



AUC

Alberta Utilities Commission

Regional Water Services Ltd.

2007-2010 General Rate Application

February 18, 2011



The Alberta Utilities Commission
Decision 2011-061: Regional Water Services Ltd.
2007-2010 General Tariff Application
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Contents

| | | |
|----------|--|-----------|
| 1 | Introduction | 1 |
| 2 | Revised application | 3 |
| 2.1 | Legislative background | 4 |
| 2.2 | Application process | 6 |
| 3 | Complaint of Monterra Interveners | 7 |
| 4 | Rate base | 9 |
| 4.1 | Treatment of sewer assets | 9 |
| 4.2 | Verification of plant-in-service amounts | 10 |
| 4.3 | Capacity of water system and plant held for future use | 13 |
| 4.4 | Contributions in aid of construction..... | 18 |
| 4.5 | Valuation of water licence | 22 |
| 4.6 | Allowance for funds used during construction | 23 |
| 4.7 | Working capital..... | 24 |
| 5 | Revenue requirement | 25 |
| 5.1 | Cost of capital | 26 |
| 5.1.1 | Capital structure | 26 |
| 5.1.2 | Return on equity..... | 26 |
| 5.1.3 | Cost of debt..... | 26 |
| 5.2 | Lot sales and customer forecast | 29 |
| 5.2.1 | Lot sales in test period | 29 |
| 5.2.2 | Forecast lot sales | 30 |
| 5.3 | Operating expenses and regulatory costs | 31 |
| 5.3.1 | Regulatory costs..... | 31 |
| 5.4 | Depreciation and amortization expense | 32 |
| 5.5 | Income tax | 33 |
| 5.6 | Deferral accounts | 34 |
| 6 | Revenue deficiency deferral account | 34 |
| 6.1 | Carrying charges | 38 |
| 7 | Rate design | 45 |
| 7.1 | Average water consumption..... | 45 |
| 7.2 | Rate structure | 47 |
| 8 | Terms and conditions of service | 52 |
| 9 | Order | 54 |
| | Appendix 1 – Proceeding participants | 55 |
| | Appendix 2 – Summary of Commission directions | 57 |
| | Appendix 3 –Final process schedule | 60 |
| | Appendix 4 – Abbreviations | 61 |

List of Tables

| | | |
|------------------|---|-----------|
| Table 1. | Gross plant-in-service as requested by RWSL..... | 13 |
| Table 2. | Capacity of water system elements..... | 16 |
| Table 3. | 2007-2010 contributions summary | 18 |
| Table 4. | RWSL working capital forecast | 25 |
| Table 5. | Cumulative number of lots sold 2007-2010 | 30 |
| Table 6. | Forecast of lot sales and occupied lots..... | 30 |
| Table 7. | Depreciation expense as forecasted by RWSL | 33 |
| Table 8. | Proposed revenue deficiency deferral account..... | 35 |
| Table 9. | RWSL proposed rate structure | 47 |
| Table 10. | Comparable rates structures of other Alberta water utilities | 48 |
| Table 11. | Comparison of monthly water bills by utility..... | 48 |
| Table 12. | Association proposed rate structure..... | 49 |
| Table 13. | Comparison of proposed monthly water bills with other Alberta utilities..... | 49 |
| Table 14. | Approved rate structure..... | 51 |
| Table 15. | Comparison of monthly bills under proposed and approved rates..... | 51 |
| Table 16. | Approved rate structure with usage charges escalated by inflation | 52 |

1 Introduction

1. Regional Water Services Ltd. (RWSL) is incorporated under the laws of Alberta and is the owner and operator of a water system providing public utility services to a residential development known as Monterra on Cochrane Lakes (Monterra). The development is in the Municipal District of Rocky View, near the Town of Cochrane.

2. On July 23, 2007, RWSL filed a general rate application (GRA) with the Alberta Energy and Utilities Board (the board or EUB), the predecessor to the Alberta Utilities Commission (the AUC or the Commission), that requested approval of a final tariff for the test periods July 1, 2007 to December 31, 2007 and January 1, 2008 to December 31, 2008 (original application, or 2007-2008 GRA). The application was related to an interim rate application that RWSL had filed with the board on May 1, 2007 and subsequently amended on July 23, 2007 (interim rate application).

3. On September 25, 2007, RWSL requested approval from the board to initiate a negotiated settlement process with respect to the 2007-2008 GRA. By letter dated October 10, 2007, the board denied RWSL's request. The board indicated that it intended to follow Directive 053: *Rate Application Process for Small Water Utilities* in considering RWSL's 2007-2008 GRA. Directive 053, (now [Rule 011: Rate Application Process for Water Utilities](#) (Rule 011)) provided for an active role by board staff to work with the utility and customers to prepare a recommendation to the board on reasonable rates for water utility service. The board considered that a formal negotiated settlement process would not be consistent with the intent of Directive 053, nor did it consider that it would be efficient to take this step at such an early stage of the GRA review process.

4. On December 11, 2007, the board issued Decision [2007-099](#)¹ approving, on an interim refundable basis, RWSL's rate for water utility service effective December 1, 2007.

5. By letter dated January 10, 2008, RWSL requested the Commission to initiate the staff assisted settlement process for its 2007-2008 GRA.

6. On February 4, 2008 RWSL filed revised terms and conditions of service to be consistent with the Commission's pro forma terms and conditions.

¹ Decision 2007-099: Regional Water Services Ltd., 2007-2008 Interim Rate Application, Application No. 1510939, December 11, 2007.

7. On March 20, 2008, the Commission responded to all matters that were currently outstanding with RWSL, including:
- a complaint made by the land owners and residents of Monterra (Monterra Group) accompanying its objection to RWSL's 2007-2008 GRA
 - a request by RWSL for review and variance of Decision 2007-099 filed on January 10, 2008
 - an application for final 2007-2008 rates filed on July 23, 2007
 - a request, dated January 10, 2008 for the AUC to initiate the staff recommendation process under Rule 011 (formally Board Directive 053)
 - an application for interim or expedited final approval of its terms and conditions of service originally filed on January 10, 2008 and resubmitted on February 4, 2008

In the letter the Commission determined that it would proceed with the Rule 011 process as previously indicated by the board and advised that Commission staff would commence the Rule 011 process shortly.

8. On July 16, 2008, the Commission approved interim general terms and conditions of service for RWSL in Decision [2008-060](#).²
9. On October 15, 2009, the Commission sent a letter to registered parties confirming that the Rule 011 process with respect to water rates for RWSL for the 2007-2008 test years was not accepted by all parties, and that resolution through a subsequent negotiated settlement process requested by RWSL was also unsuccessful. The Commission determined that a formal review process was now required to determine just and reasonable rates for RWSL.
10. On November 9, 2009, a notice of application was issued for the 2007-2008 GRA initiating a formal review process by the Commission.
11. On December 9, 2009, RWSL filed, at the request of the Commission, the written information requests and responses provided during the Rule 011 process, but excluded the information responses that were provided to Commission staff involved in the Rule 011 process on a confidential basis. The Commission had agreed to this approach by letter dated December 8, 2009, but indicated that if the Commission or a participant requests a response to those information requests, RWSL may at that time apply to the Commission for a confidentiality order.
12. On February 26, 2010, RWSL filed a revised application and revised terms and conditions of service (revised application). The revised application extended the test periods to include January 1, 2009 to December 31, 2009 and January 1, 2010 to December 31, 2010 (2007-2010 GRA).

² Decision 2008-060: Regional Water Services Ltd., Interim Approval of General Terms and Conditions of Service, Application No. 1564834, July 16, 2008.

2 Revised application

13. In the revised application, RWSL applied to the Commission in accordance with Sections 89, 90 and 91 of the *Public Utilities Act*³ for final orders:

- a) approving the 2007 test period, the 2008 test period, the 2009 test period and the 2010 test period (jointly the test periods)
- b) fixing just and reasonable rates to be charged by RWSL with respect to the provision of water services for the test periods
- c) approving the opening and year-end rate bases for the 2007 test period of \$0 and \$19,781,843 respectively
- d) approving a mid-year average rate base for the 2007 test period of \$9,943,389
- e) approving the opening and year-end rate bases for the 2008 test period of \$19,781,843 and \$18,841,155 respectively
- f) approving a mid-year average rate base for the 2008 test period of \$19,356,208
- g) approving of the opening and year-end rate bases for the 2009 test period of \$18,841,155 and \$18,384,990 respectively
- h) approving a mid-year average rate base for the 2009 test period of \$18,606,484
- i) approving the opening and year-end rate bases for the 2010 test period of \$18,384,990 and \$17,944,603 respectively
- j) approving a mid-year average rate base for the 2010 test period of \$18,172,257
- k) approving a fair rate of return for the 2007 test period, which reflects a rate of return on common equity equivalent to the average of the board's 2007 generic cost of capital determinations of 8.51 per cent on a deemed common equity ratio of 25 per cent and cost of debt of 11.20 per cent on a deemed debt ratio of 75 per cent
- l) approving a fair rate of return for the 2008 test period, which reflects a rate of return on common equity equivalent to the board's 2007 generic cost of capital determination as applied to the 2008 test period;
- m) approving a fair rate of return for the 2009 test period, which reflects a rate of return on common equity equivalent to the board's 2009 generic cost of capital determination as applied to the 2009 test period
- n) approving a fair rate of return for the 2010 test period, which reflects a rate of return on common equity of the board's 2009 generic cost of capital determinations as applied to the 2010 test period
- o) approving a net revenue requirement for the 2007 test period of \$1,542,945, including regulatory costs of \$50,000
- p) approving a net revenue requirement for the 2008 test period of \$2,900,132, including regulatory costs of \$5,000
- q) approving a net revenue requirement for the 2009 test period of \$2,748,654, including regulatory costs of \$10,000

³ RWSL filed the original 2007-2008 general rate application in accordance with Sections 61, 89, 90 and 91 of the *Public Utilities Board Act*, which has been replaced by the *Public Utilities Act*.

- r) approving a net revenue requirement for the 2010 test period of \$2,874,443, including regulatory costs of \$65,000
- s) approving the rates and methods of depreciation utilized by RWSL included in this application for the test periods
- t) approving deferral accounts for regulatory costs, utilities and insurance for the test periods
- u) approving a deferral account for the shortfall between the revenue requirement forecast and the revenue forecast (earnings shortfall)
- v) approving the terms and conditions of service and related rate schedules attached hereto
- w) granting any further or other relief that the Commission deems just and proper.

2.1 Legislative background

14. The Commission's jurisdiction to approve the rates and terms and conditions of service depends on whether RWSL is the "owner of a public utility," which in turn depends on the phrase "public utility" as these terms are defined in the *Public Utilities Act*.⁴

15. In Decision 2007-099, the board found that RWSL is the owner of a public utility as defined in the *Public Utilities Board Act* (as it was then). As such, the Commission has the authority to fix just and reasonable rates and terms and conditions of service pursuant to Section 89 of the *Public Utilities Act*. Within the scope of its authority, the Commission may on its own, or on the application of an interested party, fix just and reasonable rates. Along with individual rates, the Commission may impose joint rates, tolls or charges. The Commission may further order methods of depreciation, amortization or depletion in respect of the property of any owner of a public utility. This Section also stipulates that the Commission may rule on standards to which the utility will be held and authorizes the Commission to among other things:

- c) fix just and reasonable standards, classifications, regulations, practices, measurements or service, which shall be furnished, imposed, observed and followed subsequently by the owner of the public utility;
- e) require an owner of a public utility to establish, construct, maintain and operate, but in compliance with other provisions of this or any other Act relating to it, any reasonable extension of the owner's existing facilities when in the judgment of the Commission the extension is reasonable and practical and will furnish sufficient business to justify its construction and maintenance, and when the financial position of the owner of the public utility reasonably warrants the original expenditure required in making and operating the extension.

16. The Commission determines a rate base and fixes a fair return on rate base pursuant to Section 90 of the *Public Utilities Act*:

- (1) In fixing just and reasonable rates, tolls or charges, or schedules of them, to be imposed, observed and followed subsequently by an owner of a public utility, the

⁴ *Public Utilities Act*, Section 1(h).

Commission shall determine a rate base for the property of the owner of a public utility used or required to be used to provide service to the public within Alberta and on determining a rate base it shall fix a fair return on the rate base.

17. The Commission must give due consideration to the cost of that property when first committed to public use and to the prudent acquisition cost to the owner of the public utility. From the gross rate base determined according to these considerations, the Commission is required to deduct depreciation, amortization or depletion.⁵ Net working capital is added to rate base,⁶ but capital “contributed by” or paid for, in whole or in part, by customers is deducted. This so-called “contributed capital” is deducted from rate base so that the owner earns neither a further return on this capital, nor further return of capital (i.e. depreciation) because customers have already paid for it at zero acquisition cost to the owner.⁷

18. The objective of establishing a proper rate base is to allow the Commission to fulfill its second duty under Section 90 of the *Public Utilities Act*, namely to fix a fair return on the rate base. In fixing a fair return, the Commission is required to “give due consideration to all those facts that, in the Commission’s opinion, are relevant.”⁸ Typically, the Commission determines the fair return on the mid-year average rate base, determined according to the opening and year-end rate base amounts for each test year.

19. As the owner of a public utility, RWSL is not only subject to the Commission’s tariff jurisdiction, but to all applicable provisions of Part 2 of the *Public Utilities Act*. Additionally, the Commission’s jurisdiction is subject to the terms of the *Water Act* and any orders and regulations made under that act.⁹

20. Furthermore, the Commission has general jurisdiction to supervise public utilities under Section 85 of the *Public Utilities Act*:

85(1) The Commission shall exercise a general supervision over all public utilities, and the owners of them, and may make any orders regarding extension of works or systems, reporting and other matters, that are necessary for the convenience of the public or for the proper carrying out of any contract, charter or franchise involving the use of public property or rights.

(2) The Commission shall conduct all inquiries necessary for the obtaining of complete information as to the manner in which owners of public utilities comply with the law, or as to any other matter or thing within the jurisdiction of the Commission.

21. Lastly, Section 87 of the *Public Utilities Act* broadly authorizes the Commission to investigate:

(1) The Commission may, on its own initiative, or on the application of a person having an interest, investigate any matter concerning a public utility.

⁵ *Public Utilities Act*, Section 90(2)(a).

⁶ *Public Utilities Act*, Section 90(2)(b).

⁷ Decision 2008-023: Decision 2008-023: Westridge Utilities Inc., General Rate Application, Application No. 1462020, April 15, 2008, Section 4.1, and Erratum, May 8, 2008.

⁸ *Public Utilities Act*, Section 90(3).

⁹ Decision 2007-099, Section 2, page 8.

22. Given the above legislative framework, the Commission will exercise its jurisdiction to review the rates proposed by RWSL, the terms of service, and any other issues concerning the public utility, and exercise its power to supervise and investigate the public utility, as necessary. Accordingly, the Commission is herein issuing its decision with regard to the application and any of the aforementioned aspects.

2.2 Application process

23. When the Commission issued the notice of application (November 9, 2009) it noted that all interested parties previously registered for the Rule 011 process would be automatically registered for the formal review process. It also asked that other parties who wished to intervene in the proceeding should submit a statement of intent to participate (SIP) to the Commission. There were 21 parties registered as a result of their participation in the Rule 011 process and additional parties registered a SIP following the issuance of the notice of application.

24. In a letter dated December 9, 2009, the Commission set out a written process to review the application, which was subsequently revised on a number of occasions. The key revisions are outlined below:

- On February 4, 2010, the Commission suspended the process schedule after being informed by RWSL that it intended to provide the Commission with an amended application by February 26, 2010, and that it would formally apply for rates up to and including December 31, 2010.
- By letter dated March 12, 2010, the Commission set out a revised process schedule.
- On April 7, 2010, the Commission established further process steps in response to a request from RWSL that the Commission issue an order pursuant to subsection 13(2) of the Commission's **Rule 001: Rules of Practice (Rule 001)** (Request for Confidentiality Order). The process schedule previously established by the Commission in its letter dated March 12, 2010 was not to be affected by the additional process steps.
- On March 23, 2010, the Commission received a letter from counsel on behalf of RWSL requesting that the Commission issue an order pursuant to subsection 13(2) of the Commission's Rule 001 (Request for Confidentiality Order or Request). RWSL stated that, upon further consideration, it was prepared to provide the Commission, on a confidential basis, copies of agreements pertaining to its affiliate and third party debt financing arrangements, which were previously requested in AUC-RWS-54,¹⁰ AUC-RWS-85¹¹ and discussed in the Commission's March 12, 2010, correspondence.
- On April 26, 2010, the Commission issued its ruling on RWSL's request for a confidentiality order. The Commission granted confidentiality on limited terms which allowed access to debt financing agreements to any registered party or registered party's representative willing to sign the necessary undertakings. The Commission was of the view that in granting the request on specific terms, it would balance both

¹⁰ Exhibit 52.01.

¹¹ Exhibit 52.01.

the confidential interests of RWSL, and yet preserve the rights of registered parties to access the information for the purposes of participating in the proceeding.

- On September 16, 2010, the Commission initiated further process when it requested additional information from RWSL.

25. The final process schedule included several rounds of information requests, responses, evidentiary submissions, rebuttal submissions, argument, and reply argument. The steps and deadline dates are set out in [Appendix 3](#).

26. For the purposes of this application, the Commission considers the close of record to be November 22, 2010.

3 Complaint of Monterra Intervenors

27. In correspondence dated May 29, 2007, the EUB received a submission¹² on behalf of residents and land owners of the Monterra on Cochrane Lakes development prepared by Marcia Johnson QC which set out a complaint pursuant to the *Public Utilities Board Act* against RWSL and related companies (the complaint). The complaint requested that the EUB investigate and issue appropriate orders under Section 59 of the *Public Utilities Board Act* respecting:

- the ownership of the system and equipment for water and sewer services for Monterra, and the rights to provide such services, and the validity and legality of such ownership
- the rights of the land owners and residents of Monterra as members of a condominium association or corporation, in general and to ownership and control over the water system and whether those rights have been violated
- the actions of RWSL, Medallion Lakes Land Development Corp. and Medallion Development Corporation (Medallion) with respect to the provision of water services to Monterra, including the failure to complete the facilities and frequent failures of the temporary system
- the sufficiency and delivery of RWSL's notice respecting the Application to the residents and land owners of Monterra

28. The complaint of the Monterra residents and land owners was discussed in EUB Decision 2007-099. In that decision, the EUB ruled on a number of preliminary matters, including its jurisdiction to consider the merits of the application in light of the issues raised in the complaint. In particular, the EUB found as follows:

So, the Board having concluded that RWSL is, for present purposes, the owner of a public utility, a number of jurisdictional consequences flow. In the case of the Amended Application, the most salient of these is the Board's authority to fix just and reasonable rates and terms and conditions of service pursuant to section 89 of the PUBA [*Public Utilities Board Act*] and to determine a rate base and fix a fair return on rate base pursuant to section 90 of the PUBA. The Board is expressly authorized to make interim orders pursuant to section 62 of the PUBA. These are sufficient ingredients for the Board to consider and determine the Amended Application and the Board does so later in this Decision.

