

**2019 EDMONTON WASTE MANAGEMENT RATE  
FILING  
REVIEW BY THE UTILITY ADVISOR**

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**UTILITY ADVISOR**

**RESPONSE TO THE EDMONTON WASTE**

**MANAGEMENT**

**2019 RATE SUBMISSIONS**

**October 25, 2018**

# 2019 EDMONTON WASTE MANAGEMENT RATE FILING REVIEW BY THE UTILITY ADVISOR

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## 1.0 PURPOSE OF THIS REPORT

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This report is prepared to provide advice to the City of Edmonton Utility Committee and Edmonton City Council on the 2019 rate submissions of Waste Management. Pursuant to the terms of reference for the Utility Advisor, the rate submission has been reviewed by the Utility Advisor, and requests for additional information were sent and received.

Currently, City Council acts as both the governor and regulator of the Waste Management Utility, approving both operating and capital budgets as well as the utility customer rates.

As noted in a City of Edmonton internal legal memo dated December 7, 2009, the Municipal Government Act (MGA) provides Council with the authority to pass bylaws and otherwise regulate municipal public Utility. The MGA does not provide for any specific guidance for Council regarding municipal utility governance. To that end, the regulation of these municipal public Utility would be subject to the same duty of good faith that applies to general municipal governance. Municipal public Utility are regulated by the municipalities which operate those Utility within the municipalities. Unlike investor-owned Utility, the shareowners of the utility, and the customers of the utility are, to a large extent, the same. However, that does not change the overall objective of regulating such Utility, the establishment of just and reasonable rates, in the public interest, and not unduly discriminatory. The major difference between investor-owned Utility and municipally-owned Utility is the determination of what makes up the public interest.

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## 2.0 EXECUTIVE SUMMARY

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Last year, the Utility Advisor noted that with one exception, the Utility Advisor was very impressed with the quality of this rate application. The one exception was related to the quality of the capital business cases presented. For 2019, the quality of the capital business cases presented meets the expectations of the Utility Advisor.

The 2019 rate application is excellent, and provides adequate information to enable the Utility Committee and Council to make an evidence-based decision on rates for 2019. The Utility Advisor addresses some issues later in this report, but the issues fall into the forward-looking category, rather than the immediate rate application.

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## 3.0 PROCESS

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The following process was utilized by Waste Management and the Utility Advisor to review this application:

Monday, September 17 - Waste sends available Draft business cases to UA

Friday, September 21 - Waste sends preliminary rate filing to UA

Wednesday, September 26 - Informal meeting - Waste and UA

Wednesday, October 10 - Waste submits final rate filing to UA

Wednesday, October 17 - UA submits information requests to Waste

Monday, October 22 - Waste sends responses to UA

Tuesday, October 23 – Waste sends revised responses to UA

The Utility Advisor is very satisfied with this process, and with the responsiveness of Waste Management.

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## 4.0 SPECIFIC FINDINGS

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### 4.1 Cost of Service

The Cost of Service study identifies the ratio of revenue to costs allocated to different customer groups. Single unit residential cost recovery is 103.4%, a modest excess of revenue over costs. Multi-unit residential cost recovery is 109.6%, which is a significant over recovery. Non-residential cost recovery is 87.0%, which is a very significant under recovery.

Normally, utility rate making attempts to recover 100% plus or minus 5% (95%-105%) of costs through revenue. For single and multi-unit residential customers, Waste has some fine tuning to do with future rate design to achieve these targets.

Non-residential cost recovery is supposed to fully recover the incremental costs of providing the service while making a contribution to the fixed costs incurred to provide services to regulated customers, since the non-residential service is made possible by facilities that were put in place to

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serve residential customers. This is clearly not happening, and the Utility Advisor does not see any likelihood that this state of affairs will improve in the future.

Misallocation of customers to the wrong customer groups unfairly burdens some customer (in this case single unit residential customers). Misallocations need to be corrected quickly, and processes need to be developed to ensure proper classification of customers.

