

EPCOR Water Services Inc. - Performance Based Rates Applications and Regulatory Process

2022-2026 Water Services Application, 2022-2024 Wastewater Treatment and Drainage Services Applications

Recommendation

That Utility Committee recommend to City Council:

That the regulatory schedule and guiding objectives, set out in Attachment 1 of the February 5, 2021, Financial and Corporate Services report FCS00306, to assess the EPCOR Water Services Inc. performance based rates applications to establish new rates for water, wastewater treatment and drainage services, effective April 1, 2022, be approved.

Executive Summary

In mid-February 2021, EPCOR Water Services Inc. will be submitting performance based rates applications for approval by City Council to establish customer rates for water services for the five year period April 1, 2022 to March 31, 2027, and for wastewater and drainage services for the three year period April 1, 2022 to March 31, 2025. This report provides an overview of performance based regulation and the proposed regulatory process for Utility Committee and City Council to assess the reasonableness of the rates applications. The process includes the review by Utility Committee of the rates applications and submissions from Administration, the Utility Advisor, and the public at the June 25, 2021, Utility Committee meeting.

Report

Background

EPCOR Water Services Inc. (EWSI) provides water, wastewater treatment and drainage services to the City of Edmonton. The City of Edmonton has franchise agreements with EWSI that grant EWSI the exclusive right to provide these services within the boundaries of the City of Edmonton. As a utility, EWSI is subject to regulation to ensure services are provided at a fair price and that appropriate service levels are maintained. City Council maintains regulatory oversight responsibility for the water, wastewater treatment and drainage utilities owned and operated by EWSI. The *Public Utilities Act* and *Municipal Government Act* provide City Council with the

authority to pass bylaws relating to municipal public utilities, including those owned and operated by municipally controlled corporations, and to set terms, costs, or charges relating to those public utilities within the boundaries of the City of Edmonton. As regulator, City Council is expected to balance the interests of the customers (high quality and reliable services at reasonable costs) with the interests of EWSI (financially sustainable utility that provides fair investment returns).

City Council has approved separate bylaws to establish the customer rates and terms and conditions of service under performance based regulation for each of EPCOR Water Services and Wastewater Treatment Bylaw 17698 and EPCOR Drainage Services Bylaw 18100. Council approved Bylaw 17698 on October 25, 2016 that sets customer rates for water services and wastewater treatment services charged by EWSI for the five year period April 1, 2017 to March 31, 2022. This was the fourth performance based regulation term for water services that were first regulated under performance based regulation beginning in 2002, and the second performance based regulation term for wastewater treatment services, which were first regulated under performance based regulation beginning in 2012. With the transfer of drainage services from the City of Edmonton to EWSI effective September 1, 2017, Council also approved Bylaw 18100 on September 12, 2017 that sets customer rates for drainage services charged by EWSI for the period January 1, 2018 to March 31, 2022.

Overview of Performance Based Regulation

One of the guiding objectives of Bylaw 12294 - EPCOR Edmonton Regulated Utilities Procedures Bylaw is that “all customer charges will be based upon cost of service”. A cost of service approach is the most common method to determine regulated utility rates. Under a traditional cost of service approach, rates are generally established by the regulator every one to two years through a two phase process.

In the first phase, the regulator determines the total amount of money (“revenue requirement”) required by the utility to provide its regulated services in a year. The revenue requirement is comprised of the forecast costs required to operate, maintain and invest in the utility system plus a fair return on the utility’s investment (return on equity). The return on equity also compensates the utility for the risks inherent in operating the business.

In the second phase, individual customer rates are established that will allow the utility to recover the total annual revenue requirement. A cost of service analysis is first completed to determine how much of the total revenue requirement should be equitably recovered from each customer class (e.g. residential, commercial). A rate design analysis is then completed to determine how the individual customer rates should be designed and structured to recover the revenue requirement allocated to each customer class (e.g. fixed vs variable).

Under a performance based regulation approach, customer rates are determined for the first year of the term based on the cost of service two phase approach described above. The customer rates are then adjusted in each subsequent year by a predefined formula for the term of the performance based regulation plan. The basic formula adjusts customer rates annually by a rate of inflation (“I”) that reflects the increased cost of labour and non-labour inputs the utility uses, less an efficiency factor (“X”) to reflect the productivity improvements the utility can be expected to achieve during the performance based regulation period.

Generally the utility bears the risk of normal factors that could impact revenues and costs above the inflation and efficiency factors (I-X) (e.g. weather, consumption). However, extraordinary or uncontrollable factors that have a significant impact and are beyond the control of the utility may be eligible for a “non-routine” rate adjustment and flowed through to customers (e.g. legislative changes).