¹² Exhibit 33.01.

Notwithstanding the views just expressed and the Board's conclusion that it has jurisdiction to consider the Amended Application, the Board acknowledges and takes very seriously the concerns raised by interested parties, particularly the Monterra Interveners, with respect to the history of the MCL development, what residents understood at the time they purchased their lots with respect to utility service and the charges for that service, and what contributions they may have made in respect of the owner of the utility's capital. In the Board's view, these matters appear to be relevant to the considerations the Board must take into account in assessing the reasonableness of RWSL's proposed tariff. Board staff and the Board itself will explore these questions in the context of RWSL's Final Application. The Board expects that customers will also explore these questions, particularly as they relate to contributions and individual metering.¹³

29. RWSL submitted that it disagreed with suggestions in EUB Decision 2007-099 that the complaint has relevance to the Commission's assessment of the reasonableness of RWSL's tariff. However, RWSL indicated that it had provided argument on the basis that the Commission might consider such matters.

30. As set out in its responses to information requests, RWSL does not believe that the allegations made in the complaint have merit. In particular, RWSL submitted that an apparent belief by parties to the complaint that Monterra residents were entitled to free water services based on a letter filed as Exhibit B-2 of the May 29, 2007 letter would also imply that residents were entitled to free natural gas, telephone, and electricity service. RWSL submitted that such an interpretation would be implausible, contrary to the experience of all Alberta home owners, and contrary to evidence filed by the Association, homeowners indicated that they expected to pay water rates similar to rates they had paid in the past in Cochrane and Calgary.¹⁴

31. Even if the allegations in the complaint were true, RWSL submitted that because they relate to asserted property rights governed by contracts, the allegations are within the jurisdiction of the Courts. RWSL submitted that the complaint should not factor into any Commission decisions related to the establishment of RWSL's rate base, rate design, and revenue requirement.

Commission findings

32. Without making any assessment of the merits of the complaint, the Commission considers the fact that a number of Monterra development lot owners and residents took the time and effort to prepare and file the complaint to be sufficient to establish that there is a fundamental disagreement between Monterra lot purchasers and the Monterra developer as to whether the cost of the potable water facilities built to serve the development was included in the price of the lot.

33. Apart from this limited consideration of the existence and enduring nature of the complaint, the Commission confirms that no part of its findings in the balance of this decision required the Commission to assess the merits of any specific aspects of the complaint. The Commission notes that in Decision 2007-099, the board put the complaint in abeyance at least pending completion of the Rule 011 process. Following the issuance of this decision, the Commission will proceed with its processing of the complaint. The Commission's findings in

¹³ Decision 2007-099, page 8.

¹⁴ Exhibit 95.01, AUC-ASSOCIATION-4(a), and AUC-ASSOCIATION-5(a).

this decision have been assessed on the assumption that all of the potable water assets that RWSL has included in the application are owned by RWSL. This is done without prejudice to the Commission's consideration of the complaint.

4 Rate base

4.1 Treatment of sewer assets

34. In the financial schedules filed by RWSL on December 9, 2009,¹⁵ the rate base included a line item for "storm sewer and outfalls" in the amount of \$969,878. RWSL proposed to exactly offset this amount with a contribution addition in the same amount.

35. In an information request,¹⁶ RWSL was asked to explain the basis for its proposal to include storm sewer and outfall costs in the rate base for a public water utility. In its response, RWSL noted that because all storm sewer and outfall amounts have been completely off-set by a contribution, its proposed treatment did not impact RWSL's cost of service or rates since the net plant for the storm sewer and outfall line item is zero.

36. In a follow-up information request,¹⁷ RWSL was requested to comment on the proposition that under its proposed approach, the combined effect of future sewer asset additions and the cumulative amortization of the contribution that RWSL proposed to apply against the cost of sewer additions could lead to sewer related asset costs being recovered through RWSL's water rates over time. Additionally, RWSL was requested to discuss any potential adverse effects that might arise if the Commission were to both exclude the cost of sewer related assets from rate base and eliminate the offsetting contribution as proposed by RWSL. In its response to these questions, RWSL indicated that it had removed sewer related assets from the rate base set out in RWSL's February 26, 2010 revised application.

Commission findings

37. The Commission has determined that RWSL's initial approach of applying an offsetting contribution to sewer and outfall amounts added to rate base is not equivalent to an approach of simply excluding the sewer and outfall related assets from rate base. With the amortization of the offsetting contribution, any subsequent capital maintenance expenditures on sewer and outfall related assets could cause these costs to be recovered through potable water rates over time.¹⁸ The Commission finds that the rate treatment set out in RWSL's February 26, 2010 revised application is correct and directs RWSL to ensure that no subsequent capital maintenance expenditures on sewer related assets are added to RWSL's potable water rate base.

¹⁵ Exhibit 20.07.

¹⁶ Exhibit 17.01, AUC-RWS-044(b).

¹⁷ Exhibit 52.01, AUC-RWS-074.

¹⁸ To clarify, the Commission's notes that under RWSL's approach of adding sewer related assets with an off-setting contribution, any subsequent capital maintenance expenditures on sewer assets would also require an off-setting contribution.

4.2 Verification of plant-in-service amounts

38. RWSL's July 23, 2007 final application requested approval of a year-end 2007 rate base of \$19,623,429 and a 2008 year-end rate base of \$20,236,482.¹⁹

39. In its revised application filed on February 26, 2010, RWSL sought approval of the following year-end rate base amounts, net of accumulated depreciation and unamortized contributions:

- \$19,781,843 for year-end 2007
- \$18,841,155 for year-end 2008
- \$18,384,990 for year-end 2009
- \$17,944,603 for year-end 2010

40. RWSL requested approval of a mid-year rate base of \$9,943,389 for the period ending December 31, 2007, and mid-year rate base amounts of \$19,356,208, \$18,606,484, and \$18,172,257 for the 2008, 2009, and 2010 test years respectively. The updated rate base amounts reflected a decision by RWSL to exclude expenditures and associated contributions related to storm sewers and outfalls.

41. RWSL noted that the Commission is charged with assessing the rate base of a utility in accordance with Section 90 of the *Public Utilities Act* for the purposes of allowing the Commission to fulfill its second duty under Section 90 of the *Public Utilities Act* to fix a fair rate of return.

42. RWSL submitted that its applied-for plant-in-service amounts were appropriate, prudent, and necessary to provide safe and reliable service. RWSL further submitted that it would have been imprudent to size its potable water facilities differently and there was no evidence on the record to suggest otherwise. As such, RWSL submitted that the entire value of the plant-in-service is properly a part of the rate base and should be approved.

43. The Monterra Home Owners Association (Association) submitted that it had no way to verify that the plant addition amounts included Schedule 2.1 were based on the actual costs or that they reflected the prudently incurred acquisition costs pursuant to Section 90(2) of the *Public Utilities Act*. The Association submitted that under that Section, RWSL has the onus to establish the prudence of its costs.

44. While it acknowledged that differences exist between RWSL 2007 balance sheet amounts and rate base related capital addition figures for 2008, the Association expressed concern that it was unable to reconcile plant addition amounts submitted by RWSL with financial statements dated as of December 31, 2008.

45. In particular, the Association noted that whereas Schedule 2.1 indicates that RWSL 2007 plant additions in the amount of \$22,125,852, RWSL's balance sheet as at December 31, 2008²⁰ indicates that RWSL had fixed assets net of accumulated depreciation in the amount of \$12,850,660. The plant additions amount of \$22,125,852 is much higher even after eliminating

¹⁹ As further described in Schedule 2.0 of the final application, these amounts were requested net of accumulated depreciation and unamortized contributions.

²⁰ Exhibit 61.01, pages 39-40 of 48.

amounts related to allowance for funds used during construction (AFUDC). The Association submitted that it was especially concerned considering that amounts related to sewer facilities were removed from the 2008 balance sheet line item.

46. The Association argued that, due to discrepancies between RWSL financial statement amounts and application rate base amounts, and RWSL not adequately responding to certain information requests, the Commission should draw an adverse inference with respect to improperly verified capital addition²¹ amounts listed by RWSL in Schedule 2.1 of the revised application schedules.

47. In reply, RWSL submitted that the Association's difficulties in reconciling plant addition amounts to RWSL's financial schedules with RWSL's applied for rate base schedules may reflect differences between regulatory accounting and tax accounting practices or the fact that that the water utility is part of an entity that has both regulated and unregulated activities.

48. RWSL suggested that the Association concerns about differences between RWSL's application rate base schedules and financial statements likely reflected the Association's limited understanding of differences between tax accounting and utility accounting rather than reflecting the inaccuracy or unreliability of numbers provided by RWSL. Accordingly, RWSL submitted that the Association's suggestion that an adverse inference regarding the capital additions described in Schedule 2.1 should be drawn is not warranted.

Commission findings

49. The relief sought by RWSL requests approval of opening, mid-year, and year-end rate base amounts net of accumulated depreciation and unamortized contributions.

50. The Commission has addressed the reasonableness of gross rate base amounts requested by RWSL as applicable to each test year of the GRA from the standpoint of the accuracy of the amounts. The Commission has dealt with depreciation and contributions in aid of construction in other sections of this decision.

51. RWSL's 2007-2010 GRA represents the first time that RWSL's rate base has been before the Commission and that it will set the baseline for all future RWSL potable water rates. As such, it is very important for the Commission and interveners to be assured that all capital expenditures allowed into RWSL's initial rate base have been properly scrutinized.

52. The Commission notes that the 2008 financial statements that the Association references in its argument were provided on the record as part of RWSL's response to AUC-RWS-60, which is referenced in a similar request made by the Association in Association-RWSL-1(a). The Commission further notes that in its response to Association-RWSL-1(b), RWSL stated that "The assets of RWSL consist of the physical plant and distribution system to provide water and sewer services." Based on this response, the Commission finds no reason to expect that the assets as described in RWSL's financial statements should be significantly different from RWSL's reporting of asset values for regulatory purposes, except to the extent that the Commission would

²¹ Note that whereas the Association uses the phrase "capital contributions" at paragraph 15, page 5 of its argument, because the Association is making reference to Schedule 2.1 rather than Schedule 2.2 of RWSL's revised application schedules, the Commission has assumed that the Association is seeking a determination that the Commission should make an adverse inference with respect to the amount of RWSL's capital additions rather than with respect to RWSL's capital contributions in this section of its argument.

expect the financial statements to include sewer related assets while RWSL's rate base for regulatory purposes would not.

53. Whereas RWSL's response to Association-RWSL-1(b) includes sewer services, capital additions to December 31, 2007 totaling \$22,125,852 reported in RWSL's financial schedules²² in fact exclude sewer related assets. Given the inclusion of sewer related assets in the financial statement representation of RWSL's assets, all things being equal, the Commission would expect that the gross value of RWSL assets as reported in its 2008 financial statements would be higher than the amount reported in RWSL's financial schedules.

54. Conversely, the Commission notes that other considerations, which would, all things being equal, tend to cause asset amounts as reported in RWSL's financial statements to be lower than asset amounts reported in RWSL's financial schedules, include:

- The asset amounts shown in RWSL 2008 financial statements describe the cost of fixed assets net of accumulated depreciation, whereas the \$22,125,852 amount shown in schedule 2.1 reflects gross additions, before depreciation and amortization.
- The fact that the Association is comparing the \$13,088,887 reported as at December 31, 2008 to the \$22,125,852 amount reported as at December 31, 2007 in RWSL's Schedule 2.1.

55. The Commission finds that the Association's request in Association-RWSL-16 to provide a design basis memorandum or pre-design report for the potable water system and as built drawings was relevant to the determination of the reasonableness of RWSL's initial regulated rate base. As such, the Commission finds that RWSL's decision to decline to provide this information in its response to Association-RWSL-16 impaired the ability of the Commission and interested parties to scrutinize RWSL's initial rate base expenditures. Taking all these factors into account, the Commission rejects the Association's suggestion that it should draw an adverse inference about the accuracy of the plant-in-service amounts reported by RWSL at this time. Nevertheless, the Commission finds that the magnitude of the discrepancy between the rate base amounts and asset amounts reported in RWSL's financial statements is troubling. As such, the Commission will direct the AUC's audit group to conduct an audit of RWSL property accounts at a future date.

56. In light of the requirement for further investigation, the Commission provisionally accepts the plant-in-service amounts reported in the application as sufficiently accurate for the purpose of setting rate levels in this application, and will make a final determination as to the accuracy of RWSL's plant in-service opening, mid-year, or year-end balances at the time of RWSL's next GRA. As discussed in Section 6 of the decision, RWSL has been authorized to charge less than its full cost of service and accrue amounts into a revenue deficiency deferral account (RDDA), which will partially mitigate the effect of the noted discrepancy.

57. For greater certainty, in the event that the future AUC audit results in directions to RWSL to adjust any plant in-service opening, mid-year, or year-end balances in respect of any of the 2007 through 2010 test years, the Commission considers that any such restatements would be taken into account in a future reconciliation of the RDDA.

²² Exhibit 68.01, Schedule 2.1.

4.3 Capacity of water system and plant held for future use

58. In conjunction with its request for approval of opening, mid-year, and year-end balances for each of the 2007 through 2010 test years, RWSL provided details of these amounts in the financial schedules to the application.

59. RWSL's requested amounts for cumulative year-end gross additions to rate base, broken down by major categories are summarized in Table 1 below.²³

Table 1. Gross plant-in-service as requested by RWSL

| Category | Gross plant 7/31/2007 (\$) | Gross plant 12/31/2008 (\$) | Gross plant 12/31/2009 (\$) | Gross plant 12/31/2010 (\$) |
|---------------------------------|----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| Water treatment plants | 8,433,475 | 8,433,475 | 8,450,573 | 8,450,573 |
| Reservoirs | 1,927,000 | 1,927,000 | 1,927,000 | 1,927,000 |
| Transmission mains | 5,117,171 | 5,117,171 | 5,117,171 | 5,117,171 |
| Water pump station | 2,027,871 | 2,027,871 | 2,054,716 | 2,054,716 |
| Storm sewer, outfalls | - | - | - | - |
| Distribution mains and hydrants | 1,142,661 | 1,142,661 | 1,142,661 | 1,307,462 |
| Road crossings | - | - | - | - |
| Hydrants | - | - | - | - |
| Meters | 20,300 | 53,650 | 56,200 | 82,200 |
| Services ²⁴ | 353,950 | 353,950 | 353,950 | 461,217 |
| Engineering | - | - | - | - |
| Computer equipment | - | - | - | - |
| Office equipment | - | - | - | - |
| Equipment | 50,000 | 75,000 | 75,000 | 100,000 |
| Office building | - | - | - | - |
| Licences | - | - | - | - |
| AFUDC | 1,003,925 | 1,003,925 | 1,003,925 | 1,003,925 |
| Water licence | 2,000,000 | 2,000,000 | 2,000,000 | 2,000,000 |
| Land | 49,500 | 49,500 | 49,500 | 49,500 |
| TOTAL | 22,125,852 | 22,184,202 | 22,230,695 | 22,553,763 |

Source: Exhibit 68.01, Schedule 2.0.

60. The Association submitted that the capacity of RWSL's potable water system is significantly over-built in relation to RWSL's actual customer base. In particular, the Association submitted that, whereas the water utility infrastructure was planned for 875 residential units, RWSL's actual customer base was only 97 at December 2009. The Association submitted that RWSL's current customers obtain no benefit from the availability of excess capacity on RWSL's potable water system.

61. The Association noted that Section 90(1) of the *Public Utilities Act* specifically provides as follows:

²³ In Table 1, the term "Gross Plant" is equivalent to the column heading "Depreciation Base" as used in the "Rate Base 2.0" schedule from Exhibit 68.01.

²⁴ In the "Capital Additions 2.1" schedule from Exhibit 68.01, the line item "Services" is referred to as "Service Connections." Footnotes to the Service Connections line item indicate that the amounts added in 2009 (\$353,950) represented the estimated costs of assets contributed by the developer for 112 lots and that the 2010 capital addition (in the amount of \$107,267) represented amounts contributed in 2010.

In fixing just and reasonable rates, tolls or charges, or schedules of them, to be imposed, observed and followed subsequently by an owner of a public utility, the Commission shall determine a rate base for the property of the owner of a public utility used or required to be used to provide service to the public within Alberta and on determining a rate base it shall fix a fair return on the rate base.

62. In consideration of Section 90(1) of the *Public Utilities Act*, the Association submitted that the determination of rate base requires an assessment of the value of a utility's property (less accrued depreciation) that is required to be used in the public service. Citing a public utility reference text,²⁵ the Association submitted that in considering what is "used and useful," certain items claimed by utilities such as:

- overdeveloped property and facilities for future needs
- water rights
- property used for non-utility purposes
- moneys advanced by customers (or contributions in aid of construction)

may be questioned and may ultimately be excluded from rate base.²⁶

63. The Association defined excess capacity as: "capacity over and above that necessary to meet peak demand plus that capacity to insure that there is a margin to allow for day-to-day variations in the operating condition of installed generation."²⁷ By this definition, the Association submitted that, insofar as it can serve at least an additional 778 customers over the 97 customers served as at December, 2009, RWSL has significant excess capacity. Because of this, the Association submitted that such excess capacity should be excluded from rate base until required to be used by additional rate payers. More specifically, in order to take into account that only 120 customers will use capacity constructed for at least 875 customers, the Association submitted that RWSL's rate base should be prorated using a ratio of 120/875, utilizing calculations set out in Attachment A of the Association's argument.²⁸

64. In reply, RWSL submitted that the Association's argument that the plant and reservoir are oversized was contradicted by the fact that the expert in water systems design retained by the Association provided no evidence to this effect. RWSL submitted that an inference should be drawn by the failure of the Association's witness to provide evidence supporting the Association's position and that there is no basis to disallow any amounts from rate base.

