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Alberta Utilities Commission
Utilities Division, Calgary Office
Fifth Avenue Place
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Attention: Cameron Taylor, Application Officer

Dear Cameron:

Re: **AESO Argument in Review and Variance of Decision 2007-106
Application No. 1566390 and Proceeding ID 108**

The Alberta Electric System Operator (“AESO”) provides the following argument on the above-noted application, in accordance with the schedule set out in the January 7, 2009 letter of the Alberta Utilities Commission (“AUC”).

In preparing this argument the AESO has considered:

- relevant application materials and other evidence previously filed by the AESO and other parties in the AESO’s 2006 General Tariff Application (“GTA”), provided by the AESO as attachments to Information Response AUC.AESO-001 (a) filed on March 6, 2009 in this proceeding;
- relevant evidence previously filed by the AESO in the AESO’s 2007 GTA, provided by the AESO as an attachment to its evidence filed on January 8, 2009 in this proceeding;
- section 8.3 (pages 105-107) of Decision 2007-106 on the AESO’s 2007 GTA, released on December 21, 2007;
- material filed by the Applicants and other parties in support of the application for review and variance of Decision 2007-106;
- evidence filed by the AESO on January 8, 2009, and by the Applicants on January 9, 2009, both in this proceeding; and
- AESO responses to information requests from the AUC, filed on March 6, 2009 in this proceeding.

The AESO notes that references to the AUC in this argument include the Alberta Energy and Utilities Board (“EUB”) as its predecessor.

In Decision 2008-090 on the preliminary question, the AUC determined the Review Question to be, “Did the Board err in failing to adequately consider the effects of the 12% prepaid O&M charge within the context of the AESO’s contribution policy?” The AESO provides its argument in the context of the review question.

1 Effects Considered in Decision 2007-106

Section 8.3 (pages 105-107) of Decision 2007-106 considered the following aspects of the 12% prepaid O&M charge. Items 1.1 through 1.3 below first quote (in italics) specific text from Decision 2007-106, and then provide the AESO’s argument with respect to the quoted text.

- 1.1 *The [AUC] reiterates that it considers that it is appropriate to send economic signals to AESO customers that appropriately reflect the cost causation consequences of a customer’s decisions.* (page 106)

As explained by the AESO in Information Response AUC.AESO-003:

“...the cost causation signal provided to a DTS customer includes both:

- (i) the customer contribution related to the customer’s interconnection, if any, and
- (ii) monthly charges paid over time in accordance with the DTS rate for the service.

“As discussed in section 2 of the AESO’s evidence in this review and variance proceeding, DTS customers who paid contributions in 2006 and later years would pay both the O&M costs recovered through contributions and the O&M costs recovered through the DTS rate. In effect, those customers would receive an inappropriately inflated cost signal that represents more than the costs being caused by their services.”

The AESO’s view is consistent with the evidence of the Applicants in this proceeding, which states (page 2), “Decision 2007-106 fails to send proper economic signals and fails to appropriately reflect cost causation by double charging customers first through a prepaid amount of O&M via a customer contribution and second through the AESO tariff.” (underlining in original) Other participants in this proceeding have provided similar comments, such as Inter Pipeline Fund (“IPF”) which stated in its submission on April 10, 2008 (page 2), “IPF does not believe that cost causation is properly reflected when an over collection of certain costs is made in AESO’s rates by virtue of its ongoing DTS rate, as well as an operations and maintenance element to a capital contribution charge by a transmission facility operator.” No participant in this proceeding has supported as appropriate the payment by a customer of both the O&M costs recovered through contributions and the O&M costs recovered through the DTS rate.

The AESO considers that a cost signal which appropriately reflects the cost causation consequences of a customer’s decision should include the customer contribution and monthly DTS charges. However, the AESO submits that it is not appropriate to further inflate the cost signal by recovering O&M costs both in the customer contribution and in monthly DTS charges. In fact, such inflation of the cost signal is inconsistent with the AUC’s finding in Decision 2007-106 (page 14) that “rates based on cost causation should provide **appropriate** price signals” (bolding added).

