Additional guidelines and information related to Rule 011: Rate Application Process for Water Utilities

Introduction

This document provides additional guidelines and information related to AUC Rule 011. The information in this guideline is intended to assist utilities and customers participating in water rate applications but is not a binding document. The Commission will ultimately decide on all water rate applications based on the application and evidence applicable to the specific application.

Which water utilities are subject to regulation by the Alberta Utilities Commission?

The AUC has regulatory authority over public utilities, as defined by the Public Utilities Act. That act defines a public utility as “a system, works, plant, equipment or service for the production, transmission, delivery or furnishing of water, heat, light or power supplied by means other than electricity, either directly or indirectly to or for the public.” It explicitly excludes municipalities as owners of public utilities, unless the municipality has voluntarily come under the act. This means that investor-owned (i.e., not owned by a municipality) water utilities are subject to the AUC’s regulation.

There are multiple types of water systems, including (but not limited to) potable water, wastewater, fire, recycled water and irrigation water. Potable water systems fall under the AUC’s authority, but wastewater systems do not fall within the definition of public utility. Whether or not other types of water systems are public utilities may depend on the specific characteristics of the system. Utilities or utility customers who are unsure whether a non-potable water system is subject to the AUC’s oversight are encouraged to contact the AUC for further information.

Explaining capital rate base; depreciation and return; revenue requirements and rates

Forecast costs

Utility rate applications should be on a forecast (forward test year) basis. This means that a utility estimates (i.e., forecasts) its costs for a period of time referred to as a test period. The test period for utility rate applications is typically two to three years. Proposed rates for the test period are calculated based on the forecast costs, or revenue requirement, for the same years. The forecast of costs should be supported by historical actual cost data for the previous three or more years as well as other supporting material such as invoices.

Revenue requirement

A utility’s revenue requirement is the total revenue it needs to collect during a year in order to cover its forecast costs and profit component, including but not limited to operating, maintenance and administration costs, as well as depreciation, cost of debt and return on its capital rate base.

Capital rate base

The capital rate base is the total current net book value (i.e., historical cost minus depreciation) of the utility assets, including the physical equipment making up the utility system. The utility is responsible for establishing its capital rate base. Where the capital rate base of a utility is known, the utility will need to include in its applications details setting out how the capital is funded (through customer contributions or other gifted capital, owner equity or debt financing). Any capital funded through gifted capital, no-cost capital, including customer contributions, should not be included in rate base.

Profit: Return on equity portion of rate base

The AUC regularly issues Generic Cost of Capital decisions setting out the standard return on capital funded through owner equity. This is called the return on equity (typically a percentage) and is the primary method by which utilities earn profit. The Commission also sets the standard ratio of capital funded through owner equity and debt financing. This is the equity ratio. Return on equity is only earned on the percentage of capital deemed to be funded through owner equity. The appropriate equity ratio for water utilities is considered on a case-by-case basis based on their specific risks. Debt financing rates included in the revenue requirement are typically the actual interest rates incurred by the utility.

Profit in place of return on rate base

Where a utility does not have a sufficient rate base upon which to earn a reasonable return, the Commission may award a management fee in place of return on equity. The management fee is typically calculated as a percentage of certain utility costs.

Depreciation

Depreciation is how a utility recovers the actual cost of its capital equipment (often referred to as property, plant and equipment) over the useful life of that equipment. Capital equipment typically includes water treatment facilities, pipelines, reservoirs and distribution networks. The simplest method of calculating depreciation is the straight-line method. In this method, the annual depreciation expense to be included in revenue requirement is calculated by dividing the cost of the equipment minus its expected salvage value (the value the equipment would have when it is taken out of service) by its expected life. The resulting value is the annual depreciation cost that is included in the annual revenue requirement. This is summarized in the following formula:

Depreciation per year = (cost of asset – salvage value) / useful life of asset

There are more complicated alternatives to the straight-line method. If a utility wishes to use other methods, it should be prepared to justify and support its choice of method as part of its application.

Process steps for AUC review and assessment of water rate applications

Section 6 of Rule 011 sets out the typical process steps the AUC undertakes when reviewing and assessing a water rate application before issuing its decision. The AUC decides what process steps will occur on a case-by-case basis depending on the specifics of the application and submissions from participants. In less contentious cases, the AUC may choose to issue a decision on the utility's application for new rates with minimal process. For example, the Commission may decide to approve a water rate application without further process if:

- The requested rate change is small (e.g., proposed rates are lower than what the previously approved rates would be if increased for inflation).
- There have been no major changes to the utility's system, financial situation and customer base.
- There are no objections from customers.

The AUC's eFiling System

The AUC's website includes information about how an affected person or group can have their say about a utility project: Have your say about a utility project - AUC. As noted on that page, concerns should be submitted through the AUC's eFiling System. The eFiling System is the AUC's web-based electronic filing tool primarily used to manage, search and upload documents that the Commission will use to review and consider applications. The following webpage (How to use the eFiling System - AUC) includes links to:

- The AUC's eFiling System.
- How to create an account.
- Demonstration videos for eFiling.
- The eFiling System user guide.
- A number of other helpful eFiling System tips.

Participants can also contact the AUC's Customer Inquiries group for assistance at info@auc.ab.ca or 310 4AUC (310-4282 in Alberta).

