



## EPCOR Water Services - Review of Consumption Deferral Accounts

### RECOMMENDATION

That the May 6, 2024, EPCOR Water Services Incorporated report EXT02461, be received for information.

### Report Purpose

**Information only**

### Previous Council/Committee Action

At the June 25, 2021, Utility Committee meeting, the following motion was passed:

That Administration work with EPCOR to bring forward reports prior to the next Performance Based Rates term for Drainage Services and Wastewater Treatment effective April 1, 2025, providing further background and the appropriate regulatory treatment for the following items:

1. Improved disclosure of changes in accounting and capitalization policies and treatment;
2. Reporting the size of the workforce including actual and forecast full-time equivalents;
3. A review of how long-term debt interest rates are set for EPCOR Water Services Inc.;
4. A review of the performance measures to ensure they are increasingly stringent and challenging over time; and
5. A review of the deferral account and other adjustment mechanisms to deal with variations in usage.

### Executive Summary

- The EPCOR Water Services Inc. (EWS) report, included in Attachment 1, addresses item 5 from the June 25, 2021 Utility Committee motion.

7.1

ROUTING – Utility Committee | DELEGATION – S. Chaudhary, F. Mannarino, S. Ancel

May 6, 2024 – EPCOR Water Services Incorporated - EXT02461

## Review of Consumption Deferral Accounts

- The current state of the consumption deferral account indicates a significant positive balance, which is attributed to actual consumption levels exceeding the forecasted volumes in the PBR, primarily influenced by the impact of COVID-19, an unusually hot and dry summer, and increased population growth.
- EWS reviewed consumption trends of its residential and commercial customers who account for approximately 80% of the total consumption. Residential consumption constitutes more than 50% of the total consumption, while at the same time it is highly influenced by seasonal usage patterns and weather changes. Despite this seasonal unpredictability, EWS has demonstrated reasonable precision in forecasting its residential consumption.
- With the uncertainties related to extraordinary events such as the COVID-19 pandemic now reduced, EWS is confident that the ongoing variations in consumption are now part of its standard course of business and it is reasonable for EWS to continue managing and mitigating its consumption risk without a deferral account, as it did before 2022.
- This approach benefits ratepayers in ensuring that the rates remain unaffected by variations in consumption, resulting in stable and predictable rates over the long term.

## REPORT

### Background

Utility deferral accounts are financial mechanisms used by rate regulated utilities to defer the recognition of certain costs and revenues until a future period, thereby impacting the utility's earnings and eventually customer rates.

Historically, EWS' PBR framework never proposed the inclusion of deferral accounts for revenue or consumption variations to establish customer rates. This approach has benefited ratepayers by ensuring that EWS' rates remained relatively stable and predictable over the long term, as the rates were unaffected by variations in consumption.

In contrast, with a consumption deferral account, rates in the future PBR terms are adjusted for any revenue shortfall or surplus recorded in the previous PBR terms due to differences between the PBR forecast consumption and actual consumption. These future rate adjustments are in addition to the routine rate adjustments necessary to recover the required revenue for the future PBR term, resulting in a shift of revenue risk from the utility to the ratepayers, and eventually volatile rates for customers over the long term.

EWS' PBR forecast for the current 2022-2024/2026 PBR term was developed during mid-2020, a period marked by significant uncertainty due to the COVID-19 pandemic, which posed a challenge in accurately forecasting consumption for the 2022-2024/2026 PBR Application. To address this unique circumstance, a consumption deferral account was proposed and introduced for the

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current PBR term, with the primary objective of mitigating consumption related revenue variances. It is important to recognize that this measure was not intended to establish a precedent due to the risk of long-term rate volatility for customers.

### Current State of the Consumption Deferral Accounts

The consumption deferral amount is calculated as the difference between the PBR forecast consumption and actual consumption multiplied by the rate in effect when the difference occurs. The accumulated consumption deferral account balances for the current PBR term are shown in the table below, with a detailed breakdown provided in Table 3.0-1 of Attachment 1.

Utility (\$ millions)	2022	2023	Total
In-City Water	8.2	15.1	23.3
Wastewater Treatment	5.4	9.9	15.3
Wastewater Collection	6.1	10.4	16.5
Carrying Charges	0.6	2.4	3.0
Total Deferral Balance	\$20.3	\$37.8	\$58.1

Several factors influence variations in consumption, including differences in customer growth relative to forecast, abnormal weather patterns, changes in consumption patterns, and extraordinary events such as the COVID-19 pandemic. During the current 2022-2024/2026 PBR term, all these factors have impacted consumption, however the predominant factor influencing consumption differences has been the impact of the COVID-19 pandemic on water consumption for the residential and commercial customer classes.

