Discussion, Analysis and Recommendations of Electricity Franchise Fee and the *Utilities Affordability Statutes Amendment Act, 2024*

INTRODUCTION

As a result of Bill 19, (the *Utilities Affordability Statutes Amendment Act, 2024*), the City is required to have its electricity (EPCOR Distribution and Transmission Inc.) and natural gas (ATCO Gas and Pipelines Ltd.) franchise agreements reviewed and approved by the Alberta Utilities Commission (AUC) by March 17, 2025. The agreements need to be submitted to AUC by December 4 2024, and January 10, 2025, respectively.

The natural gas franchise agreement is already aligned with AUC regulations and requires no amendments. Furthermore the City is charging a franchise fee rate for natural gas at 35% of distribution revenue, the maximum permitted by AUC. As a result no changes are being proposed to the natural gas franchise fee and no decisions are required. The natural gas franchise agreement will be submitted by ATCO s to AUC for review and approval.

Administration is proposing changes to the electricity franchise agreement. The change includes a revision of the fee calculation formula to align with AUC guidance (franchise fee rate x distribution revenue) which will require the City to choose a franchise fee rate. The AUC permits an electricity franchise fee rate between zero and 20%.

BACKGROUND

Historically, municipalities have signed franchise agreements with utility companies to grant the exclusive right to provide regulated utility services within municipality boundaries. As part of that agreement, the utility will be charged a franchise fee (also sometimes referred to as local access fees) by the municipality for that exclusivity and for costs related to utility right of way access to public land. These franchise fees are then generally flowed through to utility ratepayers on their utility bills.

Franchise fees are typically calculated as a percentage of revenue earned by the utility for providing regulated utility services. This is generally viewed as reasonable as this is reflective of the “value” of the franchise to the utility company. Examples of typical regulated utility services include the distribution of energy such as electricity or natural gas. In Alberta, this process is regulated by the Alberta Utilities Commission (AUC) and is legislatively supported through the

Municipal Government Act, the *Electric Utilities Act* and the *Gas Utilities Act*. Non-regulated utility services, such as the sale of energy, are not subject to the same franchise fee regulation as there is generally no comparable exclusivity being given.

Historically, in general, all municipal franchise agreements required AUC approval. The current maximum percentages allowed in franchise agreements by the AUC are 20% for electricity and 35% for natural gas. Prior to Bill 19, the *Municipal Government Act* contained an exception for utilities owned by the municipality. In those cases, the municipality had the authority to directly approve the franchise agreement without need for AUC approval. Two examples of this are the City of Edmonton’s relationship with EPCOR (electricity) and the City of Calgary’s relationship with ENMAX (electricity).

On April 22, 2024, the Government of Alberta (GOA) introduced and completed the first reading of Bill 19 (the *Utilities Affordability Statutes Amendment Act, 2024*, SA 2024, c8). The intention of this legislation is to protect ratepayers by making utility bills more affordable and predictable by prohibiting the use of variable rates when calculating franchise fees. At second reading, on May 7, 2024, the Minister of Affordability and Utilities emphasized the purpose of the bill is to:

1. Help deliver relief for many Albertans struggling with cost of living
2. Decrease the “high impact of local access fees by municipalities”

On May 16, 2024, Bill 19 received royal assent and came into force through proclamation on June 20, 2024. Key concerns/principles identified by the GOA include:

1. Albertans’ need relief on their utility bills as soon as possible
2. Lack of alignment on how all Municipalities set their fees
3. Municipalities using their franchise fees to generate surplus revenue
4. Stronger regulatory oversight by the AUC over the fees by amending the *Electric Utilities Act*, *Gas Utilities Act* and *Municipal Government Act*

Bill 19 included a number of changes to statutes. The main changes include:

1. Franchise agreements for delivery of electricity (Section 139 of the *Electric Utilities Act*) and natural gas (Section 49(5) of the *Gas Utilities Act*) will require AUC approval within 270 days of Bill 19 coming into force. The deadline is March 17, 2025. To meet this timeline, the AUC has set a general application filing deadline of December 4, 2024.

2. The AUC, however, is expecting most franchise agreement applications to follow the AUC-approved formula of basing franchise fees on a per cent basis of applicable utility rate revenue and has set a later filing deadline of January 10, 2025, for these compliant applications.