- 1.2 *To the extent that the incremental capital costs of a new interconnection are at least proportionally related to incremental TFO O&M costs, it would be inappropriate to effectively confine this relationship to the optional portion of facility capital costs.* (page 106)

The AESO provided the following comments in section 3 of its evidence in this proceeding:

“The AESO’s tariff defines ‘AESO Standard Facilities’ as ‘the least-cost interconnection facilities which meet good transmission practice including applicable reliability, protection, and operating criteria and standards...’ (AESO Terms and Conditions, Article 1.1). Facilities less than this would generally not be able to supply the customer’s load while meeting applicable standards.... The customer generally has no ability to reduce the cost of an interconnection below that of Standard Facilities....”

“On the other hand, facilities in excess of standard are not considered necessary to supply the customer’s load and provide system access service....”

The monthly DTS charges a customer incurs are based on the MW and MWh volumes metered for the customer during a billing period. Those MW and MWh volumes would be the same whether the customer’s interconnection includes only standard facilities or both standard facilities and facilities in excess of standard, and would therefore result in the same monthly DTS charges in either case. In other words, monthly DTS charges would not recover any incremental TFO O&M costs attributable to facilities in excess of standard. If the initial customer contribution to excess facilities also does not include an O&M charge, then the incremental O&M costs attributable to the excess facilities would not be recovered from that customer at all.

Standard facilities, however, are the least-cost interconnection facilities able to supply the customer’s load while meeting applicable standards. The primary driver of incremental standard facilities cost is incremental load — that is, incremental MW and MWh volumes — of the customer. Standard facilities are therefore responsive to, and reflective of, incremental load requirements of the customer.

Monthly DTS charges are similarly responsive to, and reflective of, incremental load. Incremental MW and MWh volumes result in higher monthly DTS charges which appropriately recover incremental TFO O&M costs associated with incremental standard facilities. There is accordingly no need to recover incremental TFO O&M costs through customer contribution where that incremental O&M relates to standard facilities.

- 1.3 *...the [AUC] does not have any basis at this time to revise its finding in Decision 2005-096 that, on average, \$0.12 of incremental TFO O&M costs will be generated by each \$1.00 of capital investment in an interconnection facility.* (page 106)

As the AESO explained in Information Response AUC.AESO-006:

“[T]he level of the O&M charge should not be a significant factor in considering the effects of the charge within the context of the AESO’s contribution policy. The effects of the O&M charge should be examined on the basis of underlying principles. The level of the charge may then be determined separately at a later date, if necessary.”

Their was no further discussion by the AUC of other effects of the 12% prepaid O&M charge in section 8.3 of Decision 2007-106.

2 Other Effects of the 12% Prepaid O&M Charge

In section 2 of its evidence in this proceeding, the AESO identified other effects in addition to those considered in section 8.3 of Decision 2007-106. Items 2.1 through 2.5 below first quote (in italics) specific text from the AESO's evidence, and then provide additional comments with respect to the quoted text.

- 2.1 *DTS customers who paid contributions prior to January 1, 2006 (that is, prior to the addition of the O&M charge) would pay only the O&M costs recovered through the DTS rate. DTS customers who paid contributions in 2006 and later years (that is, after the addition of the O&M charge) would pay both the O&M costs recovered through the DTS rate and the O&M costs recovered through contributions. The DTS rate is the same for both groups of customers, resulting in intergenerational inequity between those groups. (page 2)*

The AESO provided additional comments on intergenerational equity in Information Response AUC.AESO-003. That response explained:

“As discussed in section 2 of the AESO's evidence in this review and variance proceeding, DTS customers who paid contributions in 2006 and later years would pay both the O&M costs recovered through contributions and the O&M costs recovered through the DTS rate. In effect, those customers would receive an inappropriately inflated cost signal that represents more than the costs being caused by their services.