Establishing customer rates under a performance based regulation approach creates stronger incentives for the utility to improve its efficiency through cost reductions and other measures since it is able to retain the increased profits from these measures for a longer period than it would under a traditional cost of service two year approach. At the same time, customers automatically share in the expected efficiency gains because they are built into rates through the efficiency factor, regardless of the actual performance of the utility. Other benefits include customers receiving stable and predictable rates over a longer term (e.g. five years) and a reduction in the frequency and cost of regulatory applications being filed and approved (“regulatory burden”).

EWSI Rate Applications

As discussed in the October 2, 2020, Financial and Corporate Services report CR_8146, EPCOR Water Services Inc. - Water, Wastewater and Drainage Based Rates Process and Timelines Report presented to Utility Committee, EWSI will be submitting applications in February 2021 for approval by City Council to establish customer rates under performance based regulation for water services for the five year period April 1, 2022 to March 31, 2027, and for wastewater and drainage services for the three year period April 1, 2022 to March 31, 2025. EWSI will then submit five year performance based rates applications for wastewater and drainage services for the period April 1, 2025 to March 31, 2030 and for water services for the period April 1, 2027 to March 31, 2032. This staggered approach for submitting rate applications will reduce the regulatory burden and allow EWSI to prepare, and give City Council, Utility Committee, and Administration the opportunity to effectively review the comprehensive rate applications.

The main elements of the water, wastewater and drainage applications to set customer rates effective April 1, 2022 will include the following:

- A mechanism to adjust customer rates, fees and charges annually under a performance based regulation formula (e.g. I-X);
- A mechanism for non-routine adjustments under the performance based regulation framework, similar to Bylaw 17698 for water and wastewater treatment services and Bylaw 18100 for drainage services;
- Terms and Conditions of service; and
- Service quality metrics and targets, detailed in a similar manner to Bylaw 17698 for water and wastewater treatment and Bylaw 18100 for drainage services.

Regulatory Process and Timelines

A comprehensive regulatory process is followed by City Council in the review and approval of utility customer rates for EWSI, and is similar in many respects to the approach used by other Provincial regulatory bodies, including the Alberta Utilities Commission. Administration has worked with EWSI to draft the proposed process and timelines in Attachment 1 for Utility Committee and City Council to review and approve the performance based rates applications for water, wastewater treatment and drainage services to set customer rates effective April 1, 2022. Key dates and milestones include the following:

- Mid-February 2021 - EWSI to submit rates applications;
- March 31, 2021 - written questions to EWSI from Councillors, Utility Advisor, and Administration;
- April 26, 2021 - written responses from EPCOR to questions;
- May 31, 2021 - written submissions from the public and reports from Administration and the Utility Advisor on the rates applications;
- June 14, 2021 - written responses from EWSI to public submissions and reports from Administration and the Utility Advisor;
- June 25, 2021 - Utility Committee meeting to review the applications and submissions from Administration, the Utility Advisor, and the public; and
- July/August 2021 - approval of the rates applications and three readings of the applicable bylaws by City Council.

The proposed process outlined in Attachment 1 is consistent in most respects to the regulatory process followed in 2016 for the approval of EWSI's water and wastewater treatment services applications to set rates for the period April 1, 2017 to March 31, 2022. The regulatory process in 2016 was guided by EPCOR Edmonton Regulated Utilities Procedures Bylaw 12294, which sets out the process for Council to approve rates applicable to any utility service provided by EPCOR within the boundaries of the City of Edmonton which the City has authority to approve. The guiding objectives for the assessment of EWSI's proposed rates as prescribed in Bylaw 12294 have also been included in Attachment 1.

Attachment 1 incorporates enhancements to the regulatory process that were presented to Utility Committee on October 2, 2020. These include Administration releasing its Reasonableness Review report further in advance of the Utility Committee hearing date to allow EWSI time to respond, moving the deadline for Councillors to submit written questions on key issues later in the regulatory schedule rather than within seven working days of first reading of the Bylaw (required by Bylaw 12294), hearing from the public at Utility Committee rather than through the public hearing format (required by Bylaw 12294), and moving first reading of the proposed Bylaw, by Council, to set customer rates from the beginning of the regulatory process (in accordance with Bylaw 12294) to the end of the process after Utility Committee has completed its deliberations and given final direction on the rates applications.

