

Review of Consumption Deferral Accounts



Report to Utility Committee

May 06, 2024

EPCOR WATER SERVICES

Response to July 9, 2021 Utility Committee Motions

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1.0 Introduction

1. The following motion was passed at the July 9, 2021, Utility Committee meeting where the Performance Based Regulation (PBR) Applications submitted by EPCOR Water Services Inc. (EWS) for Water, Wastewater Treatment and Wastewater Collection (previously Drainage Services) were reviewed.

“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.”*
2. EWS addressed items (1), (2), and (3) from the above motion in its report to Utility Committee on November 4, 2022. This report provides EWS’ recommendations for item (5) from the above motion.

2.0 Background

3. Utility deferral accounts, sometimes referred to as regulatory deferral accounts, are financial mechanisms used in rate regulated utilities to defer certain costs and revenues for collection or recovery in future years, thereby impacting the utility’s earnings, rate-setting processes, and the rates charged to customers.

4. Deferral accounts are typically reserved for situations where the costs or revenues in question are subject to a high level of uncertainty and are outside the utility’s direct control. Several types of deferral accounts exist across jurisdictions within the utility industry. Examples include deferral accounts for extraordinary events such as unexpected repairs following a natural disaster, premature asset failure/retirement,

environmental compliance costs, property taxes, franchise fees, weather/consumption, etc.

5. The following motion passed by the Utility Committee on August 27, 2021 directed EWS to accumulate consumption deferral balances over the 2022-2024 and 2022-2026 PBR terms, and subsequently collect or refund the accumulated balances over the future PBR terms.

“A deferral account for water consumption for each of Water Services, Wastewater Treatment and Drainage Services that would be accumulated during the 2022-2026 and 2022-2024 PBR terms and included in customer rates in each of the next PBR terms through a special rate adjustment.”

6. Historically, EWS never proposed the inclusion of a deferral account for revenue or consumption forecasts as part of its PBR framework for setting rates. This approach has resulted in EWS historically bearing the entire revenue risk arising from fluctuations in water consumption, which has benefited ratepayers by ensuring that EWS' rates remained relatively stable and predictable over the long term, as it was unaffected by consumption changes.

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

8. However, the COVID-19 pandemic posed a challenge in accurately forecasting consumption for the 2022-2024/2026 PBR Application, which was developed in mid-2020. To address this unique circumstance, a consumption deferral account was proposed and introduced for the current 2022-2024/2026 PBR term.

9. The primary objective of introducing the consumption deferral account was to mitigate consumption related revenue variances. It is important to recognize that this measure was not intended to establish a precedent, given the risk of long-term rate volatility for customers. To recognize the reduction in revenue volatility for EWS through the introduction of the consumption deferral accounts, the return on equity for Water and Wastewater Treatment was reduced by 25 basis points for the 2022-2024/2026 PBR term.

10. EWS was also directed to provide its recommendations for managing consumption variations in the future, which is the purpose of this report.

3.0 Current State of the Consumption Deferral Accounts

11. The consumption deferral amount is calculated as the difference between the PBR forecast consumption and actual consumption multiplied by the rate in effect for a given period when the difference occurs. Table 3.0-1 shows the accumulated consumption deferral account balances from the beginning of the current PBR term starting April 1, 2022 to December 31, 2023, along with related variations in consumption.

**Table 3.0-1
Consumption and Deferral Account Balances**

Utility / Customer Class	Annual Consumption - ML						Deferral Account Balance		
	2022			2023			\$ millions		
	PBR	Actual	Var.	PBR	Actual	Var.	2022	2023	Total
1 In-City Water									
2 Residential	34,39	36,33	1,94	44,78	47,71	2,93	3.9	6.6	10.5
	1	6	5	4	8	4			
3 Multi-Residential	13,35	14,25	903	17,62	18,93	1,31	1.3	2.0	3.3
	1	4		7	8	1			
4 Commercial	16,80	19,08	2,27	22,67	27,20	4,52	3.0	6.5	9.5
	5	4	9	7	3	6			
5 In-City Water	64,54	69,67	5,12	85,08	93,85	8,77	8.2	15.1	23.3
	7	4	7	8	9	1			
6 Wastewater Treatment									
7 Residential	34,37	35,86	1,48	44,76	47,69	2,93	1.8	3.8	5.6
	8	5	7	6	9	3			
8 Multi-Residential	13,35	14,08	735	17,62	19,02	1,39	0.9	1.8	2.7
	1	6		7	0	3			
9 Commercial	14,59	17,33	2,74	19,82	23,60	3,77	2.7	4.3	7.0
	4	8	4	5	0	5			
10 Wastewater Treatment	62,32	67,28	4,96	82,21	90,31	8,10	5.4	9.9	15.3
	3	9	6	8	9	1			
11 Wastewater Collection									
1 Residential	34,37	35,86	1,48	44,76	47,69	2,93	1.9	3.8	5.7
	8	5	7	6	9	3			
1 Multi-Residential	13,35	14,08	735	17,62	19,02	1,39	0.9	1.8	2.7
	1	6		7	0	3			