What to include in a water rate application

Before deciding on a water rate application, the Commission must be satisfied that the revenues and costs provided in the water utility's application will result in just and reasonable rates. The onus is on the water utility to provide the supporting evidence that will assist the Commission in making that determination. After reviewing the application and considering the evidence and argument filed in the proceeding, the Commission may decide that certain applied-for revenues and costs in a water utility's application are not justified. Where the Commission does not approve a particular cost, the utility may not include that cost in the rates that it charges to customers.

An application that is complete, concise and easy to understand will help to speed up the review process. As noted in Rule 011, AUC staff will be available to answer questions and provide guidance on application development. AUC staff have created sample and template documents that utilities can use to help them prepare an application.

These include:

- A fillable template rate model spreadsheet.
- A different example rate model spreadsheet.
- An example application write-up document.
- An example terms and conditions of service.

Water utilities that plan to use the sample and template documents are encouraged to ask AUC staff for support with these sample and template documents. AUC staff can be contacted through the AUC's Info team at info@auc.ab.ca or 310-4AUC (310-4282 in Alberta). These documents can be found on the AUC's website at: Rule 011 – AUC

Regardless of whether a utility uses the sample or template documents, including as much of the following information as possible in the application will assist the Commission in determining whether that water utility's costs are just and reasonable:

1. A brief written overview of the history and physical water system including water source, treatment, pumps, storage, distribution and metering facilities, with design capacities, buildings and land. Basic maps showing the service area and other system features are helpful in presenting this information. Please indicate whether the system is operating at full capacity, and if it is not, please indicate the excess system capacity.

2. Copies of licences and approvals, including:

   a) Provincial water diversion licence.
   b) Alberta Environment water treatment facility approval.

3. Details of when and how you became the owner of the water utility.

   a) Are you the original owner, or did you purchase the water utility from the previous owner, or was it through another means such as a bankruptcy sale?
   b) If you purchased the water utility from a previous owner, what was the structure of that transaction? Did you buy the entity that was the previous owner, or did you buy the assets of the previous owner? Please provide copies of the purchase or transfer agreement between you and the previous owner.
   c) If you purchased the water utility through another means, please provide copies of any documentation related to this purchase.

4. Details of the legal ownership status.

   a) If the owner of the water utility is an incorporated company, please provide the legally registered name of the company, and please provide the names of each of the shareholders and their respective ownership percentages.
   b) If the owner of the water utility is a partnership, please provide the names of each of the partners and their respective ownership percentages.
   c) If the owner of the water utility is a single individual, please provide the name of that individual.

5. Historical financial statements for previous three years and application test period projections that detail:

   a) Capital assets by asset type (e.g., land, buildings, vehicles, equipment) and the amount of any accumulated depreciation on these capital assets.
   b) Operating and administrative expenses.
   c) Revenue for all sources detailed by type.
   d) Income tax expense.
   e) All loans or other debt.
   f) If the owner of the water utility is an incorporated company, copies of the corporate income tax returns for the previous three years, including the notices of assessment received.

6. Details on any government grants that the water utility has obtained.

7. Supporting documentation for all tie-in fees or other customer/developer contributions towards water infrastructure provided as part of their lot or home purchase, or otherwise embedded in lot sales in each subdivision including:
   - Pro forma purchase and sale agreement given to land development lot purchasers.

8. All agreements between developers and the utility (or affiliates of the utility) whereby the utility agrees to provide infrastructure on behalf of the developer.

9. Supporting documentation (contracts/agreements) with the area developers and/or the municipality for the development of the water systems and service to customer base including the relationship between the developer of each subdivision and the water utility including:

   a) Development bylaw from the municipal authority.
   b) Development agreement with the municipal authority.
   c) Documentation related to any condominium corporation involved in operation of shared development infrastructure.

10. Number of customers and consumption for the previous three years, and an estimate of the number of customers for the application years. This should also include total losses, meaning the difference between water being supplied to the treatment plant minus the total water used (metered) for all customers.

11. Details on fire protection services, irrigation or other potable or non-potable services provided by the water utility, if applicable.

12. Details of all operating and management staff, or contractors, including compensation arrangements and brief job descriptions. Please indicate what percentage of time that the operating and management staff and contractors spend working on the water-related aspect of the business and how these percentages are determined.

13. A description of all the costs incurred to run the water-related aspect of the business and a reason why these costs are necessary. Please indicate who these costs are normally paid to.

14. In some cases, it may be efficient to share costs across several affiliated companies. For example, having one information technology system that serves several affiliates, with each affiliate paying a portion of the fees. If fees are paid to a parent corporation for services shared across several affiliates, the utility must still show that these costs are reasonable and demonstrate how those fees provide cost-effective benefits to customers.

15. A written description of any proposed expansion plans for the system for the next two years, detailing costs and impact on customers.

16. A written description of any proposed operating changes or enhancements to customer service and/or water quality that would impact costs.

17. Historical/current rates charged and the basis of the calculation of those charges.

18. A detailed description of any deferral accounts set up by the water utility.

19. Terms and conditions of service for the water utility, setting out the rights and obligations of the utility and its customers.

20. Any other information that is relevant to the application.

For any additional support or questions regarding Rule 011 and or your water utility application, please reach out to the AUC at info@auc.ab.ca or 310-4AUC (310-4282 in Alberta).