Administration considers the best approach to implement these enhancements is repealing Bylaw 12294, and to instead formalize the regulatory process through the regulatory schedule and guiding objectives included in Attachment 1. The procedural format for the Utility Committee hearing will be detailed in a subsequent schedule proposed by Administration and approved by Utility Committee prior to the hearing. In Financial and Corporate Services report CR_8329, also being presented to Utility Committee on February 5, 2021, Administration is recommending that Bylaw 12294 be repealed in advance of the upcoming EWSI rates applications. In the fall of 2021, Administration would then evaluate whether the process for future rates applications can best be governed through a similar regulatory schedule or if a revised rates procedures bylaw report is required.

Legal Implications

Public utilities owned or operated by municipalities providing service within that municipality are generally regulated by their municipal councils, as they are exempt from Alberta Utilities Commission regulation pursuant to s. 78.2 of the *Public Utilities Act*, RSA 2000, H-16. Public utilities that are not owned or operated by municipalities and that supply water, heat, light or power are regulated by the Alberta Utilities Commission. Public utilities that are owned or operated by a municipally controlled corporation and provide a utility service within the boundaries of the municipality are exempt from regulation by the Alberta Utilities Commission pursuant to s. 75.4 of the *Municipal Government Act*.

EPCOR Water Services and Wastewater Treatment Bylaw 17698 and EPCOR Drainage Services Bylaw 18100 set out a mechanism for setting and adjusting fees, rates and charges for water, wastewater treatment and drainage services for a period that expires March 31, 2022. Therefore, new or amending bylaws are required to set fees, rates and charges to be effective April 1, 2022.

In Financial and Corporate Services report CR_8329, also being presented to Utility Committee on February 5, 2021, Administration is recommending that EPCOR Edmonton Regulated Utilities Procedures Bylaw 12294, be repealed.

Budget/Financial Implications

Approval of the water, wastewater treatment and drainage services performance based rates applications to establish new rates effective April 1, 2022 will have financial implications on EPCOR's revenues, therefore impacting the EPCOR franchise fee and dividend received annually by the City.

Public Engagement

A Utility Committee meeting will be held in June 2021 to review the water, wastewater treatment and drainage services rates applications. Advertisement of the meeting will be completed by EWSI as outlined in Attachment 1.

In accordance with Bylaw 12294, EWSI provided Utility Committee with a public awareness and engagement plan for the performance based rates applications in October 2, 2020, Financial and Corporate Services report CR_8146, EPCOR Water Services Inc. - Water, Wastewater and Drainage Based Rates Process and Timeline Report. Through the public engagement process for the rates applications, EWSI's goal is to develop and implement rate filings that seek input from stakeholders to guide how these utilities will evolve to serve them. In addition, public engagement activities will help inform communications and campaigns to educate customers on their water, wastewater and drainage utilities.

Corporate Outcomes and Performance Management

Corporate Outcome(s): The City of Edmonton has sustainable and accessible infrastructure.			
Outcome(s)	Measure(s)	Result(s)	Target(s)
Oversight and transparency of EPCOR water, wastewater and drainage services.	Annual and periodic reporting to Utility Committee of financial performance, operating and capital programs, and service quality levels.	Annual Progress Report - Water, Wastewater, Drainage (Fall 2020) Annual Operational Plan (Feb 2021) Performance Based Rates Applications (Feb 2021)	Annual Progress Report - Water, Wastewater, Drainage (June) Annual Operational Plan (Q1)

Risk Element	Risk Description	Likelihood	Impact	Risk Score (with current mitigations)	Current Mitigations	Potential Future Mitigations
Financial	Customer rates are not sufficient to ensure the continued development of utility infrastructure and for EWSI to recover its prudently incurred costs and earn a reasonable margin of profit	1	3	3 - low	EWSI customer rates are subject to regulatory review and approval by City Council based on a comprehensive regulatory process and guiding objectives.	Ongoing monitoring and reporting of EWSI operational and financial performance to the Utility Committee.
Reputational	Utility rates are not comparable to other municipalities and are perceived as unfair by customers	2	2	4 - low	EWSI submits a comprehensive application in support of the proposed utility rates, including a comparison of rates to other municipalities. EWSI undertakes a public awareness and engagement plan for the rates application.	Ongoing monitoring and reporting of EWSI operational and financial performance to the Utility Committee.

Attachment

1. EPCOR Water Services Inc. 2022-2026 Performance Based Rates Applications - Proposed Regulatory Schedule and Guiding Objectives

Others Reviewing this Report

- C. Owen, Deputy City Manager, Communications and Engagement
- G. Cebryk, Deputy City Manager, City Operations
- A. Laughlin, Deputy City Manager, Integrated Infrastructure Services
- R. Smyth, Deputy City Manager, Citizen Services
- S. McCabe, Deputy City Manager, Urban Form and Corporate Strategic Development
- B. Andriachuk, City Solicitor