3. Section 45.01 of the *Municipal Government Act* now prohibits franchise agreements based in whole or in part using a price per kilowatt hour or per gigajoule that varies according to market prices.

4. AUC approval is now required for agreements between a municipality and a corporation controlled by and/or a subsidiary of the municipality delivering a utility service. In the past, municipality owned utilities were exempt from requiring AUC approval.

5. The Regulated Rate Option (RRO) will be renamed to be the Rate of Last Resort. This change was made to make clear to utility ratepayers of potential rate volatility.

While Bill 19 speaks to franchise fees in general, the primary focus and impacts of Bill 19 are to franchise agreements for electricity and natural gas. As such, the City of Edmonton's franchise agreement with EPCOR Water Services for water, wastewater treatment and wastewater collection is not currently an issue of concern that needs to be addressed. However the City's franchise agreement with EPCOR Distribution and Transmission (electricity) and ATCO Gas fall under the new statutes and require AUC approval.

ELECTRICITY FRANCHISE AGREEMENT

The City of Edmonton's electricity franchise agreement is with EPCOR Distribution and Transmission Inc. (EPCOR) and provides the exclusive right to distribute electricity within the City (effective January 1, 2004, to December 31, 2023). The City and EPCOR have agreed to a one year extension to December 31, 2024, and an additional extension until a new agreement is consented to by City Council and approved by the AUC.

AUC Guidance

As EPCOR is owned by the City of Edmonton, prior to Bill 19 the current franchise agreement did not require AUC approval and was instead approved by City Council. While the franchise fee calculation method currently being used by the City and Epcor is considered to be compliant with Bill 19, as it is not based on a "variable" rate, the calculation is unique to the City of Edmonton and does not follow the AUC approved method of basing franchise fees on a per cent basis of applicable utility rate revenue.

<u>Current Franchise Fee Calculation</u>

The current method of calculating franchise fees for electricity is as follows:

> ***Franchise Fee Revenue*** *= Forecasted Annual Franchise Fee Revenue (based on prior year actuals)*
>
> + *Inflation (year over year change - CPI per Statistics Canada for Edmonton)*
> + *Annual System Growth (contractually agreed amount of 1.5%)*
> + *Shortfall / Overage (based on prior year projected amount)*

Historically, the actual franchise fees charged and collected by EPCOR (for the years 2019 to 2023) were:

EPCOR ELECTRICITY FRANCHISE FEE 2019 - 2023			
Year	Franchise Revenue Budget (millions)	Franchise Revenue Actual (millions)	Variance
2019	$64.2	$64.2	-
2020	$66.0	$66.0	-
2021	$67.4	$67.4	-
2022	$71.3	$71.3	-
2023	$76.4	$76.4	-

The actual franchise fee does not vary from the budget because at year-end the City records an accrual for any over or under collection in order to only recognize an amount equivalent to the budgeted franchise fee. The shortfall or overage in current year franchise fee revenues is corrected in the next year through a corresponding adjustment in the franchise fee rate.

<u>Franchise Fee Calculation Options</u>

In Alberta, the majority of the largest municipalities currently follow the AUC approved formula (based on a percentage of applicable utility revenue) up to a maximum of 20%. Two major municipalities that do not follow the AUC approved formula are the City of Calgary and the City of Edmonton. Both municipalities also own the utility companies (ENMAX and EPCOR respectively) that provide distribution of electricity in their municipalities and as such did not previously require AUC approval for their franchise agreements.

In terms of the City of Calgary, their franchise fee is currently based on the Regulated Rate Option (RRO). The RRO is a variable rate, generally for ratepayers who are not signed to a retailer contract, and resulted in very high franchise fee revenues being earned by the City of Calgary in 2023. This was largely due to the highest RRO rates in Alberta since the RRO was created.

With that in mind, the City of Edmonton does not have the same issue as the City of Calgary due to the franchise fee formula not being based on a “variable” factor.