## **4.2 Treatment of Capital Expenditures**

A fundamental principle of most utility rate-making is that capital expenditures are not allowed into ratebase (and therefore do not impact customer rates) until the capital asset is “used and useful”, or “used and required to be used”. The reason for this is to ensure that today’s utility customers are not paying for assets before they will begin to reap the benefits of having the asset in service.

Usually, costs incurred to develop a project before it is placed in service will span more than one rate-making period. Those costs are usually accumulated in an assets under construction account (AUC), where carrying costs associated with the capital are also accumulated. From the responses to IR-UA-1 and IR-UA-2, Waste has confirmed that this treatment is in place.

## **4.3 Affiliate Transactions**

Those who have read the Utility Advisor’s previous comments on city utility rate applications will recognize that he has strong feelings about affiliate transactions. In the past, based on urgings from the Utility Advisor and the Utility committee, several affiliate transactions were reviewed to ensure that the costs of the services provided were just and reasonable. The Utility Advisor was disappointed that there was no discussion of such reviews in this rate application. While it was helpful to have reassurances given in IR-UA-5, it appears that justifying these costs is not a top-of-mind exercise for Waste management.

Waste management can either address this issue proactively in future rate applications, or anticipate increasingly insistent requests from the Utility Advisor.

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**Appendix A**  
**Information Requests from the Utility Advisor**

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**IR-UA-1**

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**Topic:**                   **Integrated Infrastructure Services**

**Reference:**           **Waste Services IIS Infrastructure Delivery Composite Capital  
Funding Request Page 9**

**Request:**

The report states that dollars will be transferred from this funding profile to a newly created standalone profile. What happens to dollars from this funding profile if the result of the analysis does not result in creation of a standalone profile?

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**RESPONSE:**

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The Waste Services IIS Infrastructure Delivery Composite capital profile CM-81-2045 sets the 2019 - 2022 capital delivery budget for Waste Services for capital projects that are anticipated to reach the third checkpoint in the PDDM process within the four year budget cycle. Waste Services began utilizing the PDDM approach under the direction of Council in 2017. Once a capital project reaches the third checkpoint, the project's business case will be updated and brought to Utility Committee and Council for approval. Until this step occurs, no funds are authorized to be spent on project delivery.

The amount included in this composite represents the Utility's best forecast of the capital costs based on concept level estimates. By forecasting future capital expenditures before full approval has been received (i.e. before reaching Checkpoint 3), the Utility is better able to provide stable consistent rate increases as requirements for PAYG can be anticipated in proposed and forecasted rates.

Adjustments to this composite will occur over time as part of the annual rate filing process, and through the Supplemental Capital Budget Adjustment process, as projects proceed through planning and design and approach Checkpoint 3. At the end of the 4 year cycle, any funding remaining within the composite would be released. Only Council approved capital expenditures are accumulated under an Asset Under Construction (AUC) account. As such, ratepayers would not bear any costs related to amortization or debt interest on unspent capital funding. Any sunk planning and design costs would be taken out of assets under construction (AUC) and written off in the year that the project is either cancelled or fails to receive approval.

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**IR-UA-2**

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**Topic:**                    **Inclusion of Capital Costs in Rates**

**Reference:**            **Waste Services IIS Infrastructure Delivery Composite Capital  
Funding Request Page 11**

**Request:**

The report states that capital funding requests for both planning and delivery phases of approved capital projects within the PDDM approach are required in order to have funds allocated to the composite profile and determine the utility rates required to support the capital budget.

The normal regulatory treatment of capital costs is to only allow them into rate base once the resulting capital project is “used and useful.” In other words, up front costs such as planning and delivery are not recovered as spent. They are accumulated (with interest) and added to the capital cost of the project, with cost recovery only beginning once the asset is placed in service.

Please explain why Waste Services planning and delivery costs should be included in rate base prior to the asset becoming used and useful.

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**RESPONSE:**

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Upfront funds requested under this composite capital funding request are not included in the calculation of rate revenue with the exception of Pay As You Go (required per Utility Fiscal Policy C558A). Project expenditures on Council approved capital profiles are accumulated under an Asset Under Construction (AUC) account until the projects are substantially complete. They are not recovered as spent. The 2019 revenue requirement only includes capital cost recovery for assets that are currently in service and any new assets going into service per their estimated in-service dates.

