

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.” Municipalities are not covered by the *Public Utilities Act* 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 and rates

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 water utility rate applications is typically two to three 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. Proposed rates for the test period are calculated based on the forecast costs, or revenue requirement, for the same years. Once final rates are

approved by the Commission, they cannot be changed unless the Commission has approved a deferral account¹ for certain costs.

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 used for the provision of utility service, 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 be tracked separately. These amounts should be amortized and the annual amortization expense is a credit against the depreciation expense. The unamortized balance at year end is an offset against the rate base balance, which means that the utility only earns a return on the rate base net of the unamortized no-cost capital/customer contributions.

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 estimated useful life of that equipment. Capital

¹ A deferral account is an accounting mechanism for public utilities to defer costs and revenues for collection or recovery in future years based on actual costs, approved by the Commission on a case by case basis. The Commission has previously set out factors it considers in approving deferral accounts. For more information, please contact AUC staff.

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

Some utilities have a large number of assets. Setting individual lives for each asset is challenging, and instead assets are divided into numerous groups that have similar characteristics. This allows for an average service life for each group to be calculated.

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

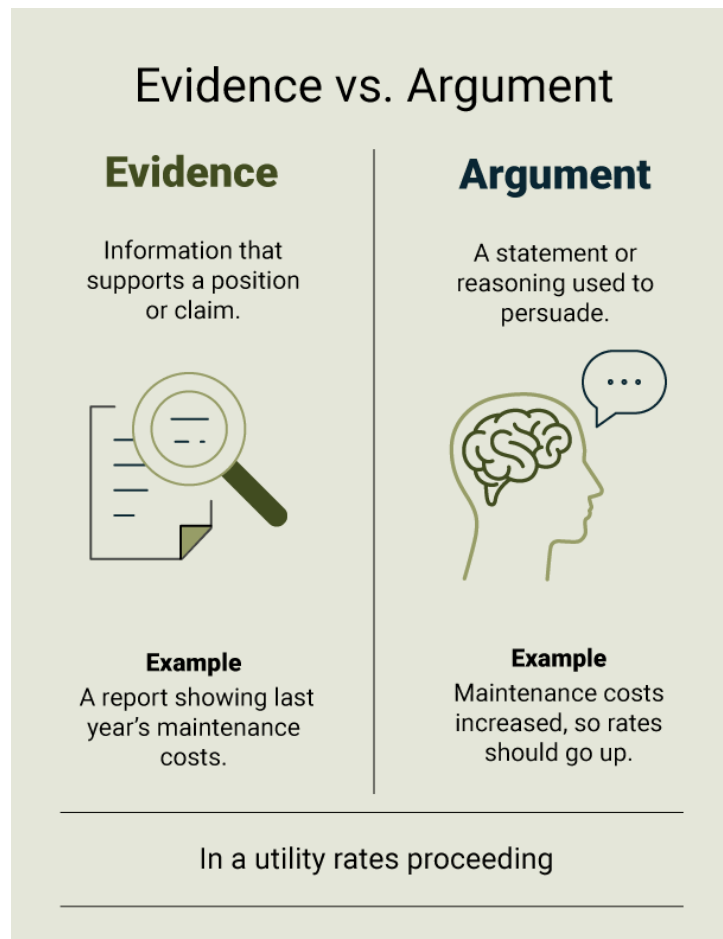
Section 6 of Rule 011 sets out the typical process steps the AUC undertakes when reviewing and assessing a water rate application before issuing its decision. The AUC decides what process steps will occur on a case-by-case basis depending on the specifics of the application and submissions from participants. 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.

When customers intervene in a water rate application, the Commission will typically ask those customers to file initial comments on the utility's application and allow them to ask written questions (referred to as information requests) of the utility. Customers will then often be granted the opportunity to file written argument and reply argument at the end of the record development stage. In addition to information requests and argument, a customer may request permission to file intervener evidence. Filing of evidence would typically occur after receiving the utility's response to information requests, and before argument and reply argument. The Commission will decide the process for each proceeding based on the specific application. The exact process steps may vary and may depend on various factors, including how complex the application is, the number of customers who are intervening, and the expected impact of the application.

Evidence and argument are not the same thing. Argument and reply argument give customers the opportunity to express their concerns with and opinions on the application. Intervener evidence is factual information provided by customers, which is used to support their concerns or opinions, or to contradict something proposed by the utility. New evidence is typically not permitted in argument or reply argument.

All application materials and any intervener evidence filed must be true and accurate to the knowledge and belief of the person on whose behalf it is filed. Utilities and interveners are encouraged to review Rule 001 for additional requirements that may apply.



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 team 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 are just and reasonable and 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 documents. AUC staff can be contacted through the AUC's Customer Inquires team at info@auc.ab.ca or 310-4AUC (310-4282 in Alberta).

Regardless of whether a utility uses the sample or template documents, providing additional information beyond what is required by Rule 011 can be helpful to the Commission in reviewing a rate application. Including as much of the following information as possible in the application will assist the Commission in determining whether the 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, 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 and Protected Areas water treatment facility approval.
 - c) Any applicable municipal approvals including supply agreements and franchise agreement with the municipality in which the utility operates.
3. Details of the ownership of the water utility.

- a) Is the applicant / current owner the original owner, or was the water utility purchased from a previous owner?
 - b) If the water utility was purchased from a previous owner, what was the structure of that transaction? For example, was it a purchase of the shares of the water utility or the assets? Were there any associated bankruptcy and insolvency proceedings? Please provide copies of the purchase or transfer agreement between the current owner(s) and the previous owner.
 - c) If the water utility was purchased or ownership of the utility was transferred through another means, please provide copies of any documentation related to this purchase / transfer.
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 the names of each of the shareholders and their respective ownership percentages. If one or more owners are corporations, also provide the names of shareholders and their respective ownership percentages of those corporations.
 - b) If a partnership has a beneficial interest in the water utility, 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.
 - d) If the water utility operates or carries on business under any other names, please provide a complete list of these names.
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, maintenance and administrative expenses.
 - c) Revenue from 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 or connection fees and other customer/developer contributions towards water infrastructure for new connections or provided as part of lot or home purchases, or otherwise embedded in lot sales in each subdivision including:
- o 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. A description of any transaction between the utility and any of the utility's affiliates, or other non-arm's length party. The utility should be prepared to justify the reasonableness of any affiliate or parent company costs included in rates.
10. Supporting documentation (contracts/agreements) with the area developers and/or the municipality for the development of the water systems and service to customers 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.
11. 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 and/or from the treatment plant minus the total water used (metered) for all customers.
12. Details on fire protection services, irrigation or other potable or non-potable services provided by the water utility, if applicable.
13. 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.
14. A written description of any proposed expansion plans for the system for the applied for test period (typically two to three years), detailing costs and impact on customers.
15. A written description of any proposed operating changes or enhancements to customer service and/or water quality that would impact costs.
16. Historical/current rates charged and the basis of the calculation of those charges.
17. A detailed description of any deferral accounts set up by the water utility.
18. Terms and conditions of service for the water utility, setting out the rights and obligations of the utility and its customers. Consideration should also be given to including a rate schedule as part of the terms and conditions of service.
19. 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).