EWS' PBR Application, which includes consumption and customer growth forecasts was prepared mid-2020, a period that was marked by significant uncertainty due to the COVID-19 pandemic. As a result, the anticipated customer growth in the PBR forecast was lower than the actual growth experienced so far. The significant increase in population growth experienced over the past two years due to net migration has further influenced the increase in actual consumption. The work from home measures implemented in 2020 led to increased residential consumption and continue to influence residential consumption trends post-pandemic. In addition, an unusually hot and dry summer over the past few years has resulted in higher seasonal consumption, while at the same time commercial consumption has rebounded to pre-pandemic levels earlier than anticipated in the PBR forecast.

EPCOR's Review of Consumption Deferral Accounts Extraordinary and unforeseen circumstances such as the COVID-19 pandemic presented significant challenges in accurately forecasting consumption patterns for the current 2022-2024/2026 PBR term, with most of the consumption differences experienced in the recent past attributed to this extraordinary event. As a result, EWS reviewed the historical average consumption trends of its residential and commercial customers

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since 2017 and compared this with its PBR forecasts for each year. Residential and commercial customers account for approximately 80% of the total consumption and these customers have experienced the highest variation in consumption during the years substantially impacted by COVID-19 (2020 and 2021).

A comparison between the anticipated (PBR forecast) and actual average consumption per customer in cubic meters from 2017 to 2023 is shown in the table below.

Customer Class	2017	2018	2019	2020	2021	2022	2023
				<i>Influenced by COVID-19</i>			
Residential Forecast	14.6	14.4	14.2	13.9	13.7	13.4	13.2
Residential Actual	14.6	14.5	13.8	14.7	15.1	14.0	13.8
Difference %	0.0%	0.7%	-2.8%	5.8%	10.2%	4.5%	4.5%
Commercial Forecast	123.5	121.9	120.3	118.7	117.2	90.1	94.0
Commercial Actual	118.1	115.3	109.3	89.9	92.8	101.7	98.9
Difference %	-4.4%	-5.4%	-9.1%	-24.3%	-20.8%	12.9%	5.2%

The actual average consumption presented in the above table shows that consumption patterns have started to align with pre-pandemic levels and indicates a positive shift towards normalization. This review also confirms the relative accuracy of EWS' residential consumption forecast, except for the years substantially impacted by COVID-19 (2020 and 2021). Residential consumption constitutes more than 50% of the total consumption and is therefore a critical factor to consider when evaluating the need for a consumption-related deferral account.

Residential consumption is highly influenced by seasonal usage patterns and weather changes. Despite this seasonal unpredictability, EWS has demonstrated reasonable precision in forecasting its residential consumption, as shown in the above table. Considering this and the normalization of consumption levels, EWS does not foresee the need to continue with consumption deferral accounts to mitigate forecast consumption risks for its future PBR terms.

The current state of the consumption deferral account indicates a significant positive balance, which suggests an expected refund that will benefit ratepayers over the upcoming PBR term. This positive balance is attributed to actual consumption levels exceeding the forecasted volumes in the PBR, primarily influenced by the impact of COVID-19, an unusually hot and dry summer, and increased population growth.

A significant negative deferral account balance stemming from lower actual consumption could also occur in the future, which would require additional rate adjustments (additional charges on customer bills) to recover the negative balance, resulting in a rate shock for customers in the future. These additional rate adjustments (additional charges) when combined with routine rate

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increases necessary for the delivery of safe and reliable utility services has the potential to cause rate shock or in the worst-case lead to rates becoming unaffordable. Deferral accounts introduce rate uncertainty and volatility for customers over an extended period and are, therefore, not recommended by EWS.

Furthermore, as part of the stakeholder engagement process for the 2025-2027 Wastewater PBR, EWS surveyed residential customers on their preference for stable and predictable bills over mechanisms such as the deferral accounts that create the potential for a positive or negative future bill adjustment (true-ups). Preliminary survey results indicate that an overwhelming majority of respondents strongly prefer that seasonal revenue variations are managed by the Utility to ensure that customer bills remain stable and predictable. Additional information on the survey results and PBR engagement will be presented as part of the 2025-2027 PBR Application.

With the uncertainties related to extraordinary events such as the COVID-19 pandemic now reduced, EWS is confident that the ongoing variations in consumption are now part of its standard course of business. Therefore, it is reasonable for EWS to continue managing and mitigating its consumption risk without a deferral account, as it did before 2022. This approach benefits ratepayers in ensuring that the rates remain unaffected by variations in consumption, resulting in stable and predictable rates over the long term.

### **EPCOR's Recommendation**

EWS recommends discontinuing the consumption deferral accounts at the end of the current Water PBR (2022-2026) and Wastewater and Drainage PBR (2022-2024) terms. EWS also recommends reflecting the accumulated deferral account balances in customer rates via a rate adjustment at the end of the current PBR term, starting in 2025 for Wastewater. These rate adjustments will correspond to the balances accumulated for each customer class to prevent cross-subsidization between classes.

## **ATTACHMENT**

1. EPCOR's Review of Consumption Deferral Accounts