65. RWSL also noted that the Association did not indicate whether RWSL would be entitled to AFUDC on the plant that the Association proposed to exclude from rate base.

66. As discussed in AUC-RWS-18, RWSL submitted that its plant could not be practically sized to the actual number of customers and had to be built in a manner that provided reasonable economies of scale. RWSL submitted that its plant was sized to meet projected growth for

²⁵ Charles F. Phillips, Jr., *The Regulation of Public Utilities Theory and Practice*, 3d ed. (Arlington, Virginia: Public Utilities Reports, Inc., 1993).

²⁶ *Ibid.*, page 316.

²⁷ *Ibid.*, page 341.

²⁸ The Commission notes that the Association's proposal to require RWSL to "pro rate" its rate base was presented in conjunction with an additional proposal to deem a contribution from the developer based on \$12,500 per lot for 875 lots. The Association's deemed contribution proposal is discussed more extensively in Section 6 of the decision.

four to five years and that the construction of these facilities at any smaller size would have been sub-optimal. RWSL stated that, based upon the expected size of the development, it was prudent in its sizing of the treatment plant, reservoir, and transmission lines. In the longer term, RWSL submitted that it is preferable to construct the optimum size of a facility, such as a treatment plant, reservoir, transmission line or power plant, rather than building a number of smaller facilities that would subsequently have to be replaced, looped, or duplicated. RWSL noted that its proposed RDDA was largely proposed on this basis.

67. The Association submitted that while excess plant capacity benefits RWSL and, in particular, the developer, RWSL did not demonstrate how the provision of overbuilt facilities would benefit rate payers in any manner, nor has it provided any justification as to why existing customers, who use approximately 1/9th of the capacity, should carry the burden of subsidizing excess capacity. The Association submitted that the developer is the beneficiary of the time lag between capacity being overbuilt and such capacity being fully utilized by a mature customer base.

68. The Association expressed concern that RWSL's response to information request AUC-RWS-96 incorrectly described the capacity of its current plant and reservoir as able to serve only 500 customers. Based on RWSL's responses to AUC-RWS-45 and AUC-RWS-72, the Association had understood that the current plant and reservoir can service approximately 800 residential units, as set out in Attachment A to the Association's argument.

69. RWSL submitted that while the Association suggests that current plant-in-service is sufficient to service 800 residences, RWSL's responses to AUC-RWS-45 and AUC-RWS-18 clearly indicate that the ability of current plant-in-service to serve 800 customers is based on average, not peak consumption. As such, RWSL submitted that in order to ensure that the system can provide reliable service under all operating and demand conditions, RWSL's evidence is clear that additional plant will be required as and when the number of customers exceeds 500.

70. The Association submitted that, at the present time, the overbuilt facilities should properly be categorized either as overdeveloped property and facilities for future needs or property that is currently "used" for a non-utility purpose (i.e. to comply with the MD's requirements and to enable the developer to sell its lots).

Commission findings

71. The Association has adopted the view that because the Monterra development was designed to serve 875 residential units and is serving an actual customer base of approximately 120 units, RWSL's rate base should be pro rated to reflect a 120/875 ratio. While the Commission considers that some capacity-related reduction of RWSL's initial rate base may be necessary, the Association's proposed approach is not reasonable and would reduce RWSL's gross rate base by a much greater amount than is warranted in the circumstances.

72. The Commission considers that because the construction of a system capable of providing potable water service to the full 875 unit size of the development is a direct result of contractual commitments that RWSL made with the M.D. of Rocky View, the Commission considers that RWSL would have reasonably made design and construction decisions with regard to the ability of the system to ensure that the capacity target is achievable when required.

73. Given RWSL's need to ensure that an 875 unit capacity of all elements of its potable water system can be achieved when required, the Commission has considered whether RWSL,

acting prudently, could have staged the construction of its potable water system to more closely match the expected construction of residential units within the Monterra development over time. In addition, the Commission notes that certain elements of the RWSL potable water delivery system were designed and constructed to accommodate possible future expansion of service outside of the boundaries of the Monterra development. The Commission has assessed the reasonableness of reducing RWSL's initial rate base on these considerations.

74. The Commission notes that RWSL provided estimates of the capacity of main components of its potable water system elements, stated in terms of maximum number of residential units that each element could supply, in responses to information requests. RWSL's estimates are summarized in Table 2 below:

Table 2. Capacity of water system elements

| | Capacity (# of residences) |
|---|-------------------------------|
| Water treatment plants | 793 |
| Raw water reservoir | 755 |
| Water pump station and transmission mains | 917 |
| Water supply | 2100 |

Source: Exhibit 66.01, (AUC-RWS-72 Attachment) and Exhibit 20.01 (AUC-RWS-12d).

75. Having regard for the capacity figures set out in Table 2, and other supporting evidence filed by RWSL, the Commission is satisfied that the majority of the potable water system elements could not be economically staged in lower capacity increments.

76. The Commission has reviewed RWSL's response to AUC-RWS-18²⁹ and notes that the water treatment plant was designed to be built in phases with the expectation that plant would reach a phase one capacity of 500 units by the end of 2011. While the target phase one capacity for the water treatment plant reflected an expected pace of residential development faster than realized, the Commission considers that it was reasonable for RWSL to have built the system to reflect the capacity projections of the developer. As further discussed in Section 6, the risk of capacity under-utilization arising from the uncertainty of the pace of residential unit development has been taken into account in the Commission's assessment of the contribution that RWSL should have required from the developer. In the absence of intervener evidence demonstrating that the water treatment plant could have been designed and constructed in stages, the Commission finds RWSL's decisions with respect to the sizing of the water treatment plant to be reasonable.

77. The Commission notes that the capacity of the raw water pumping facilities, transmission mains, and the raw water reservoir are interdependent and have been designed around the requirements of the raw water reservoir to provide storage capacity prior to treatment and use by RWSL customers.

78. The capacity of the water pump station is discussed in RWSL's response to AUC-RWS-20³⁰ and in Association-RWSL-27(g).³¹ The Commission notes that while RWSL has

²⁹ Exhibit 20.01.

³⁰ Exhibit 20.01.

³¹ Exhibit 81.03.

determined that an upgrade to a flow rate of 85 l/s at a cost of \$1,100,000 would be required to serve a system capacity of 2100 unit, at consumption rates forecast by RWSL at the present time, the water pump station facilities have a flow capacity of 45 l/s.³² Further, RWSL indicated that the current capacity of the water pump station facilities would support consumption by 917 residential units, or 42 more units than the total number of lots the Monterra development is expected to support. As 917 units is reasonably close to 875 units, the Commission has no basis to expect that the incremental costs of the pumping capacity for the additional 42 units would be significant. The Commission considers that there is no need or basis for a capacity-related reduction of amounts added to RWSL's rate base for the water pump station facilities.

79. The Commission notes that, unlike other elements of RWSL's potable water system, the capacity of RWSL's transmission mains cannot be economically staged. RWSL indicated in AUC-RWS-19³³ that none of the transmission mains are currently in active operation at the full capacity of 180 l/s. The transmission mains have the capacity to serve 2100 residential units, well above the 875 unit capacity needed to serve a fully completed Monterra development. While the Commission considers that RWSL's applied-for rate base additions in respect of transmission mains should be reduced to reflect the excess capacity, the Commission considers that the incremental cost of providing the additional capacity would be comparatively small and would largely be confined to the incremental cost related to the larger diameter pipe.

80. The Commission similarly notes that RWSL's raw water reservoir appears to have been designed and built for more capacity than required to serve the potable water requirements of the Monterra development. However, as with the incremental costs of transmission main capacity, the Commission likewise considers that the incremental cost incurred to build a larger reservoir would not warrant the pro rated reduction in costs suggested by the Association.

81. Nevertheless, the Commission has determined that some capacity related reduction in RWSL rate base should be applied in respect of the transmission mains and raw water reservoir assets. However, the Commission considers that insufficient information is currently available to determine the amount of the reductions that should be applied. Furthermore, in consideration of the Commission's finding in Section 6 that some deferral of the full recovery of RWSL's revenue requirement should be permitted, the Commission considers that there is not an urgent need to determine the precise amount of the reductions in rate base amounts at this time.

82. Considering the foregoing, the Commission directs RWSL to estimate the incremental costs incurred prior to the commencement of regulated service arising from (a) the larger diameter pipe used for transmission mains, and (b) the construction of a larger raw water reservoir. RWSL is directed to provide and fully support these estimates at the time of its next general rate application, as ordered by the Commission in Section 6. In both cases, the incremental cost assessments should reflect the incremental costs incurred relative to the cost of facilities needed to serve an 875 residential unit development without any provision for potential future expansion outside of the Monterra development.

83. In the event that the Commission determines that some amount of RWSL's initial rate base should be designated as plant held for future use, the Commission expects that any revenue requirement impacts arising from such designation should be reflected in a future reconciliation of RWSL's RDDA.

³² Exhibit 81.03.

³³ Exhibit 20.01.

4.4 Contributions in aid of construction

84. RWSL indicated that the rate base opening and year-end balances for which it was seeking approval were calculated net of contributions, which were to be amortized at the same rates as the corresponding assets.

85. RWSL noted that it had treated amounts received for meter hook-ups as contributions and applied these amounts to rate base capital additions. Similarly, amounts provided by the developer for distribution mains, hydrants, services and storm water facilities were also applied as offsets to rate base additions for these facilities.

86. As shown in Schedule 2.2 of the application, RWSL noted that it had received \$12,500 per lot as tie-in contributions from the developer, which were applied as contributions for 2007 and 2008. RWSL indicated that it intended to use future tie-in contributions to reduce the balance of the RDDA.

87. RWSL summarized the amounts of contributions of various forms and the application of such amounts against the specific components of its rate base in its response to AUC-RWS-70. This information is summarized in Table 3 below:

Table 3. 2007-2010 contributions summary

| Category | Developer (\$) | Tie-in fees (\$) | Other (\$) | Total contributions (\$) |
|---------------------------------|-------------------|---------------------|---------------|--------------------------------|
| Water treatment plants | - | 600,090 | - | 600,090 |
| Reservoirs | - | 137,125 | - | 137,125 |
| Transmission mains | - | 364,116 | - | 364,116 |
| Water pump station | - | 233,910 | - | 233,910 |
| Storm sewer, outfalls | - | - | - | - |
| Distribution mains and hydrants | 1,142,661 | - | - | 1,142,661 |
| Road crossings | - | - | - | - |
| Hydrants | - | - | - | - |
| Meters | 53,650 | - | 47,200 | 100,850 |
| Services | 353,950 | - | - | 353,950 |
| Engineering | - | - | - | - |
| Computer equipment | - | - | - | - |
| Office equipment | - | - | - | - |
| Equipment | - | 4,375 | - | 4,375 |
| Office building | - | - | - | - |
| Licences | - | - | - | - |
| AFUDC | - | - | - | - |
| Water licence | - | - | - | - |
| Land | - | - | - | - |
| TOTAL | 1,550,261 | 1,339,616 | 47,200 | 2,937,077 |

Source: Exhibit 61.01 (AUC-RWS-70 as amended to remove revenue deficiency amounts for 2009 and 2010).

88. RWSL submitted that it had explained in its response to AUC-RWS-87 that the contribution levels for tie-in fees reflected market rates, as supported by similar fees applied by

Langdon Waterworks Ltd. in a tariff application considered by the Commission in Decision [2009-108](#).³⁴

89. RWSL noted that the developer had contributed tie-in fee amounts for the first phase of the Monterra development (100 lots), before all of the lots were sold or occupied.

90. RWSL submitted that as the contribution amounts used in the application were consistent with the market in the M.D. of Rocky View, these contribution amounts and RWSL's proposal to amortize such contributions at the same rate as the underlying assets are depreciated should be found to be appropriate.

91. The Association submitted that it was clearly evident from the fact that RWSL and the developer are ultimately owned by a common shareholder that there is a linkage between the land development and the water utility.

92. The Association submitted that RWSL and the developer cannot be considered to be arm's-length parties because:

- RWSL has indicated that it will not have access to capital markets and conventional lenders until such time as it has a stable performance record and an AUC decision that confirms its income earning potential.³⁵
- The developer is the only source of financing available to RWSL.³⁶
- RWSL has stated that if it were not for the fact that RWSL is providing a required basic service, it would be unlikely that anyone would have built the water treatment facilities and provided associated mains and services.³⁷
- Distribution assets were installed for phases one and two of the Monterra development in compliance with the developer's obligation to provide water utility services to lot purchasers in both phases.³⁸

93. The Association submitted that RWSL's statement that it would not have built water treatment facilities and associated mains and services but for providing a required basic service, ignores the fact that the construction of these facilities was required as a condition of the developer being permitted to develop the Monterra development and subsequently sell Monterra development lots.³⁹

94. In consideration of the rate base amounts proposed by RWSL and the small number of serviced customers, the Association submitted that it was impossible for RWSL to be a viable stand-alone utility. The Association further submitted that the only scenario under which an arm's length stand-alone utility without its own equity or securable assets would be able to construct a plant with significantly excess capacity and without a solid customer base, would be if it received a significant capital contribution from the developer. The Association submitted

³⁴ Decision 2009-108 and (Errata): Langdon Waterworks Limited, Water Rates for Langdon Waterworks Limited, Rule 011 – Rate Application Process for Water Utilities, Application Nos. 1508905 and 1508928, July 28, 2009.

³⁵ Exhibit 60.02, page 7.

³⁶ Exhibit 61.01, AUC-RWS.54.

³⁷ Exhibit 61.01, AUC-RWS.54.

³⁸ Exhibit 24.01, AUC-RWS-52.

³⁹ Exhibit 20.01, AUC-RWS-29.

that it would be unlikely that a stand-alone utility would have simply relied on the developer's sales projections and taken on all the risk that actual customers would not materialize as forecast.

95. Under such circumstances, the Association submitted that a prudent arm's length utility would have undertaken a market and economic analysis to determine what rates they could charge to customers and would have entered into negotiations with a developer to determine the capital required from the developer to minimize risk and ensure a viable business. The Association further submitted that the Commission should particularly consider the reasonableness of passing along development risks to ratepayers when the ratepayers are unaware of this risk when purchasing a lot in a development where the water utility and the developer are owned by the same shareholder.

96. The Association argued that if RWSL were truly an arm's length stand-alone entity, it would have been prudent for RWSL to have received contributions of \$12,500 per lot up front. Accordingly, based on the number of lots set out in the Monterra development plan, RWSL would have received \$12,500 multiplied by a minimum of 875 lots, or \$10,937,500 prior to commencing construction of the utility facilities. In consideration of the above, the Association submitted that the amount that RWSL should have required Medallion to contribute up front for the construction of the utility plant should be excluded from the rate base of RWSL. Accordingly, the Association submitted that a \$12,500 per lot contribution for 875 lots totaling \$10,937,500 should be considered as a deemed contribution in aid of construction from the developer, with the effect of reducing RWSL's rate base by that amount.

97. In reply, RWSL submitted that its receipt of tie-in fee contributions for the first 100 lots in phase one, the use of tie-in fees above the initial 100 lots, and its proposed treatment of the RDDA represented a reasonable balance between the interests of current customers and the interests of future customers.

98. In correspondence dated September 16, 2010 issued following the receipt of argument and reply, the Commission indicated that, if it were to approve the establishment of a RDDA similar to that requested by RWSL, the Commission might need to consider requiring the developer to increase the amount of its contribution in aid of construction as recommended by the Association, require a higher per lot contribution, or some combination of both. The September 16, 2010 Commission correspondence further indicated that the adoption of such measures might be necessary to achieve a reasonable balance between RWSL deferring its revenue deficiencies while ensuring that the size of the RDDA does not become excessive such that repayment is unreasonable or unattainable.

99. The Association noted that RWSL's response to AUC-RWS-96(e) indicated that the goal of a zero balance in the RDDA would require an unrealistic contribution per lot and/or deeming the receipt of contributions in 2007 for lots that will not be sold until the next decade. In respect of this response, the Association submitted that RWSL's characterization of the required contribution being "unrealistic" reflected the significant over-investment that the non-arm's length developer undertook to comply with development requirements set out by the M.D. of Rocky View. The Association submitted that the developer took on this risk based on its assessment of the reward it expected. However, as Monterra Development lot purchasers were not forewarned that they would be saddled with the developer's prudent or imprudent investment decisions, it would be patently unfair to expect to pass this cost on to residents, particularly since the developer receives the primary benefit of the overbuilt capacity.

100. The supplemental argument of Julie Chamberlain⁴⁰ (Chamberlain) submitted that whereas it was apparent from RWSL's response to AUC-RWS-96 that huge losses would accumulate in the RDDA until the year 2026, the Canada Revenue Agency would not regard entities for which there is no reasonable expectation of profit to be businesses for the purposes of determining whether loss deductions will be allowed. Given the absence of a reasonable expectation of profit, Chamberlain submitted that RWSL should be considered part of the developer's business and not a stand-alone business.

101. Considering the foregoing, Chamberlain also submitted that because the utility was built for all the lots in the Monterra development, contributions for all of the lots should have been made up front and not as each lot was sold. In conclusion, Chamberlain submitted that it was not reasonable to expect utility customers to pay a rate of return on deferred losses when the developer did not properly capitalize the utility.

Commission findings

102. RWSL's rate base was not put forward for any consideration by the Commission or its predecessor prior to RWSL's commencement of construction of the potable water delivery system facilities described in the application. Therefore, RWSL's 2007-2010 GRA represents RWSL's first regulated tariff.

103. The Commission finds that, despite RWSL's proposed use of the RDDA mechanism, RWSL has not demonstrated that its proposed revenue requirement can be recovered from prospective rate payers within any reasonably foreseeable time frame under rates that would be acceptable to current or prospective purchasers of lots within the Monterra development.

104. In this circumstance, the Commission finds that by failing to require a contribution from the affiliated developer sufficient to achieve viable rates, RWSL acted imprudently prior to coming to the Commission for approval of its initial rate base within its 2007-2010 GRA.

105. In light of this imprudence, the Commission has discretion to reduce RWSL's rate base to reflect the levels necessary to achieve viable rates. In this instance, the Commission finds that the reduction in RWSL's rate base will be achieved by deeming a significantly higher aggregate contribution amount than proposed by RWSL.

106. The Commission considers that this approach is preferable to the alternative of reducing RWSL's gross rate base amounts because it preserves the accuracy of RWSL's gross property accounting records and because the deeming of a higher contribution allows this contribution amount to be amortized to zero over time, such that RWSL rate payers would be responsible for any capital expenditures that may be required to maintain RWSL's rate base over time.