“DTS customers who paid contributions prior to January 1, 2006, would not receive such an inflated signal.

“Thus, the AESO's primary concern is the inappropriate inflation of the cost causation signal for customers who paid contributions in 2006 and later years. The secondary relevant concern is that this also results in intergenerational inequity.”

- 2.2 *If the AESO's maximum investment level is regularly adjusted such that a consistent proportion of DTS customers is not subject to contributions, the maximum investment level will generally increase to offset project cost increases due to the application of an O&M charge. Such increases will diminish any economic signals sent through the inclusion of the O&M charge in the AESO's contribution policy. (page 2)*

In Information Request AUC.AESO-004, the AUC explored the derivation of an investment function that reflected the effect of the 12% O&M charge on interconnection project costs. The AESO determined that increasing the original multiplier by 12%, to $1.15 \times 112\% = 1.288$, would provide interconnection project cost coverage equivalent to that discussed on page 97 of Decision 2007-106. This is a reasonable outcome, since a 12% increase to project costs (due to the addition of an O&M charge) would be expected to result in a 12% increase to the derived investment function.

As stated in the AESO's evidence quoted above, the 12% increase in maximum investment level would offset the 12% increase to project costs. The increase to maximum investment levels would diminish (if not eliminate) any economic signals sent through the inclusion of the O&M charge. This effect was similarly discussed in section 6.5.2 of the AESO's 2007 GTA, where the AESO concluded that adding an O&M charge would provide very limited economic signals to customers.

The AESO notes that the higher maximum investment levels will address much of the concern respecting inappropriately inflated cost signals discussed in item 1.1 above and intergenerational equity discussed in item 2.1 above. A higher maximum investment level will reduce the contributions paid by customers, and accordingly reduce the O&M costs recovered through contributions. However, a higher maximum investment level will not address the other effects of the 12% prepaid O&M charge discussed in this argument.

The AESO also notes that, in their application, the Applicants stated (page 5):

“The problem of double-charging occurs because the POD cost function is derived from costs that excluded O&M costs. Since the maximum investment levels are derived from the POD cost function, they also currently include no provision for O&M costs.”

Information Response AUC.AESO-004 showed that adding an O&M charge to project costs and then increasing maximum investment levels by an equivalent amount would provide the same project cost coverage and would send the same economic signals as the initial AUC determination in Decision 2007-106. Such an approach would address the concern stated in the quoted section of the review application.

However, while increasing maximum investment levels would provide similar cost coverage and similar economic signals, it would increase the complexity of the determination of an appropriate maximum investment level to be used in the AESO's contribution policy. It would be simpler to not add an O&M charge to project costs in the first place, such that maximum investment levels need not be increased as a result.

The AESO therefore submits that there is no need to increase the AESO's maximum investment level to reflect the effect of the 12% O&M charge. Rather, the O&M charge should not be added to the cost of the standard facilities of a project (which are those costs eligible for investment).

This is consistent with the position of the Applicants stated in their application (page 7):

“An alternative approach is to attempt to correct the problem by adjusting the maximum investment level to recognize prepaid O&M costs. This is more complex and will not produce a more accurate result than simply removing the charge from standard facilities.”

- 2.3 *The AESO's contribution policy will include an O&M charge on all costs, while the contribution policies of distribution facility owners ("DFOs") will not include an O&M charge or will include an O&M charge only on "optional facilities" for load customers.*
(page 2)

The AESO further explored the effects on harmonization of AESO and DFO contribution policies in Information Response AUC.AESO-005, and in particular noted the following:

"[T]he AESO considers that a customer should receive cost signals which encourage the choice of the most economic option for service to that customer, regardless of whether that option involves a transmission or a distribution connection. If the tariffs of the AESO or the DFOs could influence a customer to prefer other than the most economic option, the AESO suggests harmonization of the tariff provisions which cause such unwarranted influence would be worthwhile."

