finds that Fortis's proposal to implement this using the Y factor under PBR with an equivalent treatment applied during the 2023 cost-of-service rebasing and any subsequent PBR term is reasonable. The Commission approves the proposal to submit an annual forecast for the AESO contribution Y factor amounts which would be subject to a true-up in a subsequent annual rate filing.

22. The Commission finds that it may be necessary to establish a deferral account that is amortized over a longer period in the event that expensing AESO customer contributions in the year they occur will cause rate shock. The Commission agrees with parties that the amortization period should be as short as possible and that the deferral account should only be used to reduce the impact of rate shock. The Commission agrees with Fortis and EPCOR that the DFOs should have discretion to recommend an amortization period on a case-by-case basis that takes into account a DFO's unique circumstances, such as impact on credit metrics or customer rates.

23. Although the Commission has typically used a 10 per cent threshold from previously approved rates to define rate shock, it retains discretion to consider whether rate shock may exist,

14 Exhibit 26521-X0023, UCA submission, paragraphs 28-32.
15 Exhibit 26521-X0042, AML-AUC-2021JUL16-002 (c), pages 1-3.
16 Exhibit 26521-X0022, CCA submission, paragraphs 9-12.
17 Exhibit 26521-X0022, CCA submission, paragraph 13.
18 Exhibit 26521-X0073, EPCOR final submission, paragraph 25.
19 Exhibit 26521-X0069, ENMAX final submission, paragraph 31.

on a case-by-case basis, as a result of expensing AESO customer contributions in a given rate year.

24. With respect to the use of a reserve account as suggested by the UCA and the CCA, in light of its above findings that the amortization period should be as short as possible, the Commission finds that establishing a reserve account for a short time frame would be more complex than the deferral account mechanism proposed by the DFOs. A reserve account may be more advantageous if AESO customer contributions were amortized over a longer period of time (however, as the UCA pointed out in this case, the mechanism looks increasingly similar to the prior process of including the contributions in the DFO rate base).

3.2.1 Carrying costs

25. Fortis and EPCOR suggested recovering carrying charges on balances related to prior year Y factor true-ups in accordance with Rule 023.[20] However, at the same time, Fortis pointed out that if a deferral account is used to deal with larger AESO contributions that can contribute to, or cause, rate shock, the amounts may need to be amortized over a longer period of time. In this event, a DFO would be required to fund the deferral account through a debt instrument that may have an interest rate higher than the short-term credit facilities used to finance the cost items included in the annual Y factor. To ensure that a DFO would "suffer no loss," Fortis advocated for the actual interest costs associated with the specific deferral debt funding to be flowed through to customers. In this regard, Fortis observed that the longer the DFO is required to fund the deferral, the more expensive it will likely be for customers, resulting in potentially compounding rate impacts.

26. Fortis contended that funding large AESO customer contribution deferral amounts using only debt would impose greater risk on the company and customers. Fortis explained that higher debt balances could result in lower credit metrics such as funds from operations to debt ratio, potentially increasing interest rate costs that are passed on to customers.[21] In light of these considerations, Fortis suggested that DFOs be afforded discretion to propose an appropriate recovery period that considers the circumstances at the time, including the potential effect on credit metrics and customer rate impacts.[22] In general, the DFOs supported flowing through the actual interest costs, with the exception of ATCO Electric, which stated that WACC should be used for deferral account balances.

27. The CCA stated that it considers that the debt-only financing costs are most appropriately based on the specified debt issued to fund specific AESO contributions and the amounts should be assessed for reasonableness.[23]

28. In response to a Commission IR, the UCA stated that Rule 023 requirements should apply to any deferral account balances arising from AESO contributions. The UCA pointed out that there is no collection of any interest for an amount that is charged and collected within one year. If the amounts are collected after the 12-month period but within two years, the Bank of Canada's bank rate plus 1½ per cent from Rule 023 should apply. However, if the term exceeds

[20] Exhibit 26521-X0011, EPCOR submission, paragraph 6; Exhibit 26521-X0015, Fortis submission, paragraph 5.
[21] Exhibit 26521-X0015, Fortis submission, paragraph 9.
[22] Exhibit 26521-X0071, Fortis submission, paragraph 8.
[23] Exhibit 26521-X0052, CCA-AUC-2021JUL16-003(a)-(b), pages 1-2.

two years, the UCA agreed that some sort of flow-through may be warranted, such as Fortis's debt-only cost.[24]

29. The Commission expects that DFOs will propose carrying costs calculated using Rule 023 on any deferral account balances, but acknowledges that the DFOs actual debt costs to fund AESO customer contributions may be different, and as such, the Commission will review any carrying cost requests as part of any AESO customer contributions deferral proposal presented by a DFO. The Commission agrees with Fortis and EPCOR that the DFOs should have discretion to recommend an amortization period on a case-by-case basis that takes into account a DFO's unique circumstances, such as any impact on credit metrics or customer rates. As such, the Commission will review each deferral account proposal, including the carrying costs and amortization, on a case-by-case basis.