107. Notwithstanding the above, the Commission has determined that RWSL should be permitted to recover a portion of its revenue requirement through the use of the RDDA mechanism. The amount of the deemed contribution that will be required by the Commission is assessed in conjunction with the Commission's examination of the RDDA mechanism inputs, assumptions and results. This is discussed in Section 6 below.

⁴⁰ Exhibit 109.01.

4.5 Valuation of water licence

108. RWSL sought the inclusion of the water licence in rate base in the amount of \$2.0 million. The water licence was owned by Cochrane Lakes Water Company (CLWC), which was subsequently renamed Regional Water Services Ltd. CLWC was initially acquired for \$2.0 million in October 2003 by a numbered company, which subsequently became Regional Utilities Corp (RUC). RUC is the parent of RWSL. RWSL submitted that the water licence represented the primary asset of CLWC and noted that, for the purposes of the rate application, RWSL had valued the water licence at \$2.0 million because the primary purpose of acquiring CLWC was to acquire the water licence.

109. RWSL explained that CLWC had some other assets, other than the water licence, that had an approximate book value of \$800,000. RWSL submitted that CLWC had undertaken some preliminary work to get water from the Bow River to the vicinity of the Town of Cochrane, but the purpose of acquiring the company was to acquire the water licence.⁴¹

110. RWSL submitted that the water licence is “property” within the meaning of Section 90(2)(a) of the *Public Utilities Act* and is required to provide service to the public. An independent third party valued the water licence at \$2.2 million as at the date at which the licence was first used to provide service to the public (July 1, 2007). RWSL submitted that its conservative estimate of \$2.0 million properly belongs in the rate base.

111. The Association submitted that RWSL should not be permitted to include the water licence costs in its rate base. The Association noted that as CLWC became RWSL on June 4, 2007, RWSL and CLWC are, in essence, the same entity. Given that CLWC continues to exist and operate under the name of RWSL, the Association submitted that it is difficult to recognize any gain in the market value of the assets of CLWC/RWSL, other than by reference to the share purchase, RWSL has not been able to verify the actual costs of the water licence and thus has not established a historical cost for the water licence.

112. In reply, RWSL submitted that the Association’s opposition to including the value of the water licence in rate base runs contrary to the Commission’s duty pursuant to Section 90(2) of the *Public Utilities Act* to consider the value of the assets when first committed to public use and the prudent acquisition costs of the property. Furthermore, RWSL submitted that evidence in the proceeding establishes the cost of the licence at \$2.0 million through the share purchase of CLWC and that this amount was corroborated by an independent valuation conducted at the date the licence was first used to provide service to the public, which concluded that the licence had a value of \$2.2 million on the open market.

113. As water service would not be possible without the licence, RWSL submitted that the value of the licence properly forms part of RWSL’s rate base. Accordingly, RWSL submitted that the Commission should reject the Association’s proposal to disallow the value of the water licence.

Commission findings

114. The Commission considers that to the extent that RWSL has designed and constructed a potable water system utilizing a surface water source subject to a licence requirement, the prudent cost of such a licence forms part of RWSL’s cost of service.

⁴¹ Exhibit 60.01, AUC-RWS-67 and Exhibit 20.01, AUC-RWS-12.

115. The Commission further notes that, while the parent of RWSL obtained other assets with a book value of \$800,000 at the time of the CLWC share purchase,⁴² no evidence was brought forward to suggest that these other assets could have been sold for this amount, or that they provided value of at least this amount to RWSL's parent. Accordingly, the Commission concludes that a water licence was acquired for a cost of \$2.0 million in 2003. Based on the third party market valuation as at July 1, 2007 provided by RWSL, the Commission accepts that RWSL could not have acquired the water licence for less than \$2.0 million at the time RWSL entered into regulated utility service.

116. However, unlike most other types of assets used by RWSL's potable water system, it is relatively straight forward to pro rate the cost of the water licence to reflect the proportion of the maximum forecast capacity of the water licence that may be required.

117. In this regard, the Commission notes that, in its response to AUC-RWS-12, RWSL indicated that the water diversion rate of 1,227,314 m³ set out in RWSL's water licence could service 2100 housing units under certain assumptions as to consumption, peak demand and storage. Taking the ratio of the maximum forecast size of the development (875) to the 2100 unit maximum capacity of the water licence, the Commission has determined that only \$833,333 should be added to RWSL's rate base in respect of the cost of the water licence at this time. The Commission directs RWSL to treat the balance of the cost of the water licence (\$1,166,667) as capacity held for future use.

118. In consideration of the potential for some or all of the remaining capacity of RWSL's water licence to be required as a result of a possible increase to the density of the Monterra development and/or expansion of RWSL's potable water system beyond the current boundaries of Monterra, the Commission directs RWSL to ensure that no portion of the capacity of the water licence be offered for sale without seeking the express approval of the Commission.

119. In the event that capacity under the water licence beyond that required to serve 875 lots is required, resulting in the transfer from capacity held for future use to capacity in service, RWSL would be entitled to the equivalent of AFUDC to be calculated from July 1, 2007 to the date that the capacity is used for active service within RWSL's system. The Commission anticipates that the amount of any future entitlement to AFUDC would be determined at that time.

4.6 Allowance for funds used during construction

120. RWSL sought to include an AFUDC in the amount of \$1,003,925 in rate base effective July 1, 2007. RWSL provided a more detailed derivation of this amount in Schedule 3.0 of its revised application's financial schedules. As more particularly described therein, RWSL based its requested AFUDC amount on a mid-year construction work in progress balance of \$9,536,214, exclusive of land and water licence costs. RWSL applied an assumed rate of return of 10.53 per cent based on its applied for capital structure, debt cost and equity rates.

121. The Association did not address AFUDC in the body of its argument. However, in Attachment A to its argument, the Association's proposals for 2007 capital additions totaling \$17,546,410 exclude RWSL's proposed \$1,003,925 AFUDC allowance.⁴³ In addition, notation to the AFUDC line item in Attachment A to the Association's argument states: "Should be disallowed."

⁴² Exhibit 61.01, AUC-RWS-67(b).

⁴³ Exhibit 98.01, Attachment A, page 12.

122. In reply, RWSL submitted that the Association's recommended disallowance of AFUDC is contrary to the use of a mid-year approach to rate base accounting, under which it is understood that the utility will receive a non-cash return on its investment in the form of AFUDC for the first half of the year.

Commission findings

123. The Commission has reviewed RWSL's calculation of AFUDC in Schedule 3.0 and is satisfied that RWSL's calculation method only attributes AFUDC in respect of 2007. The Commission considers that RWSL has correctly made an allowance for AFUDC reflective of the fact that it only receives a rate base return on plant-in-service valued on a mid-year basis in that year. However, in accordance with the Commission's findings in Section 5.4 of this decision, RWSL is directed to recalculate its AFUDC allowance at the time of its re-filing to reflect the return of 2.69 per cent and to reflect Commission findings in Section 4.3 above that certain RWSL property was constructed for future use.

124. RWSL stated in response to information request AUC-RWS-18(a) that the plant commenced operations on July 31, 2007, at the time some assets were turned over to RWSL from Medallion, assuming acquisition costs included capitalized financing and administrative costs. While the Commission notes that RWSL has not indicated whether any gross plant-in-service amounts include AFUDC, the Commission clarifies that since RWSL's potable water facilities were not built pursuant to any mandated direction set out by the Commission, RWSL was fully at risk and has no entitlement to a regulated return for all expenditures on potable water facilities made prior to coming into service on July 1, 2007. Accordingly, in the event that the AUC audit of RWSL property records contemplated in Section 4.2 determines that any such allowances have been accrued, the Commission may require RWSL to restate its gross plant-in-service balances after July 1, 2007 to remove any such amounts.

125. Further to the Commission's findings in Section 4.5, the Commission considers that RWSL may be entitled to AFUDC from July 1, 2007 in the event that gross rate base amounts designated as plant held for future use (PHFFU) are brought into active service at a future date. In that event, the calculation of AFUDC, including the determination of the weighted average cost of capital rates that should apply after July 1, 2007 for PHFFU assets brought into service, should be determined as and when the allowance of PHFFU assets into rate base occurs.

126. The Commission discusses RWSL's calculation of depreciation expense related to AFUDC amounts in Section 5.4 of this decision.

4.7 Working capital

127. RWSL noted that it had calculated its working capital requirement based on assumptions that most expenses would be paid on average at mid-month and that customers would pay on the 20th day following the end of the month. RWSL also noted that it had assumed that debt and equity returns would be paid at the end of the month, implying a lag of 20 days.

128. RWSL noted that its working calculations were shown in Schedule 2.5 of the application, but were not questioned. RWSL also submitted that its approach understates working capital requirements in light of the fact that rate revenues do not cover operating costs. Accordingly, RWSL submitted that its working capital allowance should be approved as filed.

Table 4. RWSL working capital forecast

| | | 2007 | | 2008 | | 2009 | | 2010 | |
|---------------|----------|---------|----------------|-----------|----------------|-----------|----------------|-----------|----------------|
| | Lag days | Amount | Rev Req. | Amount | Rev Req. | Amount | Rev Req. | Amount | Rev Req. |
| Op. expense | 35 | 181,621 | 17,416 | 361,544 | 34,669 | 283,584 | 27,193 | 398,979 | 38,258 |
| Property tax | 35 | 7,500 | 719 | 15,756 | 1,511 | - | - | - | - |
| Depreciation | 35 | 257,033 | 24,647 | 480,107 | 46,038 | 473,480 | 45,402 | 475,108 | 45,558 |
| Income tax | 0 | - | - | - | - | - | - | - | - |
| Debt return | 20 | 835,245 | 45,767 | 1,625,921 | 89,092 | 1,562,945 | 85,641 | 1,526,470 | 83,642 |
| Equity return | 20 | 211,546 | 11,592 | 411,803 | 22,565 | 418,646 | 22,940 | 408,876 | 22,404 |
| Regulatory | 35 | 50,000 | 4,795 | 5,000 | 479 | - | - | 65,000 | 6,233 |
| Total | | | 104,935 | | 194,353 | | 181,175 | | 196,096 |

Source: Exhibit 68.01, Schedule 2.5.

Commission findings

129. The Commission accepts that the lag day calculations used for each working capital line item shown in Schedule 2.5 of the application are reasonable. RWSL is directed to recalculate working capital amounts at the time of its refiling to reflect all other findings made in this decision that impact working capital calculations.

5 Revenue requirement

130. RWSL provided its revenue requirement in Schedule 5 of its application. The forecast net revenue requirement is:⁴⁴

- \$1,542,945 for the 2007 test period
- \$2,900,132 for the 2008 test period
- \$2,748,654 for the 2009 test period
- \$2,874,433 for the 2010 test period

131. RWSL is forecasting a large shortfall in its revenue recovery under the proposed rates.⁴⁵

132. The remainder of this section addresses components of revenue requirements, including:

- Cost of capital
- Lot sales and customer forecast
- Operating expenses and regulatory costs
- Depreciation and amortization expense

⁴⁴ Exhibit 60.02, Section 5, page 8.

⁴⁵ Exhibit 60.02, Section 2, page 4.

- Income tax
- Deferral accounts

5.1 Cost of capital

133. RWSL's proposed capitalization and return for the test periods were detailed in Schedule 3.0 of the application. RWSL has projected a weighted average cost of capital of 10.53 per cent for 2007 and 2008 and 10.65 per cent for 2009 and 2010.⁴⁶

5.1.1 Capital structure

134. RWSL requested that the Commission approve a deemed capital structure of 75 per cent debt and 25 per cent equity (75:25). RWSL submitted that, while its risk profile likely justified a higher common equity return, RWSL is 100 per cent debt financed and therefore a deemed capital structure with more equity results in a return less than RWSL's cost of capital.⁴⁷

135. RWSL explained that it does not have access to conventional lenders and does not expect this to change until it has more customers, regulatory certainty and a reasonable probability of recovering its costs. RWSL examined the capital structure of other water utilities and noted the approved capital structure of Langdon Waterworks Ltd., which had a deemed capital structure of 75:25, and considered that this capital structure would be reasonable for RWSL. RWSL submitted that the requested capital structure would recover the average cost of capital and, in the long term, should provide customers with the lowest overall cost.⁴⁸

136. RWSL clarified that it was only prepared to accept the 75:25 capital structure provided it receives its debt costs and noted that the requested capital structure assumes Commission approval of RWSL's proposed rates and deferral accounts. RWSL stated that, if the capital structure were changed from that applied for, RWSL would require a higher return on equity.

5.1.2 Return on equity

137. RWSL proposed that the 2007 generic cost of capital rate of return of 8.51 per cent be applied to its 25 per cent deemed common equity for each of the 2007 and 2008 test years. Further, RWSL requested that the 9.0 per cent rate of return on common equity approved in Decision 2009-216⁴⁹ apply for the 2009 and 2010 test years.

5.1.3 Cost of debt

138. RWSL requested that a debt cost of 11.2 per cent be applied to its 75 per cent deemed debt. RWSL explained that the cost of debt reflects the various sources of debt that were provided by an affiliated company while the facilities were being built and reflects the related risk. It explained further that the requested 11.2 per cent rate is less than the debt costs of the affiliate.

139. RWSL argued that comparisons to the approved debt costs of other utilities would not take into account the reasons why the debt cost of utilities are different and submitted that the

⁴⁶ Exhibit 68.01.

⁴⁷ Exhibit 81.02, AUC-RWS-086.

⁴⁸ Exhibit 20.01, AUC-RWS-011(b-c).

⁴⁹ Decision 2009-216: 2009 Generic Cost of Capital, Application No. 1578571, Proceeding ID. 85, November 12, 2009.

Commission was obligated to look at the unique circumstances of each utility in determining the debt costs to be allowed for that utility. RWSL pointed out that the board stated the following in discussing the cost of debt in Decision 2005-028.⁵⁰

In the Board's view, it would be in accord with normal practice for the appropriate debt cost to be set in reference to the actual interest rate paid, unless the actual interest rate is considered unreliable, inappropriate or irrelevant. In the absence of a reliable and relevant actual interest rate then an estimate of the appropriate market interest rate should be used.⁵¹

140. RWSL submitted that in *Northwestern Utilities Ltd. v. Edmonton (City)*,⁵² the Supreme Court of Canada established the fair return standard to be applied by regulators in Canada.

The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise. In fixing this net return the Board should take into consideration the rate of interest which the company is obliged to pay upon its bonds as a result of having to sell them at a time when the rate of interest payable thereon exceeded that payable on bonds issued at the time of the hearing. To properly fix a fair return the Board must necessarily be informed of the rate of return which money would yield in other fields of investments. [emphasis added].

141. RWSL argued that these decisions supported its position that a fair rate of return for one utility may not be fair in the context of another.⁵³ RWSL also referred to *TransCanada Pipelines Limited v. Canada (NEB)*⁵⁴ and argued that Justice Rothstein's comments therein suggest that the cost of debt is not generally contentious, as it is easily ascertainable, consisting of the weighted average interest rate for the test year on the utility's outstanding long term debt.

142. RWSL submitted that it has provided the actual cost of its debt and noted that the Commission (and its predecessor) has previously opined that in most circumstances, it is appropriate to use the actual cost of debt as it is generally directly observable and quantifiable. RWSL argued that the only information on the record of this proceeding establishes that the actual cost of RWSL's debt is at least 11.2 per cent.

143. RWSL explained that the financing agreements establishing RWSL's actual debt costs were provided to the Commission in confidence pursuant to the Commission's ruling on the confidentiality order dated April 26, 2010. RWSL noted that the agreements show that the effective rates associated with the transactions are, on average, in excess of the requested debt rate of 11.2 per cent.

⁵⁰ Decision 2005-028: Westridge Utilities Inc., General Rate Application, Application No. 1352216, April 19, 2005.

⁵¹ Decision 2005-028, page 17.

⁵² S.C.R 186 [1929].

⁵³ Exhibit 102.02, paragraph 27, page 6.

⁵⁴ 2004 FCA 149, paragraph 43.

144. RWSL submitted that, as a small water utility, with a limited customer base, its risks are high and this must be taken into account when considering RWSL's debt costs. RWSL argued that it would be unfair and inequitable for the Commission to reduce the debt costs requested, given that it had established that actual debt costs are greater than the rate requested.

145. Chamberlain submitted that the cost of debt requested by RWSL is unreasonable. Chamberlain pointed out that the 11.2 per cent being requested was five per cent above the business prime rate in 2007, which was an average of six per cent. Chamberlain further suggested that the debt is obtained from a related party and therefore the debt should be construed as equity. Chamberlain recommended that the cost of debt should be at a rate no higher than eight per cent.

146. The Association argued that the 11.2 per cent debt cost requested by RWSL reflects a risk that RWSL and its lenders chose to take on and no stand-alone utility would be able to take on that risk. As such, the risk premium included in the cost of debt should be carried by RWSL and its lenders and not by the rate payers.

147. The Association submitted that a return on debt in line with debt rates approved for Westridge Utilities Inc. (Decision 2005-028) at eight per cent on a 57 per cent debt ratio or for Langdon Waterworks Ltd. (Decision 2009-108) at seven per cent on a 75 per cent ratio should be approved for RWSL.

Commission findings

148. The Commission must determine the capital structure and the cost of financing related to the net rate base amount established by the Commission. The Commission will address capital structure, return on equity and debt cost separately.

Capital structure

149. In considering capital structure, the Commission considers what is warranted for the portion of rate base after no cost capital associated with deemed contributions has been taken into account.

150. RWSL has requested a 75:25 (debt to equity) ratio. The interveners did not take issue with this proposed capital structure.

151. The Commission finds the capital structure requested by RWSL for the 2007-2010 test period to be reasonable at this time. However, the Commission expects that RWSL will need to address and change its level of debt and equity over time in order to ensure that the utility remains financially viable, while continuing to provide a safe and reliable service. Accordingly, in subsequent rate reviews, the Commission will reassess the deemed capital structure and expects RWSL to justify the requested capital structure in relation to its actual debt and equity, and the financing of net rate base (i.e., rate base not financed by no cost capital).

Return on equity

152. The Commission determined in Decision 2009-216 that water utilities are entitled to the generic cost of capital rate of return on equity established in that decision. Accordingly, the Commission approves RWSL's proposal to apply the 2007 generic cost of capital rate of return

on common equity of 8.51 per cent for 2007 and 2008, and to apply the 9.0 per cent rate of return on common equity approved in Decision 2009-216 for 2009 and 2010.