As such, due to the changes resulting from Bill 19, the City has the following options:

1. Retain the Current Formula
2. Change to the AUC-Approved Formula (per cent of utility distribution revenue)

Option 1: Retain the Current Formula

Per AUC direction, the expectation is that most applicants will follow the AUC approved model (based on a per cent of distribution revenue). Any deviation will likely bring increased scrutiny as the onus will be on applicants to prove legislative compliance and that rates will be reasonable and just. A listing of pros and cons of this option are listed below:

PROS	CONS
1. Formula is inherently more stable for budgeting as variables in the formula are less volatile (i.e. inflation, predetermined system growth) and provide steady predictable growth. 2. The current formula has a built in true up mechanism, where any undercollection in franchise fee revenues (mostly due to changes from forecasted consumption) are made up through an increase in franchise fees collected in the next year.	1. While more stable, the City may be under collecting potential franchise fee revenues as municipalities are permitted to collect electricity franchise fees up to 20% of applicable revenues. 2. The current formula inherently is more complicated to explain and to justify certain components (i.e. system growth of 1.5%), and the annual shortfall/overage true up mechanism.

Option 2: Change to the AUC-Approved Formula (per cent of utility distribution revenue)

The recommended AUC-approved formula is based on the following calculation:

> ***Franchise Fee Revenue*** *= Forecasted distribution revenue x franchise rate (per cent)*

When reviewing municipalities in the surrounding Edmonton Metropolitan Region, with the majority having utility services provided by FortisAlberta, there is a fair amount of variability in the percentage rate being utilized. All are using the AUC-approved formula.

A summary of the larger municipalities in the surrounding Edmonton Metropolitan Region and across Alberta is shown below:

Municipality	Percentage	Category
Beaumont	17.25%	Edmonton Metropolitan Area
Fort Saskatchewan	0.00%	Edmonton Metropolitan Area
Leduc	16.00%	Edmonton Metropolitan Area
Spruce Grove	20.00%	Edmonton Metropolitan Area
St. Albert	15.00%	Edmonton Metropolitan Area
Stony Plain	20.00%	Edmonton Metropolitan Area
Strathcona County	0.00%	Edmonton Metropolitan Area
Red Deer	15.00%	Other Provincial Municipalities
Lethbridge	15.50%	Other Provincial Municipalities
Airdrie	20.00%	Other Provincial Municipalities
Grand Prairie	10.00%	Other Provincial Municipalities
Cochrane	17.00%	Other Provincial Municipalities
Okotoks	20.00%	Other Provincial Municipalities
Chestermere	11.50%	Other Provincial Municipalities

As shown above, with the exception of Fort Saskatchewan and Strathcona County, all of the municipalities in the surrounding Edmonton Metropolitan Region have percentage rates ranging from 15.00% to 20.00%, with the average franchise fee rate of 17.65% for those collecting a franchise fee (excluding Fort Saskatchewan and Strathcona County). When considering municipal rates across the province the range is from 10.00% to 20.00%, with the average franchise fee rate of 16.4% for those collecting a franchise fee (excluding Fort Saskatchewan and Strathcona County).

City of Calgary franchise fee calculation previously relied on the market price (i.e., the Regulated Rate Option) and is currently under review. Their proposed franchise fee rate and calculation is not publicly available at this time.

The table below provides an analysis of the potential franchise fee amount based on a range of franchise rates using the AUC-approved formula (Option 2), compared to the current approved franchise fee in the City's budget (Option 1). The analysis is provided for 2025 to 2027, with only 2025 and 2026 being approved in the budget, and 2027 provided as a forecast.

Based on analysis of the 2025, 2026 and 2027 forecast distribution revenue, provided by EPCOR, the current effective franchise fee rate is approximately 15.3% to 15.5%. Any rate in this range would result in franchise fee revenues that are within +/- $1 million of the current franchise fees being collected by the City under the existing franchise fee formula. Due to the change in distribution revenue forecasts year over year, it is not possible to calculate a franchise fee rate that produces exactly the same franchise fee revenue from 2025-2027 generated under the current formula.