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**IR-UA-3**

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**Topic:**                   **Costs**

**Reference:**           **Waste Services IIS Infrastructure Delivery Composite Capital  
Funding Request Page 15**

**Request:**

The table included in section 7.3 Costs includes a note “funded by Utility Pool”. What does this mean?

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**RESPONSE:**

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The note is simply intended to indicate that this profile is funded through Utility rates, and is not funded through tax levy. The note is redundant and perhaps should have been removed as the profile is specific to Waste Services.



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**IR-UA-4**

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**Topic:**                   **Justification of Upgrade/Renewal Costs**

**Reference:**           **Waste Services Facilities and Infrastructure Composite  
Upgrade/Renewal Capital Funding Request Page 16**

**Request:**

The conclusion states that this profile will provide capital funding for capital maintenance, renewal, upgrade, and improvement projects for Waste Services which are valued at less than \$5 million. How will the Utility Committee be assured that such projects are subjected to a business case approach, with evaluation and costing of reasonable options, including a do-nothing option?

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**RESPONSE:**

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Within Waste Services, the Technical Services section is responsible for capital project management. In 2018, Technical Services developed and is implementing a formal project management process for managing capital projects. The project management process covers the full lifecycle of project management, including project intake, prioritization, business case development, project approval, planning, delivery, monitoring and closure.

In addition, Technical Services has developed an internal business case development process, as a part of the overall capital project management process, for capital projects that fall under this capital funding request. The business case template used throughout this process is consistent with the corporate template used for business cases intended for City Council approval although it is appropriately scaled to the level of project cost, impact and risk. In particular, the internal business case development process includes an examination of viable options and compares any recommendation against the “do nothing” scenario. During the project development phase, if the anticipated spend for a project is expected to exceed the \$5 million threshold, a standalone profile will be created and a business case will be brought forward to the Utility Committee and Council for approval.

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**IR-UA-5**

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**Topic:**                    **Shared Services**

**Reference:**            **Waste Services 2019 Rate Filing Section 9.5**

**Request:**

In the past, Waste Services has provided analysis of value of services received from several of the Shared Services providers.

- a. Were any of the 2019 forecast costs identified in section 9.5 analyzed to ensure that Waste Services is receiving the indicated services at rates that are fair and reasonable to Waste Services customers?
- b. Is there any plan going forward to review these costs on a regular basis to ensure that Waste Services continues to receive the indicated services at rates that are fair and reasonable to Waste Services customers?

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**RESPONSE:**

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The City of Edmonton employs a Shared Services model whereby support services required for the operations of all City businesses are provided through centralized areas of expertise. This approach takes advantage of efficiencies gained through economies of scale and opportunities to provide more robust systems and services (e.g. technology related services). The Waste Management Utility Fiscal Policy C558A requires that the Utility operate under a full cost approach thus requiring the Utility to pay for its portion of shared services.

As part of the City's 2019-2022 Operating Budget development, Shared Service providers performed a review of their costs and the shared service allocation methodologies resulting in updates to the cost allocation drivers. This change resulted in several changes to the allocation of shared service costs from the service providers to the Utility. For example, technology related services are now based on a weighting of the number of PCs and applications supported versus the prior methodology which allocated costs primarily based on FTEs. The allocation methodologies used by the Shared Service providers were reviewed by Waste Services for reasonableness.

In contrast, Intra-Municipal Services are charged to the Utility for on-demand services provided through other City of Edmonton programs which are not incorporated in shared services charges. These are direct charges for services such as dedicated support for communication and engagement initiatives,

on demand building repairs and maintenance, posting of vacant positions to job sites, and security services for special events.

For 2019, as part of the strategic review of Waste Services operations, a review of the key intra-municipal services required to support the Utility will be completed, including clarifying the resources, deliverables, and approximate costs associated with these services and, where appropriate, establishing service level agreements. This work will ensure the Utility continues to receive fair value for customers for these services.