Cost of debt

153. RWSL submitted that it is 100 per cent debt financed and that the requested 11.2 per cent cost of debt is directly tied to the actual interest paid under various financing agreements held by an affiliated company. Based on the confidential information filed by RWSL, the Commission has knowledge of the actual interest rate payable under these agreements and the purposes for which the financing was obtained. Upon reviewing the financing agreements, the Commission was able to verify the effective rates associated with the transactions. Accordingly, the Commission finds that the effective rate is at least 11.2 per cent, as requested by RWSL.

154. The Commission agrees with the finding of the board that:

In the Board's view, it would be in accord with normal practice for the appropriate debt cost to be set in reference to the actual interest rate paid, unless the actual interest rate is considered unreliable, inappropriate or irrelevant. In the absence of a reliable and relevant actual interest rate then an estimate of the appropriate market interest rate should be used.⁵⁵

155. The Commission accepts the contention that alternative sources of financing would not be available to RWSL until it has more customers, regulatory certainty and a reasonable probability of recovering its costs. Accordingly, the Commission is prepared to approve the requested 11.2 per cent debt cost for the test years because the financing agreements held by the affiliate and mirrored down to RWSL are likely the only debt available to support the rate base. As such, the Commission considers that the 11.2 per cent interest rate is the best available indication of the actual interest rate available to the utility. The Commission will nonetheless reassess RWSL's debt costs at the time of RWSL's next rate review.

156. Accordingly, the Commission approves RWSL's request for a weighted average cost of capital (WACC) of 10.53 per cent for 2007 and 2008 and 10.65 per cent for 2009 and 2010.

5.2 Lot sales and customer forecast

157. RWSL provided actual data on lot sales for the years it was available and provided a forecast for 2010. RWSL also provided an estimate of the cumulative number of lots forecast to be sold in subsequent years, until the maximum 875 lots is reached.

5.2.1 Lot sales in test period

158. In response to the Commission's information request AUC-RWS-096, RWSL provided the actual number of lots sold for 2007-2009 and an updated forecast of the total number of lots forecast to be sold in 2010.⁵⁶ The forecast number of lots to be sold in 2010 was 147, with 104 of those lots occupied in that year. Table 5 lists the cumulative total number of lots sold in each of the test years 2007-2010.

⁵⁵ Decision 2005-028, page 17.

⁵⁶ Exhibit 106.03, AUC-RWS-096, AUC 96(a).

Table 5. Cumulative number of lots sold 2007-2010

| Year | |
|------|-----|
| 2007 | 41 |
| 2008 | 74 |
| 2009 | 95 |
| 2010 | 147 |

Source: Exhibit 106.03, AUC-RWS-096, AUC 96(a).

5.2.2 Forecast lot sales

159. RWSL provided a forecast of cumulative lot sales for the remaining lots, which projected that the last of the 875 lots would be sold in 2025. The following table provides RWSL's forecast of lot sales and occupancies. Lot sales are expected to increase yearly from 25 lots sold in 2011, increasing to 60 lots sold in 2017, and leveling off thereafter until the maximum number of lots is reached, as outlined in the table below.⁵⁷

Table 6. Forecast of lot sales and occupied lots

| Year | No. lots sold | Occupancies | | Year | No. lots sold | Occupancies |
|------|---------------|-------------|--|------|---------------|-------------|
| 2011 | 169 | 139 | | 2019 | 535 | 490 |
| 2012 | 194 | 175 | | 2020 | 595 | 550 |
| 2013 | 224 | 201 | | 2021 | 655 | 610 |
| 2014 | 260 | 233 | | 2022 | 715 | 670 |
| 2015 | 303 | 271 | | 2023 | 775 | 730 |
| 2016 | 355 | 316 | | 2024 | 835 | 790 |
| 2017 | 415 | 370 | | 2025 | 875 | 855 |
| 2018 | 475 | 430 | | 2026 | 875 | 875 |

Source: Exhibit 106.03, AUC-RWS-096, AUC 96(a).

160. RWSL did not initially forecast customers or lot sales beyond 2010. RWSL submitted that the projection of lot sales and occupancies submitted in response to AUC-RWS-096 was prepared solely for regulatory purposes. RWSL cautioned that the projection of lot sales and customer occupancies was provided by Medallion as a best estimate based upon currently available information, but should not be considered a forward looking financial forecast and that no reliance should be placed on the projection other than for the purpose of responding to the Commission's information request. RWSL also explained that the projection could change going forward based upon many factors, including overall housing sales and economic activity in Alberta and the Calgary area.

Commission findings

161. The Commission accepts RWSL's forecast of lot sales and occupancies for the purposes of this application and recognizes that the projection could change going forward.

⁵⁷ In response to AUC-RWS-006 (Exhibit 20.01), RWSL anticipated, at that time, "... achieving 100 customers by the end of 2008. For 2009 the estimate is 100 connections, 2010 and 2011 are projected at 150 per year. This projection is dependent upon many factors, including overall housing sales and economic activity in Alberta and the Calgary area." There was no projection beyond 2011.

5.3 Operating expenses and regulatory costs

162. RWSL provided a forecast of operating expenses in Schedule 4.1 of the application. RWSL indicated that cost increases from the 2007 level (which was based on six months of operations) reflect the circumstances of the Calgary economy and the projected increase in customers. RWSL explained that the requested 2008 and 2009 operating costs are less than twice the 2007 request and the 2010 costs are only about \$11,000 more than the 2007 costs (with 2007 costs calculated on an annual basis).⁵⁸ RWSL submitted that the requested operating expenses are reasonable, particularly in light of the increasing number of customers over the test years.

163. In response to AUC-RWS-2, RWSL stated it had no full time employees, but that it paid administrative fees to Medallion and operating fees to Pure Elements, both on a monthly basis.⁵⁹

164. RWSL explained that the proposed rates do not cover operating expenses over the test period and that it intended to capture any shortfall in a RDDA. This is dealt with further in Section 6 of this decision.

165. The Association submitted that operating costs related to information and education should be disallowed given the lack of information and education provided to RWSL's customers. The Association explained that it was only through participating in this proceeding that a Monterra resident or potential lot owner could clearly understand the level of potable water cost a Monterra resident could expect to pay and the significant RDDA proposed to be established.

166. In reply, RWSL pointed out that it was the Association that was requesting the information and it was the Association that was suggesting to RWSL that it should provide additional information to new customers. RWSL submitted that the amounts allocated to information and education are reasonable, are not a significant component of RWSL's revenue requirement and should be approved by the Commission.

5.3.1 Regulatory costs

167. RWSL has requested a net revenue requirement that includes \$130,000 in regulatory costs for the test years 2007 to 2010, broken down as follows:

- \$50,000 in 2007
- \$5,000 in 2008
- \$10,000 in 2009
- \$65,000 in 2010

168. RWSL explained that the 2010 forecast includes an estimate of \$15,000 for intervenor costs for this proceeding. RWSL has proposed that a deferral account for regulatory costs be established to capture the differences between forecast and actual costs.

169. In response to information request AUC-RWS-60, RWSL indicated that the actual regulatory costs for 2007 were \$39,600 instead of the forecast \$50,000.⁶⁰

⁵⁸ Exhibit 99.02, paragraph 38, page 7.

⁵⁹ Exhibit 20.01, AUC-RWS-002.

170. The Association submitted that customers that use the utility in the future will have the benefit of the regulatory costs already incurred to set the rate base, a fair return, and reasonable rates. Therefore, all regulatory costs should be deferred.

Commission findings

171. The Commission approves the operating expense forecast provided by RWSL, including the costs related to information and education. The Commission considers that the information and education expense is warranted and agrees with RWSL that these costs are not a significant component of RWSL's revenue requirement.

172. The Commission approves the actual amount of \$39,600 for regulatory costs in 2007 and the forecast regulatory costs provided by RWSL for 2008-2010. RWSL provided an updated forecast of regulatory costs in its revised application which added the \$15,000 in intervener costs in 2010. In light of this update, the Commission denies RWSL's proposal to establish a deferral account for regulatory costs.

5.4 Depreciation and amortization expense

173. RWSL discussed its calculation of depreciation expense at page five of its revised application. RWSL noted that, consistent with its approach of assuming that capital additions are made at mid-year, RWSL applied a half a year's depreciation in the year of capital additions.

174. In its response to AUC-RWS-25(a), RWSL indicated that the depreciation rates used in the application were not set on the basis of a depreciation study. Instead, RWSL indicated that the depreciation rates used in the application were based on a review of depreciation rates adopted for Langdon Waterworks Ltd.

⁶⁰ Exhibit 61.01, AUC-RWS-60.

Table 7. Depreciation expense as forecasted by RWSL

| Account | Depreciation Rate | Depreciation expense 2007 (\$) | Depreciation expense 2008 (\$) | Depreciation expense 2009 (\$) | Depreciation expense 2010 (\$) |
|-------------------------------|-------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Water treatment plants | 3.00% | 126,502 | 253,004 | 253,261 | 253,517 |
| Reservoirs | 2.00% | 19,270 | 38,540 | 38,540 | 38,540 |
| Transmission mains | 2.00% | 51,172 | 102,343 | 102,343 | 102,343 |
| Water pump station | 4.00% | 40,557 | 81,115 | 81,652 | 82,189 |
| Distribution mains & hydrants | 2.00% | 11,427 | 22,853 | 22,853 | 24,501 |
| Road crossings | 0.00% | 0 | 0 | | |
| Hydrants | 0.00% | 0 | 0 | | |
| Meters | 3.00% | 305 | 1,109 | 1,648 | 2,076 |
| Services | 3.00% | 5,309 | 10,618 | 10,618 | 12,227 |
| Engineering | 0.00% | 0 | | | |
| Computer equipment | 0.00% | 0 | | | |
| Office equipment | 0.00% | 0 | | | |
| Equipment | 7.00% | 1,750 | 4,375 | 5,250 | 6,125 |
| Office building | 0.00% | 0 | | | |
| Licences | 0.00% | 0 | | | |
| AFUDC | 2.69% | 26,981 | 26,981 | 26,981 | |
| Water licence | 0.00% | 0 | | | |
| Equipment | 7.00% | 0 | | | |
| Land | 0.00% | 0 | | | |
| Total | | 283,273 | 540,940 | 543,146 | 521,519 |

Source: Exhibit 68.01, Schedule 2.3 and Schedule 7.1. Note totals do not add due to rounding.

175. In its response to AUC-RWS-25(b), RWSL explained that the rate for amortizing AFUDC balances was based on a weighted average of RWSL's depreciation rates.

Commission findings

176. The Commission notes that no parties addressed depreciation rates or depreciation expense in argument or reply argument.

177. The Commission considers that the depreciation rates proposed by RWSL are reasonable and approves their use for the determination of the depreciation expense.

178. The Commission similarly agrees that RWSL's proposal to amortize AFUDC at 2.69 per cent per year is reasonable.

179. The Commission notes that, whereas RWSL calculates the amortization of AFUDC for 2007, 2008, and 2009 in Schedule 7.1, RWSL does not show an amount for the amortization of AFUDC for 2010 in Schedule 7.1. RWSL is directed to correct this error or otherwise explain the reason for this discrepancy in its refiling application.

5.5 Income tax

180. In its initial application, RWSL submitted that the difference between the deemed income taxes and income taxes collected in rates would be treated as no cost capital. Subsequently, in

response to AUC-RWS-064, RWSL stated that its revised application used flow-through income taxes in line with its proposal to defer the shortfall between expenses and revenue.⁶¹

Commission findings

181. The Commission utilizes the application of flow-through income taxes for many of the utilities under its jurisdiction and approves RWSL's adoption of this method for income taxes.

5.6 Deferral accounts

182. RWSL requested a deferral account be established for:

- regulatory costs
- utilities
- insurance
- revenue deficiency

183. RWSL explained that a deferral account for utilities was needed for differences between forecast and actual costs associated with the cost of gas and electricity for the treatment plant, reservoir and pumps.

184. A deferral account was requested for insurance costs because the estimated cost of insurance for 2007 was based on quotes.

185. The RDDA account is addressed in Section 6 of this decision.

Commission findings

186. The Commission does not usually allow operating costs to be subject to deferral account treatment. Evidence must be provided that a reasonably accurate forecast of a cost is not possible before the Commission will approve deferral account treatment for a particular cost. Alternatively, the Commission would require evidence to show that any variances in these expenses from the forecast amounts are going to be significant relative to the total revenue requirement, and outside the utility's control.

187. The Commission does not consider that a deferral account is necessary for insurance or utilities. A difference in the forecast amount for insurance relative to the quote for 2007 should not be a significant amount. As well, variations in gas and electric expenses can either be favourable or unfavourable relative to forecast amounts and as a result, in aggregate, the differences should not accumulate to a significant amount. Further, given the size of the expense, any differences would not be a significant amount relative to the revenue requirement. Hence the Commission denies RWSL's request that a deferral account be established for insurance and utilities.

6 Revenue deficiency deferral account

188. RWSL indicated that it would recover only about two per cent of its revenue requirement for 2007 and three per cent of its revenue requirement for 2008. In 2009, the proposed rates

⁶¹ Exhibit 61.01, AUC-RWS-064.

would recover approximately five per cent of the revenue requirement and in 2010 approximately eight per cent.⁶²

189. RWSL requested that the shortfall in revenue requirement over the test period be put into a RDDA. RWSL submitted that the RDDA is similar to the treatment afforded Enbridge Gas New Brunswick (EGNB)⁶³ by the New Brunswick Energy and Utilities Board (NBEUB) in its startup phase and Heritage Gas Inc. (Heritage Gas)⁶⁴ by the Nova Scotia Utility and Review Board (NSUARB) in its startup phase. It also noted that, while the mechanism is somewhat different, the result is similar to the approach taken by the Public Utilities Board in Decision E890097⁶⁵ with respect to the phasing in of a large power plant.⁶⁶

190. RWSL noted that the purpose of the RDDA is to mitigate the impact on existing customers during the test period by deferring a portion of the revenue requirement as it would take a number of years for customer growth to reach the level that could support the full revenue requirement.⁶⁷ RWSL submitted that its proposed RDDA methodology provides intergenerational equity while not unduly burdening existing customers.

191. RWSL provided the amounts to be applied to the RDDA in Schedule 2.4 of the revised application and reproduced in Table 8 below. Table 8 demonstrates that the shortfall in revenue requirement totalled approximately \$1.5 million for the 2007 test year, \$2.8 million for 2008, \$2.7 million for 2009, and \$2.8 million for the 2010 test year under the RWSL proposed rates.

Table 8. Proposed revenue deficiency deferral account⁶⁸

| | | 2007 | 2008 | 2009 | 2010 |
|---|---|-------------|--------------------|--------------------|---------------------|
| 1 | Shortfall in revenue | (1,513,665) | (2,793,932) | (2,657,833) | (2,762,220) |
| 2 | Carrying charges, % | | 10.53% | 10.65% | 10.65% |
| 3 | Carrying charges, \$ | | (306,417) | (632,922) | (991,608) |
| 4 | Contributions | | - | 25,000 | 362,500 |
| 5 | Total including carrying charges | | (4,614,013) | (7,929,767) | (12,046,096) |

192. RWSL requested that the RDDA earn a carrying charge equal to the weighted average cost capital of 10.53 per cent for 2008 and 10.65 per cent for the 2009 and 2010 test years. The corresponding amounts are shown on rows two and three of Table 8 above.

193. RWSL proposed to use the developer's contributions of \$12,500 per lot related to tie-in fees to reduce the RDDA amounts starting in 2009 and continuing until all 875 lots had been sold. RWSL proposed that the balance that remained in the RDDA, once the plant is fully utilized, would be amortized. The reductions to the RDDA are shown on row four in the table above.

⁶² Exhibit 60.02, page 6.

⁶³ New Brunswick Board of Commissioners of Public Utilities, Decision June 23, 2000.

⁶⁴ 2004 NSUARB 72.

⁶⁵ Decision E89097: Alberta Power Limited, Transalta Utilities Corporation and Edmonton Power & EEMA – In the matter of the price for which APL, EP and TransAlta shall sell electric energy to the Alberta Electric Energy marketing Agency in 1990 pursuant to the Electric Energy Marketing Act, December 15, 1989.

⁶⁶ Exhibit 60.02, page 6.

⁶⁷ Exhibit 60.02, page 3 and Exhibit 99, paragraph 46, page 9.

⁶⁸ Exhibit 68, Schedule 2.4.

194. In addition, RWSL noted that the developer contributed tie-in fees for the first phase of the development, consisting of 100 lots, prior to all the lots being sold or occupied. RWSL submitted that its proposed treatment of the RDDA, and use of the tie-in fees above the initial 100 lots, attempts to balance the interests of current customers with the interests of future customers.⁶⁹

195. RWSL forecast that a balance of \$12 million would accumulate in the RDDA by the end of the 2010 test year.⁷⁰

196. The Association asked that the Commission reject RWSL's proposal to create the RDDA and suggested RWSL should set up a non-regulatory account instead:

The revenue deficiency account applied for by RWSL should not be approved. RWSL can set up a non-regulatory account based on its current proposal and ask that all or parts of such amounts be moved to its rate base in future applications to the Commission, at which times consideration can be given to actual developer contributions received and actual capacity used or required to be used, without any time lags between these two events.⁷¹

197. The Association submitted that, if the Commission approved the RDDA as a way of phasing in the new plant while the customer base grew to absorb it, at a minimum, the RDDA should only be amortized once the full 875 lots are sold.⁷²

198. The Association expressed concern that, if approved, the RDDA would be allowed to accumulate to the forecast balance of \$12 million in 2010. It noted that this amount would equal 66 per cent of RWSL's proposed rate base. The Association drew parallels between the EGNB and RWSL cases, indicating that in 2000, EGNB initially forecast that its deferral account would peak at \$13 million. However, in 2005, EGNB forecast this amount to peak at \$133 million in 2011.

199. Chamberlain expressed similar concerns, indicating that "it is quite apparent from the schedules that huge losses would accumulate in the RDDA account up until the year 2026."⁷³

200. The Association submitted that the scenarios considered in the EGNB and Heritage Gas decisions that RWSL relied upon as precedents for its proposed RDDA contained some key differences. In the scenarios considered in the precedents that RWSL relied upon, important distinctions include:

- a) consideration of the need for the applicable facilities by the applicable regulator prior to approval thereof
- b) provision of a required basic service, as a pre-condition to construct a development tied to such facilities was not applicable
- c) an analysis by the gas utilities of the economic viability (considered correctly or incorrectly) of these stand-alone entities

⁶⁹ Exhibit 102.02, paragraph 20, page 5.