Estimation of EDTI Franchise Fee Revenue
Comparing Franchise Fee Revenue Current Calculation to AUC Approved Formula

Proposed Franchise Fee (FF) Percent	2025 FF Revenue Forecast: OPTION 2 AUC Approved Formula *(Effective March 17, 2025)*	2025 FF Revenue Forecast: OPTION 1 Retain Current Formula	2025 FF Revenue Forecast: Increase / (Decrease)	2026 FF Revenue Forecast: OPTION 2 AUC Approved Formula	2026 FF Revenue Forecast: OPTION 1 Retain Current Formula	2026 FF Revenue Forecast: Increase / (Decrease)	2027 FF Revenue Forecast: OPTION 2 AUC Approved Formula	2027 FF Revenue Forecast: OPTION 1 Retain Current Formula	2027 FF Revenue Forecast: Increase / (Decrease)
Distribution Revenue Per EDTI *	$545,066,463			$564,797,980			$577,912,383		
15.00%	$ 82,144,558	$ 83,298,322	$ (1,153,765)	$ 84,719,697	$ 86,463,659	$ (1,743,962)	$ 86,686,857	$ 89,922,205	$ (3,235,347)
15.28%	83,298,322	83,298,322	0	86,313,739	86,463,659	(149,920)	88,317,912	89,922,205	(1,604,293)
15.50%	84,188,557	83,298,322	890,235	87,543,687	86,463,659	1,080,028	89,576,419	89,922,205	(345,785)
16.00%	86,232,556	83,298,322	2,934,234	90,367,677	86,463,659	3,904,018	92,465,981	89,922,205	2,543,776
16.50%	88,276,555	83,298,322	4,978,233	93,191,667	86,463,659	6,728,008	95,355,543	89,922,205	5,433,338
17.00%	90,320,555	83,298,322	7,022,232	96,015,657	86,463,659	9,551,998	98,245,105	89,922,205	8,322,900
17.50%	92,364,554	83,298,322	9,066,232	98,839,647	86,463,659	12,375,988	101,134,667	89,922,205	11,212,462
17.65%	92,977,754	83,298,322	9,679,431	99,686,843	86,463,659	13,223,185	102,001,536	89,922,205	12,079,331
18.00%	94,408,553	83,298,322	11,110,231	101,663,636	86,463,659	15,199,978	104,024,229	89,922,205	14,102,024
18.50%	96,452,552	83,298,322	13,154,230	104,487,626	86,463,659	18,023,968	106,913,791	89,922,205	16,991,586
19.00%	98,496,552	83,298,322	15,198,229	107,311,616	86,463,659	20,847,958	109,803,353	89,922,205	19,881,148
19.50%	100,540,551	83,298,322	17,242,229	110,135,606	86,463,659	23,671,948	112,692,915	89,922,205	22,770,710
20.00%	102,584,550	83,298,322	19,286,228	112,959,596	86,463,659	26,495,937	115,582,477	89,922,205	25,660,272

* Based on Distribution Revenue Forecast Per EDTI

A listing of pros and cons of this option are listed below:

PROS	CONS
1. The AUC-approved formula would be in alignment with the majority of municipalities in Alberta, and would align with AUC guidance, therefore resulting in less scrutiny. 2. The formula is inherently easier to calculate with less complexity to justify. 3. The City would be able to increase the franchise fee percentage up to 20% without needing further AUC approval.	1. Revenues may be more volatile as amounts received would be tied to the amount of distribution revenue earned by EPCOR, however given the stable customer base and relatively stable consumption figures this concern is somewhat mitigated.

If the decision is made to implement the AUC-approved formula, consideration will need to be given on the exact percentage rate to apply as well. Three potential options are:

Option 2A: Implement a percentage rate equal to 15.5% (equivalent to the effective percentage rate based on the current calculation). This will ensure that the resulting franchise fee revenues are within +/- $1 million compared to the current planned franchise fees for 2025-2027.

Option 2B: Implement a percentage rate based on an average of surrounding communities of 17.65%, which would result in approximately $9.7 to $13.2 million more in franchise fees compared to the approved 2025 to 2026 budget.

Option 2C: Implement a franchise fee rate anywhere between 15.5% and 17.65%.

The current franchise agreement grants EPCOR the exclusive right and license to use the City of Edmonton's rights of way to construct, install, maintain, operate, repair, replace, extend and remove electric power distribution assets necessary to provide electric power utility services and the exclusive right to distribute electric power within the City of Edmonton. In exchange for these rights, EPCOR pays a franchise fee to the City. Electric power distribution franchise fees are not considered to be in lieu of property taxes, which are levied separately.