30. In Decision 26061-D01-2021, the Commission directed that any DFO proposal should exclude the return-on-equity component and the use of WACC as part of the recovery of any incurred financing costs associated with AESO customer contributions.[25] Accordingly, the Commission will not consider proposals including the use of WACC as part of the recovery of financing costs for any deferral account proposal brought forward by a DFO.

3.3 Implementation

31. In Decision 26061-D01-2021, the Commission stated that a change to the DFO tariff recovery mechanism will be applied on a prospective basis to new AESO customer contributions, effective as of the date of that decision, which is April 23, 2021. The DFOs were directed to track all AESO customer contributions that occurred after that date as placeholders.[26] The Commission also stated:

> 143. Further, it is the Commission's preference that the revised accounting treatment of AESO customer contributions by DFOs be designed in such a way that no changes are required to the current PBR plans, including changes to the K-bar mechanism, or to the current DFO PBR rates. The Commission considers that the change in regulatory accounting treatment of new AESO customer contributions will be reflected in DFO's rates as part of the upcoming DFO cost-of-service rebasing process for 2023.[27]

32. As such, the Commission directs each DFO to include in its 2023 cost-of-service rebasing application any forecasts of AESO customer contributions for 2023 to be accounted for as expenses, as set out in this decision. This must include any deferral account proposals as approved above, including proposed carrying costs and amortization period, in the event that AESO customer contributions are forecast to contribute to rate shock. Further, the opening 2023 forecast rate base must not include any AESO customer contributions made after April 23, 2021, as they are to be treated as expense amounts in accordance with the findings in this decision.

24 Exhibit 26521-X0058, UCA-AUC-2021JUL16-003(a)-(b), pages 1-2.
25 Decision 26061-D01-2021, paragraph 139.
26 Decision 26061-D01-2021, paragraph 142.
27 Decision 26061-D01-2021, paragraph 143.

4 Order

33. It is hereby ordered that:

(1) ATCO Electric Ltd., ENMAX Power Corporation, EPCOR Distribution & Transmission Inc. and FortisAlberta Inc. shall include in each of their 2023 cost-of-service rebasing applications any AESO customer contribution forecasts for 2023 to be accounted for as expenses as set out in this decision. Their application must also include any deferral account proposals as approved above, including carrying costs and amortization period, in the event AESO customer contributions are forecast to contribute to rate shock. Further, the opening 2023 forecast rate base must not include any AESO customer contributions made after April 23, 2021, as such AESO customer contributions are to be treated as expense amounts in accordance with the findings in this decision.

Dated on October 6, 2021.

Alberta Utilities Commission

(original signed by)

Carolyn Dahl Rees
Chair

(original signed by)

Douglas A. Larder, QC
Vice-Chair

(original signed by)

Kristi Sebalj
Commission Member

Appendix 1 – Proceeding participants

Name of organization (abbreviation) **Company name of counsel or representative**
AltaLink Management Ltd. (AltaLink or AML)
ATCO Electric Ltd. Bennett Jones LLP
ENMAX Power Corporation (ENMAX) Torys LLP
EPCOR Distribution & Transmission Inc. (EPCOR or EDTI)
FortisAlberta Inc. (Fortis)
Consumers' Coalition of Alberta (CCA)
Office of the Utilities Consumer Advocate (UCA) Russ Bell & Associates Inc. Brownlee LLP

Alberta Utilities Commission Commission panel C. Dahl Rees, Chair D.A. Larder, QC, Vice-Chair K. Sebalj, Commission Member Commission staff A. Sabo (Commission counsel) A. Spurrell D. Mitchell M. McJannet E. Deryabina

Appendix 2 – Summary of Commission directions

This section is provided for the convenience of readers. In the event of any difference between the directions in this section and those in the main body of the decision, the wording in the main body of the decision shall prevail.

1. As such, the Commission directs each DFO to include in its 2023 cost-of-service rebasing application any forecasts of AESO customer contributions for 2023 to be accounted for as expenses, as set out in this decision. This must include any deferral account proposals as approved above, including proposed carrying costs and amortization period, in the event that AESO customer contributions are forecast to contribute to rate shock. Further, the opening 2023 forecast rate base must not include any AESO customer contributions made after April 23, 2021, as they are to be treated as expense amounts in accordance with the findings in this decision. .... paragraph 32