⁷⁰ Ibid.

⁷¹ Exhibit 100, paragraph 17, page 4.

⁷² Exhibit 111, paragraph 10, page 3.

⁷³ Exhibit 109, page 1.

- d) the same entities had the obligations related to construction and operation of the facilities and receive the benefit related to the ability to sell any excess capacity on the facilities⁷⁴

201. The Association submitted that, unlike in EGNB and Heritage Gas, in RWSL's application:

- a) The regulator did not determine the need for the utility facilities, prior to its construction. Decisions about the sizing, costing of the construction and transfer of the facilities from Medallion to RWSL were made outside the regulatory environment and based on Medallion's development plans.
- b) Provision of the utility services was a pre-condition imposed by the [Municipal District of Rocky View] on the developer (not RWSL), for development of the Monterra development.
- c) RWSL could not have been considered to be an economically viable stand-alone entity.
- d) RWSL wants the credits for construction and operation of the utility to be collected from its ratepayers, while the developer in essence receives the benefit of being able to sell the excess capacity through the sale of additional lots in the development. (In this regard, the price the developer sells such lots at includes the cost of the \$12,500 contribution amount.)⁷⁵

202. Accordingly, the Association submitted that RWSL cannot rely on these decisions to ask for treatment similar to what resulted from the EGNB and Heritage Gas decisions.

203. The Association submitted:

If anything, the Enbridge situation shows what should not be done. It is also patently unfair for a utility to construct excess capacity based on its affiliated developer's requirements and obligations and then set up a mechanism under which its rate payers ultimately pick up the tab for the time lag between construction of such facilities and such facilities having a mature customer base.⁷⁶

204. In addition, the Association submitted that the EGNB and Heritage Gas decisions do not provide a precedent for RWSL's proposed treatment of future developer contributions to reduce its RDDA.⁷⁷

205. The Association took exception with RWSL's contention that it is actually RWSL and its lenders, particularly its parent, who are at risk for collecting any remaining balance in the RDDA.⁷⁸ The Association submitted that if RWSL's proposed RDDA is approved in full as requested, it is ultimately RWSL's customers who are at risk for payment of this account. The Association pointed out that, if no customers are added in the next 10 years and the RDDA

⁷⁴ Exhibit 98, paragraph 57, page 11.

⁷⁵ Ibid., paragraph 58, page 11.

⁷⁶ Exhibit 98, paragraph 60, page 12.

⁷⁷ Exhibit 100, paragraph 11, pages 3-4.

⁷⁸ Exhibit 99, paragraph 50, page 10.

continues to accrue at the same level as indicated in the application, there is no guarantee that RWSL would not want to collect its approved revenue deficiency from its customer base.⁷⁹

206. The Association argued that because RWSL chose to take on the risk and to potentially reap the benefits of having over-built facilities, collecting or not collecting any shortfall should also appropriately remain with RWSL or its related companies.

207. In reply to the Association's comments regarding the EGNB and Heritage Gas decisions, RWSL explained that these examples:

[W]ere not provided to indicate, nor to suggest that RWSL was in exactly the same situation as the utilities in question in those provinces nor was its proposal exactly the same. The point of the examples was to show that a revenue deficiency deferral account was a method to mitigate or phase in costs for a new project. Nevertheless, RWSL submits that the use of a deferral account is both warranted and appropriate in its circumstances.⁸⁰ [footnote omitted]

208. RWSL submitted that it would like to see the RDDA reduced to zero as quickly as possible given that it is ultimately RWSL and its lenders who are at risk of collecting the RDDA in the future. At the same time, however, RWSL considers this to be an unreasonable assumption at the time of the application.⁸¹

209. RWSL took issue with the Association's recommendation that the RDDA should not be amortized until all of the 875 lots are sold. RWSL submitted that it is not able to accurately predict when the 875 lots will be sold. In addition, RWSL submitted that other factors have an impact on when the RDDA balance can be amortized such as the approved carrying cost and the timing when actual revenues start covering operating costs. Because of these uncertainties, RWSL submitted it would prefer the Commission not to set the specific point of time when the RDDA should be amortized.⁸²

6.1 Carrying charges

210. RWSL applied for approval to earn a carrying charge on the RDDA balance that equals the weighted average cost capital.

211. In response to the Commission's information requests AUC-RWS-81⁸³ and AUC-RWS-96,⁸⁴ regarding the application of [AUC Rule 023: Rules Respecting Payment of Interest \(Rule 023\)](#) to RWSL's RDDA, RWSL submitted that

[T]he imposition of the Rule 23 rate would jeopardize [RWSL's] ability to finance its operations and continue to make any required investments so that it can continue to operate in the future. Regional submits that with interest based upon the Rule 23 amount it would be unable to raise capital to fund the RDDA. As a further consequence the imposition of the Rule 23 rate would also result in a violation of the fair return standard.⁸⁵

⁷⁹ Exhibit 100, paragraph 13, page 4.

⁸⁰ Exhibit 99, paragraph 48, page 9.

⁸¹ Exhibit 110, paragraph 22, page 4.

⁸² Exhibit 113, paragraph 13, page 3.

⁸³ Exhibit 66, AUC-RWS-81, page 27.

⁸⁴ Exhibit 106.02, AUC-RWS-96, page 27.

⁸⁵ Exhibit 110, paragraph 12, page 2.

212. RWSL also submitted that the use of Rule 023 does not approximate the reasonable carrying costs on a deferral balance in a case like RWSL is facing. In addition, RWSL noted that the result of Rule 023 is in essence an amount equal to the chartered bank prime rate, whereas RWSL's evidence suggests that it does not have access to bank financing, let alone at the prime rate.⁸⁶

213. As a result, RWSL submitted that it would not be reasonable to utilize the Rule 023 interest rate for the proposed RDDA.

214. Chamberlain expressed the following concerns with RWSL's proposed carrying charges:

1. It is quite apparent from the schedules that huge losses would accumulate in the RDDA account up until the year 2026. Revenue Canada does not consider it a business and will not allow deduction of losses if there is no reasonable expectation of profit. Given there is no reasonable expectation of profit this utility should be considered part of the developer's business and not a stand-alone business.
2. It is not reasonable to expect utility customers to pay a rate of return on deferred losses (RDDA) that appear to never be recoverable.
3. It is not reasonable to expect utility customers to pay a rate of return on deferred losses when the major reason for the deferred losses is that the utility was overbuilt for the current market.
4. It is not reasonable to expect utility customers to pay a rate of return on deferred losses when the developer did not properly capitalize the utility.⁸⁷

215. RWSL submitted that Chamberlain's argument should be disregarded on the basis that the assumptions of RWSL being overbuilt and not properly capitalized (discussed in Section 4.3 of this decision) are not valid.⁸⁸

Commission findings

204. The Commission is not prepared to grant RWSL's request for a RDDA on the terms RWSL proposed, however it is prepared to grant a more limited form of a RDDA. The Commission's findings and reasons are subdivided into the following parts:

- Purpose
- Amounts to be accumulated
- Carrying charges

Purpose

216. In approving a deferral account, the Commission must consider the validity of establishing a revenue deficiency deferral account as requested by RWSL. In *Calgary (City) v. Alberta Energy and Utilities Board*, the Alberta Court of Appeal stated the following with respect to a deferred gas account (DGA):⁸⁹

⁸⁶ Ibid., paragraph 15, page 3.

⁸⁷ Exhibit 109, page 1.

⁸⁸ Exhibit 113, paragraphs 3-8, pages 1-2.

⁸⁹ *Calgary (City) v. Alberta Energy and Utilities Board*, 2010 ABCA 132.

The DGA should not be treated as a catch-all for fixing errors, including those with a long history or resulting from human error, when adequate processes have not been in place to capture and correct the problem at an early stage.

217. Notwithstanding, the Alberta Court of Appeal also ruled that the Commission would have general authority “to employ other tools (such as the gas purchase adjustment clause and DGAs) that assist in the discharge of its obligation to set just and reasonable rates.”⁹⁰

218. In Decision 2006-042,⁹¹ the board recognized that deferral accounts can serve to capture differences that in turn get trued up, but they expressed concern that those adjustments should not “arise from circumstances relating to utility mismanagement or imprudence, and [considered] that such adjustments will require careful consideration before being allowed into the [deferral account], particularly where they would result in recovery to the utility.”⁹² The board recognized that deferral accounts have inherent intergenerational aspects and considered it important not to prolong the period before dealing with adjustments.⁹³ The Commission also recognizes that RWSL has proposed the RDDA as a way to provide intergenerational equity by not putting an excessive burden on the existing customers during the 2007-2010 test years.

219. The Commission notes that RWSL’s proposal to defer the full recovery of its revenue requirement by accumulating revenue requirement shortfalls in its proposed RDDA was justified on the basis that similar mechanisms proposed by Heritage Gas and EGNB were approved by the NSUARB and the NBEUB respectively.

220. The Commission has reviewed several NSUARB and NBEUB decisions pertinent to the use of RDDAs by Heritage Gas and EGNB and has determined that the underlying circumstances giving rise to the RWSL’s requirement to significantly defer recovery of its revenue requirement are not directly comparable to the circumstances leading to the adoption of RDDAs by EGNB and Heritage Gas.

221. The Commission notes that in both cases, the NSUARB and the NBEUB considered the need for Heritage Gas and EGNB to charge rates well below the fully-allocated cost of service to facilitate the ability of natural gas connections to compete with heating oil. In both cases, the approval of below cost developmental rates and corresponding RDDAs was made before the majority of the construction of the respective natural gas distribution systems had begun.

222. The Commission finds the NSUARB and NBEUB approvals of developmental rates prior to the majority of system infrastructure construction to be fundamentally different from RWSL’s request to approve below cost rates and the RDDA after the major components of RWSL’s water distribution system infrastructure were completed pursuant to privately negotiated agreements between RWSL and the developer that were entered into prior to RWSL becoming a regulated public utility.

223. The Commission finds RWSL’s circumstances to be fundamentally different from the greenfield franchised utility development scenarios considered in Nova Scotia and New

⁹⁰ Ibid.

⁹¹ Decision 2006-042: ATCO Gas – A Division of ATCO Gas and Pipelines Ltd. (This Decision is also applicable to Direct Energy Regulated Services and AltaGas Utilities Inc.) Deferred Gas Account Limitation Period, Application No. 1407502, May 11, 2006.

⁹² Decision 2006-042, page 8, paragraph 4.

⁹³ Decision 2006-042, page 12.

Brunswick, where franchised utilities were both empowered and obligated to provide service in furtherance of natural gas infrastructure development policies set out in New Brunswick and Nova Scotia legislation.

224. The Commission notes that in both the Heritage Gas and EGNB cases referenced by RWSL, an economic viability analysis and a date certain of when the shortfall would be eliminated was provided. In both cases, the length of time that a development period of below-cost rates would be required was dramatically underestimated. In RWSL's case, the Commission considers that the analysis provided by RWSL in response to supplemental information request AUC-RWS-96 has dramatically demonstrated there is no foreseeable prospect that RWSL's proposal will converge to stable rates and a zero balance in the RDDA, even with contributions of \$12,500 per lot being used to offset the RDDA balance.

225. The Commission considers that some utilization of the RDDA mechanism is in the public interest because of the shared interest that RWSL and its existing customers have in realizing the continued expansion of the Monterra development. However, in light of the differences outlined above, the Commission has determined that a more limited utilization of the RDDA is warranted in this case.

Amounts to be accumulated

226. In AUC-RWS-096, the Commission requested that RWSL provide additional information so that it could gain a better understanding of

- the extent of accumulations to the RDDA over time
- whether elimination of the RDDA could be reasonably attainable in the foreseeable future
- whether any balance to be amortized once the plant is fully used can reasonably be recovered from customers over time⁹⁴

227. In response to this information request, RWSL projected that the full 875 lots would be sold and occupied by 2026.⁹⁵ RWSL also indicated that the RDDA would reach \$119.3 million in 2026 under its proposed rate design (taking into account the planned per lot contributions in the amount of \$12,500/lot as an offset to the RDDA). The forecast balance of the RDDA represents an amount greater than \$136,000 per occupied lot. RWSL's projection also forecasts that RWSL will still only be recovering 60 per cent of its total revenue requirement in 2026, which means additional shortfalls will be accruing each year. The Commission does not consider it reasonable for RWSL to accumulate this amount in the RDDA and expect to recover it from customers over time.

228. In approving the RDDA, the Commission must balance the interests of RWSL with the interests of customers. The Commission must take into account the magnitude of the amounts to be accumulated and ultimately to be recovered from customers, as well as the length of time the deficiency is to be incurred by RWSL.

229. To assess what is reasonable with respect to the RDDA, the Commission first considered whether the developer's contribution in aid of construction amount was sufficient and second, whether the amount of the per lot contribution was sufficient to offset the amount accumulating in the RDDA. The Commission considers that a combination of both of these measures is

⁹⁴ Exhibit 106.02, AUC-RWS-096.

⁹⁵ Exhibit 106.08, AUC 96(a)a.

required to ensure that the size of the RDDA does not increase to the point that repayment is unreasonable or unattainable.

230. As outlined in Section 4.4 of this decision, the Commission found that, in failing to require a contribution from the affiliated developer sufficient to achieve viable rates, RWSL acted imprudently prior to coming to the Commission for approval of its initial rate base in its 2007-2010 GRA. In light of this imprudence, the Commission reduced RWSL's rate base to reflect the levels necessary to achieve viable rates.

231. The Association recommended that the Commission require a deemed developer contribution in aid of construction of over \$10.9 million (875 x \$12,500) to reduce the rate base, which would in turn reduce the amount of the revenue shortfall accumulating in the RDDA each year.

232. The Commission has reviewed the scenarios developed by RWSL in response to AUC-RWS-096, as well as the copy of the model RWSL provided in excel format. Prior to making a determination of the level of developer contribution required, the Commission established the following parameters:

- The balance in the RDDA should be amortized once RWSL passes the breakeven point and is no longer experiencing a revenue shortfall, which the Commission expects should occur prior to the sale of all 875 lots. Alternatively, it should be amortized at the time the last of the 875 lots is sold.
- The balance in the RDDA should not be excessive. It should be able to be recovered from existing customers over a maximum 24-month period, without placing an undue burden on customers.

233. To achieve this balance, the Commission has deemed a developer contribution in aid of construction in the amount of \$15.0 million as an offset to rate base, which is roughly two-thirds of the value of total plant additions. The Commission expects that this will allow RWSL to reach the cross-over point and start to recover its full revenue requirement before 2025.

234. The Commission expects that, even with the contribution of no cost capital as an offset to rate base, the size of the RDDA would still be excessive. In order to keep the RDDA balance at a manageable level, the Commission will deem a per lot contribution of \$25,000 per lot on a go-forward basis, starting from the date of this decision. This deemed contribution will serve to offset the balance of the RDDA as proposed by RWSL, except that the amount will be double the current \$12,500 per lot contributions. At this level, the Commission projects that the balance in the RDDA, at the point RWSL starts to break-even, at approximately year 2025 would be in the order of \$500,000.

235. Accordingly, RWSL is directed, in its compliance filing, to incorporate a deemed developer contribution in aid of construction in the amount of \$15.0 million and a per lot contribution, on a go-forward basis, of \$25,000 per lot.

236. RWSL is directed to either allocate these additional contribution amounts to specific property accounts as done in Schedule 2.2, or amortize the entire incremental deemed contribution amounts at RWSL's 2.69 per cent per year composite depreciation rate, comparable

to RWSL's proposal for amortizing AFUDC. RWSL is directed to describe the approach for amortizing the deemed contribution amounts at the time of its refiling.

237. While Decision 2008-060 expressly found that the per lot contribution (tie-in fee) of \$12,500 should be approved on an interim refundable basis and that tie-in fees applied after April 1, 2008 may be subject to adjustment after that date,⁹⁶ the Commission considers that its finding to increase the tie-in fee should only apply prospectively from the date of this decision. In consideration of this finding, RWSL is directed to revise schedule B of its T&Cs to increase the tie-in fee from \$12,500 to \$25,000 in its refiling.

238. RWSL is also directed to update the Commission on the status of lot sales and the functioning of the RDDA mechanism within three years from the date of this decision and to file a full rate application within five years of the date of this decision. In both instances, the Commission will assess whether the RDDA mechanism is functioning as anticipated. The Commission considers that it is ultimately RWSL and its affiliated lenders who are at risk for collecting the RDDA balance in the future. Therefore, if at anytime the Commission determines that the RDDA is growing at a level that is not manageable, the Commission may direct RWSL to further increase the levels of deemed contributions.

Carrying charges

239. In information request AUC-RWS-081, the Commission asked RWSL to explain why it had not calculated the payment of interest for the RDDA in line with Rule 023 instead of using the requested weighted average cost of capital.⁹⁷

240. Rule 023 States:

3(1) A utility may request that the Commission approve the payment of interest on adjustments of utility company rates, tolls or charges or other costs or charges administered within the Commission's jurisdiction.

(2) The Commission shall, when considering a request received under subsection 3(1) of these rules, consider the following:

- (a) an adjustment from interim to final approved rates will normally be excluded from the awarding of interest since the interim rate is designed to reduce significant amounts that would otherwise be outstanding, except in situations where the adjustment resulted from significant errors or excesses on the part of the utility concerned or from circumstances that could not otherwise be contemplated when the rates in question were set;
- (b) the regulatory lag before implementation of the rate adjustment must exceed a period of twelve months;
- (c) or general utility rates, the minimum amount of the forecast aggregate change in revenue shall ordinarily be the greater of $\pm\$1,000,000$ or $\pm 3\%$ of the revenue from the rates being revised which may be tailored where unusual circumstances or conditions preclude its use or where acceptable procedures already exist;

⁹⁶ Decision 2008-060, page 10.

⁹⁷ AUC Rule 023: *Rules Respecting Payment of Interest.*

- (d) interest will be calculated from the date on which the rate adjustment becomes effective;
- (e) interest will be calculated using a rate equal to the Bank of Canada's Bank Rate plus 1½%, subject to any previously approved Commission procedure for awarding interest.