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Utility / Customer Class		Annual Consumption - ML						Deferral Account Balance		
		2022			2023			\$ millions		
		PBR	Actual	Var.	PBR	Actual	Var.	2022	2023	Total
14	Commercial	14,590	17,327	2,737	19,825	23,600	3,775	3.3	4.8	8.1
15	Wastewater Collection	62,319	67,278	4,959	82,218	90,319	8,101	6.1	10.4	16.5
16	Balance w/o Carrying Charges							19.7	35.4	55.1
17	Carrying Charges							0.6	2.4	3.0
18	Total Deferral Balance							20.3	37.8	58.1

12. Several factors contribute to variations in consumption, including differences in customer growth relative to forecast, abnormal weather patterns, changes in consumption patterns and trends, and extraordinary events such as the COVID-19 pandemic.

13. During the current 2022-2024/2026 PBR term, all of the above factors have impacted consumption, however the predominant factor influencing consumption variance has been the impact of the COVID-19 pandemic on water consumption for the residential and commercial customer classes.

14. EWS' PBR forecast was prepared mid-2020, a period 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 have also led to increased residential consumption and continue to influence residential consumption trends post-pandemic.

15. Additionally, an unusually hot and dry summer over the past years has resulted in higher seasonal consumption. The commercial consumption has also rebounded to pre-pandemic levels earlier than anticipated in the PBR forecast.

4.0 Review of Consumption Deferral and Adjustment Mechanism

16. The vast majority of the variation in consumption can be attributed to unforeseen circumstances, such as the COVID-19 pandemic, making it challenging to forecast consumption patterns accurately. It is therefore important to review historical

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consumption trends over the past few years. To this end, EWS reviewed the historical average consumption of its residential and commercial customers since 2017 and compared this with its 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). Table 4.0-1 shows a comparison between the anticipated and actual average consumption per customer in cubic meters from 2017 to 2023.

Table 4.0-1
2017 – 2023 Average Consumption per Customer in m³

Customer Class	2017	2018	2019	2020	2021	2022	2023
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%

17. The actual consumption data presented in Table 4.0-1 indicates 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). Since residential consumption constitutes more than 50% of the total consumption, it is a critical factor to consider when evaluating the need for a consumption-related deferral account.

18. Residential consumption is highly influenced by seasonal usage patterns and weather changes. However, EWS has demonstrated reasonable precision in forecasting residential consumption, as shown in Table 4.0-1. 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.

19. 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.

20. The current state of the consumption deferral account, as shown in Table 3.0-1, 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, as outlined in section 3.0.

21. 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.

22. These additional rate adjustments (additional charges) when combined with routine rate 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, which could lead to suboptimal investment in utility infrastructure when some of the required investment is deferred to a future period. Deferral accounts introduce rate uncertainty and volatility for customers over an extended period and are, therefore, not recommended by EWS.

23. 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. These customers do not appear to be in favour of bearing weather-related risks on their utility bills. Additional information on the survey results and PBR engagement will be presented as part of the 2025-2027 PBR Application.

24. EWS will continue tracking the consumption deferral balances for the remaining duration of the 2022-2026 Water PBR and the 2022-2024 Wastewater PBR. However, this tracking will be discontinued at the end of these PBR terms. Any accumulated deferral account balances during these terms will be reflected in customer rates over the future PBR term. The future rate adjustments will correspond to the balances accumulated for each customer class to prevent cross-subsidization between customer classes. The shift of consumption risk from ratepayers back to EWS is deemed in the interest of ratepayers, and it enhances the long-term stability and predictability of rates.

5.0 EPCOR's Recommendations

25. EWS recommends discontinuing the consumption deferral accounts at the end of the current Water PBR (2022-2026) and Wastewater 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.