Through discussions with various municipalities, EPCOR, and external utility consultants there is not necessarily a best practice to determine the appropriate franchise fee rate. The franchise fee collected by the City from the utility is based on the value of the exclusive right and license provided to the utility company to use the city's land to provide the service and collect associated distribution revenues. From Administration's discussions and research the rate is typically based on a combination of factors including:

- Property tax tolerance: Certain municipalities are facing budget pressures and chose to increase franchise fees instead of property taxes to manage the operating budget funding shortfall.
- System growth: The City's existing electricity franchise fee formula based a part of the increase on the growth of the distribution system, which is estimated to be 1.5% per year.
- Population growth: Certain municipalities discussed the growing population as a rationale for increasing the franchise fee rate.
- Inflation: The City's existing electricity franchise fee formula bases a part of the annual increase on inflation.

Each municipality seems to use factors differently and the most commonly used factor in recent years was property tax tolerance. In other words, if the property tax was at a level that councils were not comfortable increasing, and there were still budget pressures to fund, it seemed that the councils leaned towards increasing the franchise fee rates.

In order to properly value the franchise, a thorough review of the valuation process would be required. This may require the expertise of external consultants to ensure utility providers are being charged appropriately for the benefits they are receiving from the City and is reflective of the true cost of doing business.

The decision of what the appropriate percentage rate to implement will need to consider the current political environment, considering many utility ratepayers are also tax payers, as well as factor in the economic environment given recent impacts of inflation, cost of living, and property tax increases.

It would be reasonable to align the City's franchise fee rate to the rates being charged by surrounding municipalities. Generally speaking, municipalities in similar regions are facing the same financial, economic, population, and political factors, which all impact the valuation of the franchise.

RECOMMENDATION

Administration's recommendation for the Electricity Franchise Agreement based on the facts, analysis and discussion above is that the City and EPCOR update the current agreement calculation to the AUC-approved per cent based formula using a rate to match the current franchise fee revenue stream and add a clause to allow for moving up to the maximum rate of 20% with Council approval.

Administration is recommending the City's Electricity franchise fee formula be changed to a per cent of distribution revenue implementing a 15.5% rate. This rate will result in franchise fee revenues being within +/- $1 million compared to the current planned franchise fees for 2025-2027. This rate results in the least impact to ratepayers, while complying with the AUC approved model. This approach also acknowledges there are currently many financial pressures (e.g. inflation, cost of living, etc.) affecting the City, the utility ratepayers and taxpayers.

It is also recommended the City explore in the future the option to gradually increase the rate towards the 20% maximum allowed by the AUC. This would be accompanied through a thorough review of the valuation of the franchise and may consider population/economic growth, utility system growth, and current rates being implemented by surrounding municipalities.

NEXT STEPS

Based upon the timelines proposed in the AUC Bulletin, Administration and EPCOR have decided to proceed with a new agreement based on the proposed AUC formula for Utility Committee's consideration. Administration seeks Utility Committee's recommendation of Bylaw 20959 containing the new Electricity Franchise Agreement to City Council for three readings, after which the agreement will need to be advertised and submitted to AUC in early December. This agreement has an earlier due date than the natural gas agreement, because the current agreement varies from the AUC model. The franchise agreement and bylaw will be written to come into effect on March 17, 2025, once the AUC has approved the franchise agreement application and in line with the deadline set by Bill 19.

The franchise fee agreement with ATCO for natural gas does not need to be changed, as the calculation complies with Bill 19 and the AUC model. This agreement does not have to go to Utility Committee or Council for any reasons associated with Bill 19. The agreement does have to be advertised and resubmitted to the AUC by January 10, 2025, and the process will be administered by ATCO with support from the City as required.

November 8, 2024	Electricity Franchise Agreement Bylaw to Utility Committee
Week of November 11, 2024	Electricity Franchise Agreement Bylaw to Council for three readings
Week of November 11, 2024	Advertisement of the Electricity Franchise Agreement by EPCOR immediately following Council approval, as required by AUC

Replacement Attachment 3

December 4, 2024	Electricity Franchise Agreement to Alberta Utilities Commission (Application Filing Due Date for agreements that may not be compliant)
January 10, 2025	Natural Gas Franchise Agreement to Alberta Utilities Commission (Application Filing Due Date for compliant agreements)
March 17, 2025	Alberta Utilities Commission to complete review of all applications