241. In response to AUC-RWS-081 RWSL stated:

Under accepted utility practice a utility is entitled to recover its reasonable costs. RWSL has obtained debt at the best rates available to it. The debt cost forms part of the reasonable costs of RWSL, and was necessary in order for RWSL to obtain sufficient capital to provide utility service. RWSL was only prepared to finance the Revenue Deficiency if the return on it was similar to return on rate base or its debt cost. RWSL would seek recovery of the full amount if it were required to subsidize the utility customers by several hundred basis points. As stated elsewhere in the Application and filings RWSL cannot obtain financing at rates even remotely close to those described in Rule 023, which is effectively chartered bank prime rate. Moreover Rule 23 does not appear to be intended to apply in the circumstances. If it did it could also presumably apply to all utility debt – RWSL does not understand this is what the AUC had in mind for Rule 23. If Rule 23 can be utilized to access debt at the rates set out therein RWSL would be very interested in accessing such funds.

242. In previous decisions of the board that dealt with Rule 023, a distinction was made for deferral accounts that are short term or long term in nature. For longer term deferral accounts the weighted average cost of capital had been found by the board to be more appropriate.

243. In cases where the choice of rate between using the weighted average cost of capital and Rule 023 yields a similar result, the board determined that Rule 023 interest is a simpler calculation and therefore the use of Rule 023 was preferred:

- In Decision [2003-037](#) the board stated "...given the minimal difference in financing charges that would result from a calculation using the cost of capital approach suggested by AP versus the interest rate determination using IL 2000-1, the Board will accept the calculation method to determine financing as reasonable for this Application. Since deferral account balances may be positive or negative and provide carrying costs to either the company or customers, as long as the method of calculation is consistently applied, neither party will be disadvantaged by use of AE's simpler calculation method."⁹⁸
- In Decision [2004-032](#) the board stated "Although the amount of the lowered interest rate proposed by AE is small, the Board is not persuaded by AE's submission that a rate lower than the rate specified by Board [IL 2000-1](#) General Policy for Payment of Interest, which is the Bank of Canada rate plus 1.5%, should be used."⁹⁹

244. In Decision [2001-92](#), the board stated that long term carrying costs, as long as they are based on prudent investments, should be recovered by the utility. Following the determination of business risk, the board also found that it should ensure that the WACC rate compensates the

⁹⁸ Decision 2003-037: ATCO Electric Ltd., 2001 Regulated Rate Option Tariff, Part G: Final 2001 Deferral Account Balances, Application No. 1285072, May 12, 2003, page 9.

⁹⁹ Decision 2004-032: ATCO Electric Ltd., 2004 Interim Distribution Tariff and 2004 Rider G, Application No. 1337218, April 21, 2004, page 11.

utility for the relevant level of financial risk since utilities require fair compensation. The board went on to state that the deferral accounts which accrue this long term carrying cost should not represent an investment opportunity for the utility. The WACC approach is however in opposition to the Rule 023 methodology for interim deferral accounts.¹⁰⁰

245. In Decision 2008-050, the Commission used a mix of WACC and Rule 023: “The Commission concurs with AP at this time that the appropriate methodology for calculating financing charges for the 2006 and 2007 balances is WACC based on mid-year balances and Rule 023 13-month methodology for the 2008 balance...”¹⁰¹

246. While the Rule 023 methodology may be appropriate for certain short term deferral accounts where there are unknown carrying cost variables, in the current application the carrying cost is known for the RDDA. The Commission accepts RWSL’s argument that the use of Rule 023 does not approximate the reasonable carrying costs on a deferral balance in RWSL’s case because it does not have access to bank financing at the Bank of Canada bank rate plus 1½ per cent implied in Rule 023. The Commission finds RWSL’s proposal to earn a carrying charge on the RDDA balance to be just and reasonable and directs that the carrying charge be calculated at the weighted average cost of capital, rather than on the Rule 023 methodology.

247. In light of the foregoing, the Commission grants RWSL’s request to set up a revenue deficiency deferral account to reflect a shortfall between the revenue requirement forecast and the actual revenue, in accordance with the findings set out above.

7 Rate design

7.1 Average water consumption

248. RWSL used an average consumption of 20 m³ per household in its rate design. RWSL explained that actual water consumption, by its metered customers, for the years 2007-2009 was used to determine the average water consumption estimate. RWSL stated that for 2007 and 2008, actual water consumption was less than 20 m³ per customer per month and, while the average in 2009 was slightly higher than 20 m³, the median was less than 20 m³ per month per metered customer. RWSL also noted that 50 per cent of its customers use less than 20 m³, while most of the other 50 per cent use only slightly more than 20 m³.¹⁰²

249. The Association submitted that RWSL’s average consumption level of 20 m³ per customer, per month was too low. It suggested that the average water consumption was already above that level and noted that the actual water usage data provided by RWSL does not reflect ultimate water demand, as the numbers are based on pre-landscaping of the occupied lots.

250. The Association filed evidence of the actual water usage for two households in the Monterra development. One of the households, a family of four residing on a 0.41 acre lot had an average actual water consumption of 36 m³ per month over the period March 2009 to February 2010. The other household, a family of four residing on a 0.37 acre lot, had an average actual

¹⁰⁰ Decision 2001-92: GENCO and DISCO 2000 Pool Price Deferral Accounts Proceeding, Part K: Recovery Period, Carrying Cost Rates, Collection Issues, and Hedging, December 12, 2001.

¹⁰¹ Decision 2008-050: ATCO Pipelines South, 2007 Other Pipeline Delivery Deferral Account, Application No. 1553222, June 11, 2008.

¹⁰² Exhibit 99.02, paragraphs 61-62, pages 11-12.

water consumption of 51 m³ per month over the period June 1, 2008 to September 9, 2008; May 2009 to August 2009; and March 2010.¹⁰³

251. The Association submitted that an average consumption level of 37 m³ per month, per household, would better reflect water usage for the Monterra development assuming a full landscaping build-out. The Association pointed out that the minimum lot size for phase one of the development is 0.33 acres.

252. The Association explained that its estimate of 37 m³ was derived from looking at the typical water use for domestic purposes of a four member household plus an estimate of the average water use during the landscaping irrigation season. It was assumed that domestic use would remain relatively stable throughout the year at an average water usage of 15.6 m³ per month (excluding irrigation). It calculated that an additional water usage of 54 m³ per month, on average, would be used during the irrigation season (May to September). The estimate for irrigation usage was calculated using the assumption that a healthy lawn requires 2.5 centimetres of water every seven to ten days, which also took into account the historical precipitation for Calgary and the average lot size (less the area taken up, on average, by the house and driveway).¹⁰⁴

253. The Association requested that the Commission make a determination that its estimate of 37 m³ average household consumption per month is reasonable for the Monterra development.

254. In reply, RWSL submitted that the numbers presented by the Association are skewed by excessive water use at certain times, which raises the monthly average significantly. It noted that if these months are excluded, the average usage would have been below the 20 m³ base consumption utilized by RWSL in its rate design.

Commission findings

255. The Commission has reviewed the actual water use data supplied by RWSL and the water bills submitted by the Association and considers that an average 20 m³ per month, per household is low for the Monterra development. The Commission agrees with the Association that the actual water use data supplied by RWSL does not reflect the full landscaping build-out of the occupied lots. However, it also notes that the water use numbers reflected in the bills provided by the Association reflect high water usage associated with establishing landscaping on a newly occupied lot.

256. The Commission also recognizes that the average water use distribution that RWSL used to obtain an estimate of revenue is weighted in favour of usage over 30 m³. The first two tiers (under 20 m³ and between 20-30 m³) were each assumed to represent 20 per cent of the average water use and the third tier (over 30 m³) was assumed to represent 60 per cent of the average water use.¹⁰⁵

257. In making a determination on what can reasonably be expected as an average household consumption level for the Monterra development, the Commission must balance the actual use numbers supplied by RWSL against the Association's argument that the actual numbers do not reflect the ultimate water demand for households in the Monterra development. The Commission

¹⁰³ Exhibit 84.01, Schedule A.

¹⁰⁴ Ibid., Schedule C, pages 1-2.

¹⁰⁵ Exhibit 60.02, Schedule 6.0.

finds that the average use, per household per month for the Monterra development should be set at 30 m³.

7.2 Rate structure

258. RWSL stated that the rates it has proposed are not cost based; instead they are meant to reflect the costs that would exist once the area is fully developed and the plant is fully utilized. RWSL submitted that over 97 per cent of the costs are fixed according to its class cost of service study.¹⁰⁶ RWSL submitted that charging rates based on an application of the class cost of service study would place an unfair burden on the existing customers.

259. RWSL proposed a two-part inclining block rate for 2007 through 2009 with a proposed change to a three-part inclining block rate in 2010. RWSL explained that a fixed charge of \$90 per month and a variable charge of \$1.50 for consumption up to 20 m³ would result in a customer at that level paying \$120 per month. At this usage level, the fixed charge would represent 75 per cent of the total monthly revenue from a customer.¹⁰⁷

260. In Decision 2007-099, the board approved interim rates that consisted of a fixed charge of \$46 per month and usage charges of \$1.50/m³ up to 20 m³ and \$4.10/m³ over 20 m³. It also established a maximum combined charge of \$117.00 per month.

261. RWSL explained that the proposed change in 2010 was in part to reflect the 2009 consumption data. RWSL explained that, by incorporating an intermediate block, the rate structure would recognize the fact that the majority of customers consume 30 m³ or less. The proposed rate structure is provided in Table 9. RWSL also maintained its proposed fixed charge of \$90 per customer per month. The fixed charge was meant to recover all of the projected customer costs as well as a small percentage of the demand costs.

Table 9. RWSL proposed rate structure

| | Usage | 2007-2009 rates | Usage | 2010 rates |
|--------------|-------------------------|---------------------|---------------------------|---------------------|
| Fixed charge | | \$90/month | | \$90/month |
| First tier | Up to 20 m ³ | 1.50/m ³ | Up to 20 m ³ | 1.00/m ³ |
| Second tier | Over 20 m ³ | 4.10/m ³ | Btw. 20-30 m ³ | 2.00/m ³ |
| Third tier | n/a | | Over 30 m ³ | 4.10/m ³ |

Source: Exhibit 68.01, Schedule 6.0.

262. RWSL argued that a three-block design would be a more efficient way to promote water conservation. RWSL indicated that it wanted the rate design to incent customers to achieve certain levels of water conservation. RWSL explained that adding another block at a lower rate would give customers an additional incentive to lower their monthly bill by conserving water. RWSL proposed that the first two blocks do not unduly charge those customers whose consumption is less than 30 m³, as the majority of customers have consumption below this level.¹⁰⁸

¹⁰⁶ Exhibit 60.02, page 7. A summary of the class cost of service study is provided in Exhibit 68.01, Schedule 7.0.

¹⁰⁷ Exhibit 20.01, AUC-RWS-005.

¹⁰⁸ Exhibit 81.02, AUC-RWS-092(a-c).

263. The Association agreed with RWSL that cost based rates were not feasible and looked to the rates charged by comparable utilities to assess RWSL's proposed rates. It noted that there are a number of examples of two or three tiered systems for water utilities and the rates proposed by RWSL produce a significantly higher total charge than water utility bills in other Alberta communities. The Association provided the rate structures and charges for a number of Alberta water utilities, which are reproduced in Table 10.

Table 10. Comparable rates structures of other Alberta water utilities

| | Cochrane (monthly) | | Chestermere (monthly) | | Calgary (monthly) | |
|--------------|-----------------------|------------------------|-----------------------|---------------------|------------------------|----------|
| Fixed charge | \$0 | | \$14.68 | | \$11.50 | |
| First tier | \$1.06/m ³ | < 25 m ³ | \$0.55/m ³ | < 18 m ³ | \$1.254/m ³ | No Limit |
| Second tier | \$1.41/m ³ | 25 – 60 m ³ | \$1.20/m ³ | > 18 m ³ | n/a | n/a |
| Third tier | \$2.10/m ³ | > 60 m ³ | n/a | n/a | n/a | n/a |

| | Edmonton (monthly) | | Rocky View (quarterly) | |
|--------------|-------------------------|---------------------|------------------------|----------------------|
| Fixed charge | \$10.84 | | \$30.00 | |
| First tier | \$1.5870/m ³ | < 60 m ³ | \$0.930/m ³ | < 300 m ³ |
| Second tier | \$1.6404/m ³ | > 60 m ³ | \$1.86/m ³ | > 300 m ³ |
| Third tier | n/a | n/a | n/a | n/a |

Source: Exhibit 84.01, Schedule D.

264. The Association also calculated the total monthly water bill for each utility for a variety of water use levels to compare them to RWSL's proposed rates. The results are shown in Table 11.

Table 11. Comparison of monthly water bills by utility

| | Water usage | | | |
|----------------------|-------------------|-------------------|-------------------|--------------------|
| | 20 m ³ | 30 m ³ | 60 m ³ | 100 m ³ |
| Cochrane | \$21.20 | \$33.55 | \$75.85 | \$159.85 |
| Chestermere | \$26.98 | \$38.98 | \$74.98 | \$122.98 |
| Calgary | \$36.58 | \$49.12 | \$86.74 | \$136.90 |
| Edmonton | \$42.58 | \$58.45 | \$106.06 | \$171.68 |
| Rocky View | \$28.60 | \$37.90 | \$65.80 | \$103.00 |
| RWSL Proposed | \$110.00 | \$130.00 | \$253.00 | \$417.00 |

Source: Exhibit 84.01, Schedule D.

265. The Association submitted that RWSL's rates should be at a level more in line with rates charged by utilities in other Alberta communities. The Association supported a three-tiered approach, but recommended an alternative inclining block framework and a lower rate for the third tier. The Association also considered a fixed fee of \$90 per month excessive when compared to the fixed fees charged by utilities in other communities. The Association proposed a fixed fee in the range of \$20 to \$30 a month.

266. In summary, the Association proposed monthly rates based on a three block inclining structure as follows:

Table 12. Association proposed rate structure

| | Charge | Usage |
|--------------|-----------------------|------------------------|
| Fixed charge | \$30.00 | |
| First tier | \$1.00/m ³ | < 30 m ³ |
| Second tier | \$2.00/m ³ | 30 – 60 m ³ |
| Third tier | \$3.50/m ³ | > 60 m ³ |

Source: Exhibit 84.01.

267. A comparison of the total monthly water bill using the charges proposed by the Association compared to other communities and to RWSL's proposed charges is provided in Table 13.

Table 13. Comparison of proposed monthly water bills with other Alberta utilities

| | Water usage | | | |
|-----------------------------|-------------------|-------------------|-------------------|--------------------|
| | 20 m ³ | 30 m ³ | 60 m ³ | 100 m ³ |
| Cochrane | \$21.20 | \$33.55 | \$75.85 | \$159.85 |
| Chestermere | \$26.98 | \$38.98 | \$74.98 | \$122.98 |
| Calgary | \$36.58 | \$49.12 | \$86.74 | \$136.90 |
| Edmonton | \$42.58 | \$58.45 | \$106.06 | \$171.68 |
| Rocky View | \$28.60 | \$37.90 | \$65.80 | \$103.00 |
| RWSL proposed | \$110.00 | \$130.00 | \$253.00 | \$417.00 |
| Association proposed | \$50.00 | \$60.00 | \$120.00 | \$260.00 |

Source: Exhibit 84.01, Schedule D.

268. The Association submitted that the rate structure it proposed is more in line with other communities and requested that the Commission approve its proposed rate structure as just and reasonable.

269. RWSL submitted that the rate structure proposed by the Association did not consider the unique circumstances of RWSL, including differences in the size of the utility's rate base, or issues related to the cost of capital, including business risk. It pointed out that the circumstances related to both the Edmonton and Calgary water utilities would be vastly different to RWSL. RWSL argued that, because the facts underpinning the rates for each utility are unique, a comparison to other utilities is of limited relevance to an assessment of RWSL's requested rates.

Commission findings

270. Ensuring the safe and reliable provision of water utility service is the primary concern of the Commission. In this case, where the rates proposed by RWSL do not recover the revenue requirement, the Commission must balance the interests of customers with respect to the affordability of water service against the requirement of the water utility to recover its costs and earn a reasonable return. For the 2007-2010 test period, RWSL has proposed rates that are not cost based, but are meant to reflect the costs that would exist once the area is fully developed and

the plant is fully utilized. The Association has proposed an alternative rate structure that it argued is more in line with water rates at other Alberta water utilities, but would also have the effect of increasing the revenue shortfall experienced by RWSL.

271. RWSL has proposed to keep the two-block rate design it had originally proposed for the test years 2007 through 2009, and introduced a new three-block design for 2010. The Association proposed a three-block design. The Commission agrees with RWSL that the three block design has the potential to promote water conservation. The Commission considers this to be a secondary consideration, but important nonetheless. RWSL based the three tiers of its three-block design on the assumed monthly average consumption of 20 m³. The Commission previously found that 30 m³ is a more reasonable estimate of the average use per household per month for the Monterra development. As such, the Commission considers that the three tiers of the rate structure proposed by the Association are better suited to the usage characteristics of customers within the Monterra development. The Commission directs RWSL to use the following block structure:

- usage under 30 m³
- usage between 30 m³ to 60 m³
- usage over 60 m³

272. The Commission is not prepared to accept either the fixed charge or the usage charges proposed by the Association. Upon changing the block structure, the Commission considered the usage charge that should apply in each block. The Commission agrees with RWSL's approach of setting the rates at a level that would reflect the conditions as they would exist once the area is fully developed and the plant is fully utilized, without placing an unfair burden on the existing customers. The Commission finds that the following usage charges achieve this objective:

- \$1.50 /m³ for usage under 30 m³
- \$2.50 /m³ for usage between 30 m³ and 60 m³
- \$3.50 /m³ for usage over 60 m³

273. RWSL proposed a fixed charge of \$90 per month, whereas the Association submitted that a fixed charge of \$30 per month would be more in line with what is charged by other Alberta water utilities. At the time it requested interim rates, RWSL indicated that fixed charges representing 75 per cent of the revenue from a customer with an average water consumption of 20 m³ would be a reasonable fixed charge. In Decision 2007-099, the board approved interim rates that set out a fixed charge of \$46 per month. The Commission considers that, given RWSL's current size, most of its costs are fixed in nature. It further considers that a large fixed charge is needed at this time to provide revenue stability, which should also assist RWSL in its efforts to attract third-party lending institutions to finance its debt requirements. The Commission finds that a fixed cost of \$70 per month is reasonable, which, when compared to RWSL's estimate, would represent 70 per cent of the total monthly revenue from the same customer.

274. The Commission finds that the maximum combined charge of \$117.00 per month that was established on an interim basis in Decision 2007-099 will not form part of the rate structure

on a go forward basis because to do so would be contrary to the Commission's objective to reduce the balance in the RDDA.

275. The approved rate structure is summarized in the table below.

Table 14. Approved rate structure

| | Charge | Usage |
|--------------|-----------------------|------------------------|
| Fixed charge | \$70.00 | |
| First tier | \$1.50/m ³ | < 30 m ³ |
| Second tier | \$2.50/m ³ | 30 – 60 m ³ |
| Third tier | \$3.50/m ³ | > 60 m ³ |

276. A comparison of the monthly charge based on RWSL's proposed rate structure, the Association's proposed rate structure, and the rate structure approved by the Commission is provided in the following table.

Table 15. Comparison of monthly bills under proposed and approved rates

| | Water usage | | | |
|-----------------------------|-------------------|-------------------|-------------------|--------------------|
| | 20 m ³ | 30 m ³ | 60 m ³ | 100 m ³ |
| RWSL proposed | \$110.00 | \$130.00 | \$253.00 | \$417.00 |
| Association proposed | \$50.00 | \$60.00 | \$120.00 | \$260.00 |
| Approved | \$100.00 | \$115.00 | \$190.00 | \$330.00 |

277. The Commission notes that interim rates approved effective December 1, 2007 have remained in effect for billing purposes and have formed the basis for revenues collected by RWSL since that date. The Commission gave some consideration to truing up rate levels collected under the rate structure set out in Table 14 above and collecting the resulting shortfall by way of a rider. However, under the interim rate, the charge for usage up to 20 m³ is the same as the approved rate for usage up to 30 m³, at \$1.50 per m³. Further, the actual average monthly consumption levels for each of 2007-2009 was at approximately 20 m³. While the fixed charge is lower under the interim rates, the interim rates also established a maximum combined charge of \$117.00 per month. In light of these factors, the Commission finds that the additional complexity involved in calculating and applying such a rider is not warranted, especially considering the Commission's approval of the RDDA.

278. The Commission similarly considers that while the test period for which RWSL has applied has ended, the additional complexity involved in truing up customer bills already issued based on the approved interim rates outweighs the benefit that RWSL would derive from the relatively small amount of incremental revenue arising from use of the higher rates in January and February 2011. Accordingly, the Commission considers that RWSL customer billing under the rate structure set out in Table 14 should commence effective March 1, 2011.

279. Finally, the Commission notes its direction in Section 6 that RWSL is to file a GRA within five years of the date of this decision. While revenues collected under the rate structure set out in Table 14 above are not sufficient to recover RWSL's forecasted O&M expenses, it is reasonable to expect that the O&M costs incurred by RWSL over a five-year period will rise

with inflation. Given this, the Commission considers that an escalator in the amount of two per cent per annum should be applied to the approved usage charges of the rate structure outlined in Table 14. The effect of applying an escalator on the usage charges in each future year is summarized below in Table 16.

Table 16. Approved rate structure with usage charges escalated by inflation

| | Usage | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|--------------|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Fixed charge | | \$70.00 | \$70.00 | \$70.00 | \$70.00 | \$70.00 |
| First tier | < 30 m ³ | \$1.50/m ³ | \$1.53/m ³ | \$1.56/m ³ | \$1.59/m ³ | \$1.62/m ³ |
| Second tier | 30 – 60 m ³ | \$2.50/m ³ | \$2.55/m ³ | \$2.60/m ³ | \$2.65/m ³ | \$2.71/m ³ |
| Third tier | > 60 m ³ | \$3.50/m ³ | \$3.57/m ³ | \$3.64/m ³ | \$3.71/m ³ | \$3.79/m ³ |

280. RWSL is directed to revise Schedule C of its T&Cs to reflect the approved rate structure set out in Table 14 and to include a tariff schedule that reflects the rates outlined in Table 16 over a five-year period. RWSL is directed to reflect these changes in its refiling.

8 Terms and conditions of service

281. RWSL stated that Decision 2008-060 approved the T&Cs for RWSL on an interim refundable basis.

282. In its revised application, RWSL proposed some amendments to the T&Cs approved in Decision 2008-060. RWSL explained that the primary purposes for making the proposed amendments were the elimination of the flat rate service option, to ensure customers have a meter and are provided meter service, and to eliminate the maximum monthly charge provisions.¹⁰⁹

283. The changes to the T&Cs were summarized as follows:¹¹⁰

- Section 3.8.2 Service Connection Charge was amended to eliminate flat rate service.
- Section 3.9 .1 was amended to specifically reflect that Optional Facilities must be requested by the customer. This was a concern expressed by the Commission.
- Section 3.9.3 Water Availability Charge was amended to provide a service to contractors/developer prior to the installation of a meter. In these circumstances the contractor/developer would pay a one time Water Connection Charge of \$300.00 as well as a monthly Water Availability Charge of \$120.00.
- Schedule A was amended to provide for the elimination of the flat rate service option.
- Schedule B was amended to eliminate the flat rate service and the related connection charge for that service.

¹⁰⁹ Exhibit 99.02, paragraph 65, page 12.

¹¹⁰ Ibid., paragraphs 66-71, page 12.

- Schedule C was amended to provide for the new proposed three block usage rate and to eliminate the maximum amount chargeable per month.

Commission findings

284. The revised T&Cs were not addressed by parties in argument or reply argument. In Decision 2008-060, RWSL was required by the Commission to amend Section 3.9.1 to include wording recognizing that “Optional Facilities must be specifically requested by a customer before they will be considered by the company.”¹¹¹ During the information request phase of this application, AUC-RWS-061 made note of RWSL’s omission of this language in its proposed T&Cs. RWSL stated that the procedural order did not stipulate a date by which RWSL was to revise its application, but subsequently filed the revisions before the close of record. The Commission finds that RWSL complied with this direction and there were no objections by the interveners with respect to the change to Section 3.9.1 of the proposed T&Cs.

285. Accordingly, the general terms and conditions of service, as revised and filed on February 26, 2010, are approved by the Commission, subject to the changes to Schedule B and Schedule C of the T&Cs. RWSL is directed to reflect these changes in its refiling.

¹¹¹ Decision 2008-060, Section 3.5, page 10.

9 Order

286. It is hereby ordered that Regional Water Services Ltd. refile its 2007-2010 General Rate Application to reflect the findings, conclusions and directions in this decision on or before March 31, 2011.

Dated on February 18, 2011.

The Alberta Utilities Commission

(original signed by)

Anne Michaud
Panel Chair

(original signed by)

Mark Kolesar
Commission Member

(original signed by)

Tudor Beattie, QC
Commission Member

Appendix 1 – Proceeding participants

| Name of organization (Abbreviation) Counsel or Representative |
|---|
| Regional Water Services Ltd. (RWSL) L. Manning K. Verleih H. Johnson |
| J. Chamberlain |
| D. Chamberlain |
| D. Chiphair |
| J. Chipchar |
| G. Reid |
| C. and M. Gulaga |
| D. Haase |
| R. and M. Johnston |
| G. and S. Layden |
| T and W. McPike |
| R. and W. O'Bray |
| V. Paradis |
| D. and J. Reid |
| G. Sapak |
| B. and L. Stin R. Twyman S. Hryclw |
| G. and A. Swedlo |
| M. and D. Ulriksen |
| S. and A. Winkler |
| T. Zelter |

Alberta Utilities Commission

Commission Panel

A. Michaud, Panel Chair
M. Kolesar, Commission Member
T. Beattie, QC, Commission Member

Commission Staff

R. Marx (Commission Counsel)
W. MacKenzie
J. Halls
O. Vasetsky
P. Hlavac-Winsor

Appendix 2 – Summary of Commission directions

This section is provided for the convenience of readers. In the event of any difference between the Directions in this section and those in the main body of the decision, the wording in the main body of the decision shall prevail.

1. The Commission has determined that RWSL's initial approach of applying an offsetting contribution to sewer and outfall amounts added to rate base is not equivalent to an approach of simply excluding the sewer and outfall related assets from rate base. With the amortization of the offsetting contribution, any subsequent capital maintenance expenditures on sewer and outfall related assets could cause these costs to be recovered through potable water rates over time. The Commission finds that the rate treatment set out in RWSL's February 26, 2010 revised application is correct and directs RWSL to ensure that no subsequent capital maintenance expenditures on sewer related assets are added to RWSL's potable water rate base. Paragraph 37
2. The Commission finds that the Association's request in Association-RWSL-16 to provide a design basis memorandum or pre-design report for the potable water system and as built drawings was relevant to the determination of the reasonableness of RWSL's initial regulated rate base. As such, the Commission finds that RWSL's decision to decline to provide this information in its response to Association-RWSL-16 impaired the ability of the Commission and interested parties to scrutinize RWSL's initial rate base expenditures. Taking all these factors into account, the Commission rejects the Association's suggestion that it should draw an adverse inference about the accuracy of the plant-in-service amounts reported by RWSL at this time. Nevertheless, the Commission finds that the magnitude of the discrepancy between the rate base amounts and asset amounts reported in RWSL's financial statements is troubling. As such, the Commission will direct the AUC's audit group to conduct an audit of RWSL property accounts at a future date..... Paragraph 55
3. Considering the foregoing, the Commission directs RWSL to estimate the incremental costs incurred prior to the commencement of regulated service arising from (a) the larger diameter pipe used for transmission mains, and (b) the construction of a larger raw water reservoir. RWSL is directed to provide and fully support these estimates at the time of its next general rate application, as ordered by the Commission in Section 6. In both cases, the incremental cost assessments should reflect the incremental costs incurred relative to the cost of facilities needed to serve an 875 residential unit development without any provision for potential future expansion outside of the Monterra development. Paragraph 82
4. In this regard, the Commission notes that, in its response to AUC-RWS-12, RWSL indicated that the water diversion rate of 1,227,314 m³ set out in RWSL's water licence could service 2100 housing units under certain assumptions as to consumption, peak demand and storage. Taking the ratio of the maximum forecast size of the development (875) to the 2100 unit maximum capacity of the water licence, the Commission has determined that only \$833,333 should be added to RWSL's rate base in respect of the cost of the water licence at this time. The Commission directs RWSL to treat the balance of the cost of the water licence (\$1,166,667) as capacity held for future use. Paragraph 117

5. In consideration of the potential for some or all of the remaining capacity of RWSL's water licence to be required as a result of a possible increase to the density of the Monterra development and/or expansion of RWSL's potable water system beyond the current boundaries of Monterra, the Commission directs RWSL to ensure that no portion of the capacity of the water licence be offered for sale without seeking the express approval of the Commission. Paragraph 118
6. The Commission has reviewed RWSL's calculation of AFUDC in Schedule 3.0 and is satisfied that RWSL's calculation method only attributes AFUDC in respect of 2007. The Commission considers that RWSL has correctly made an allowance for AFUDC reflective of the fact that it only receives a rate base return on plant-in-service valued on a mid-year basis in that year. However, in accordance with the Commission's findings in Section 5.4 of this decision, RWSL is directed to recalculate its AFUDC allowance at the time of its refiling to reflect the return of 2.69 per cent and to reflect Commission findings in Section 4.3 above that certain RWSL property was constructed for future use. Paragraph 123
7. The Commission accepts that the lag day calculations used for each working capital line item shown in Schedule 2.5 of the application are reasonable. RWSL is directed to recalculate working capital amounts at the time of its refiling to reflect all other findings made in this decision that impact working capital calculations. Paragraph 129
8. The Commission notes that, whereas RWSL calculates the amortization of AFUDC for 2007, 2008, and 2009 in Schedule 7.1, RWSL does not show an amount for the amortization of AFUDC for 2010 in Schedule 7.1. RWSL is directed to correct this error or otherwise explain the reason for this discrepancy in its refiling application. Paragraph 179
9. Accordingly, RWSL is directed, in its compliance filing, to incorporate a deemed developer contribution in aid of construction in the amount of \$15.0 million and a per lot contribution, on a go-forward basis, of \$25,000 per lot. Paragraph 235
10. RWSL is directed to either allocate these additional contribution amounts to specific property accounts as done in Schedule 2.2, or amortize the entire incremental deemed contribution amounts at RWSL's 2.69 per cent per year composite depreciation rate, comparable to RWSL's proposal for amortizing AFUDC. RWSL is directed to describe the approach for amortizing the deemed contribution amounts at the time of its refiling. Paragraph 236
11. While Decision 2008-060 expressly found that the per lot contribution (tie-in fee) of \$12,500 should be approved on an interim refundable basis and that tie-in fees applied after April 1, 2008 may be subject to adjustment after that date, the Commission considers that its finding to increase the tie-in fee should only apply prospectively from the date of this decision. In consideration of this finding, RWSL is directed to revise schedule B of its T&Cs to increase the tie-in fee from \$12,500 to \$25,000 in its refiling. Paragraph 237
12. RWSL is also directed to update the Commission on the status of lot sales and the functioning of the RDDA mechanism within three years from the date of this decision and to file a full rate application within five years of the date of this decision. In both instances, the Commission will assess whether the RDDA mechanism is functioning as anticipated. The Commission considers that it is ultimately RWSL and its affiliated lenders who are at risk for collecting the RDDA balance in the future. Therefore, if at

- anytime the Commission determines that the RDDA is growing at a level that is not manageable, the Commission may direct RWSL to further increase the levels of deemed contributions. Paragraph 238
13. While the Rule 023 methodology may be appropriate for certain short term deferral accounts where there are unknown carrying cost variables, in the current application the carrying cost is known for the RDDA. The Commission accepts RWSL's argument that the use of Rule 023 does not approximate the reasonable carrying costs on a deferral balance in RWSL's case because it does not have access to bank financing at the Bank of Canada bank rate plus 1½ per cent implied in Rule 023. The Commission finds RWSL's proposal to earn a carrying charge on the RDDA balance to be just and reasonable and directs that the carrying charge be calculated at the weighted average cost of capital, rather than on the Rule 023 methodology. Paragraph 246
14. RWSL has proposed to keep the two-block rate design it had originally proposed for the test years 2007 through 2009, and introduced a new three-block design for 2010. The Association proposed a three-block design. The Commission agrees with RWSL that the three block design has the potential to promote water conservation. The Commission considers this to be a secondary consideration, but important nonetheless. RWSL based the three tiers of its three-block design on the assumed monthly average consumption of 20 m³. The Commission previously found that 30 m³ is a more reasonable estimate of the average use per household per month for the Monterra development. As such, the Commission considers that the three tiers of the rate structure proposed by the Association are better suited to the usage characteristics of customers within the Monterra development. The Commission directs RWSL to use the following block structure
- usage under 30 m³
 - usage between 30 m³ to 60 m³
 - usage over 60 m³ Paragraph 271
15. RWSL is directed to revise Schedule C of its T&Cs to reflect the approved rate structure set out in Table 14 and to include a tariff schedule that reflects the rates outlined in Table 16 over a five-year period. RWSL is directed to reflect these changes in its refiling. Paragraph 280
16. Accordingly, the general terms and conditions of service, as revised and filed on February 26, 2010, are approved by the Commission, subject to the changes to Schedule B and Schedule C of the T&Cs. RWSL is directed to reflect these changes in its refiling. Paragraph 285

Appendix 3 –Final process schedule

[\(return to text\)](#)

| Item | Deadline |
|--|--------------------|
| Rule 011 Process | |
| Information Requests to Applicant (Round 1) | July 10, 2008 |
| Information Responses from the Applicant (Round 1) | July 30, 2008 |
| Information Requests to Applicant (Round 2) | August 20, 2008 |
| Information Responses from the Applicant (Round 2) | September 24, 2008 |
| Information Requests to Applicant (Round 3) | October 13, 2008 |
| Information Responses from the Applicant (Round 3) | November 3, 2008 |
| Formal Review Process | |
| Notice of Application | November 9, 2009 |
| Participation Closing Date | December 1, 2009 |
| Information Requests to Applicant (Round 4) | January 21, 2010 |
| Information Responses from the Applicant (Round 4) | February 26, 2010 |
| IRs to Applicant (Round 5) | March 24, 2010 |
| Information Responses from Applicant (Round 5) | April 9, 2010 |
| Evidence from Interveners | April 16, 2010 |
| IRs to Interveners (Round 1) | April 30, 2010 |
| Information Responses from Interveners (Round 1) | May 14, 2010 |
| Confidentiality Order | |
| IRs on Confidential Information to Applicant (Round 6) | May 14, 2010 |
| IR Responses on Confidential Information (Round 6) | May 21, 2010 |
| Formal Review Process (Continued) | |
| Rebuttal Evidence | May 28, 2010 |
| Argument | June 11, 2010 |
| Reply Argument | June 25, 2010 |
| Information Requests to Applicant (Round 7) | September 16, 2010 |
| Information Responses from the Applicant (Round 7) | October 15, 2010 |
| Supplemental Argument | November 08, 2010 |
| Supplemental Reply Argument | November 22, 2010 |

Appendix 4 – Abbreviations

| Abbreviation | Name in full |
|-------------------|--|
| 2007-2008 GRA | original general rate application |
| 2007-2010 GRA | revised general rate application |
| AFUDC | allowance for funds used during construction |
| Association | Monterra Home Owners Association |
| AUC or Commission | Alberta Utilities Commission |
| Chamberlain | Julie Chamberlain |
| CLWC | Cochrane Lakes Water Company |
| Complaint | In correspondence dated May 29, 2007, the EUB received a submission on behalf of residents and land owners of the Monterra on Cochrane Lakes development prepared by Marcia Johnson QC which set out a complaint pursuant to the <i>Public Utilities Board Act</i> against RWSL and related companies. |
| DGA | deferred gas account |
| EGNB | Enbridge Gas New Brunswick |
| EUB or the board | Alberta Energy and Utilities Board |
| GRA | general rate application |
| Heritage Gas | Heritage Gas Inc. |
| Medallion | Medallion Lakes Land Development Corporation and Medallion Development Corporation |
| Monterra Group | Landowners and Residents of Monterra to file the complaint |
| NBEUB | New Brunswick Energy and Utilities Board |
| NSUARB | Nova Scotia Utility and Review Board |
| PHFFU | plant held for future use |
| RDDA | revenue deficiency deferral account |
| RUC | Regional Utilities Corporation |
| RWSL | Regional Water Services Limited |
| SIP | statement of intent to participate |
| T&Cs | Terms and Conditions of Service |
| WACC | weighted average cost of capital |