The AESO also noted that "it would be more efficient and expedient to change one tariff (the AESO's) rather than multiple tariffs of several DFOs."

- 2.4 *TFOs would need to modify their accounting processes to properly record the O&M charge as a prepaid expense rather than as a contribution in aid of construction.*
(page 3)

The AESO noted TFO accounting complexity concerns in section 6.5.2 of its 2007 GTA. The AESO further explained in Information Response BR.AESO-013 in that proceeding that TFOs may need to account for the O&M portions of contributions separately and apply them against actual O&M expenses over some appropriate period of time. The TFO processes and practices to account for the O&M charge would need to comply with generally accepted accounting principles (GAAP) as well as be consistent with the assumptions underlying the O&M charge in the AESO's tariff.

- 2.5 *The AESO would need to develop consistent practices to address:*
- *application of the O&M charge to contract terms shorter than 20 years;*
 - *changes to the O&M charge resulting from increases, decreases, and staging of contract capacity; and*
 - *impacts on the O&M charge of sharing of facilities or of reclassification of facilities between system and customer.* (page 3)

The AESO noted tariff practice concerns in section 6.5.2 of its 2007 GTA. As well, Information Response BR.AESO-013 in that proceeding considered that the AESO's DTS rate may need to be adjusted to recover only the net TFO O&M costs, which would reflect the total O&M expenses of all TFOs less the amounts forecast to be recovered from O&M charges paid through contributions.

3 Other Matters Raised in Information Requests

Information Request AUC.AESO-002 (d) asked whether establishing a minimum level for an O&M charge partially mitigated potential "double-charging" that may be caused by applying the O&M charge. The AESO acknowledged that reducing the O&M charge would mitigate, but not eliminate, the effects of the charge. However, the AESO further explained that it seems unreasonable to add a charge in an effort to reflect cost causation and send appropriate price

signals, and then reduce that charge because the signals sent are inappropriate. The AESO submits that a more reasonable approach would be to not add the charge to begin with.

Information Request AUC.AESO-003 suggested that as long as “an O&M charge...is made known to an interconnecting DTS customer prior to making a definitive investment decision, the goal of sending cost causation signals should be considered to be of greater importance” than other considerations. The AESO agreed that sending cost causation signals is of greater importance, but noted that the signals given must reasonably represent the costs being caused, as discussed in item 1.1 above.

4 Costs to Which the O&M Charge Could Apply

In its April 10, 2008 submission on the review and variance application, TransAlta raised the matter of distinguishing between categories of interconnection costs to which the O&M charge could apply.

In section 3 of its evidence in this proceeding, the AESO stated (page 3) that it is appropriate to assess an O&M charge on the cost of facilities in excess of standard, but inappropriate to assess such a charge on the cost of standard facilities whether above or below the AESO’s maximum investment.

At page 2 of their evidence, the Applicants supported a request “specifically to remove O&M charges for that portion of standard facilities covered by the AESO’s investment policy.” However, the Applicants also noted the AESO’s submission that an O&M charge should not apply to any standard facilities whether above or below the AESO’s maximum investment. The Applicants accordingly suggested (page 3) that the matter “may warrant further consideration by the AUC in the context of the present review application.”

The AESO considers that the comments provided in its evidence, as well as the discussion in item 1.2 of this argument, sufficiently examine the matter raised by TransAlta and demonstrate that all costs of standard facilities, whether above or below the AESO’s maximum investment, should not be subject to an O&M charge. Such an approach would address consistency, intergenerational equity, and the other concerns summarized in section 3 of the AESO’s evidence.

At page 6 of their application, the Applicants acknowledged the efficacy of such an approach and stated, “The simplest way for the [AUC] to rectify this inequity is to direct the AESO to charge 12% prepaid O&M expenses on optional facilities only.”

The AESO therefore submits, for the reasons summarized above, that an O&M charge should apply only to the cost of facilities in excess of standard, and should not apply to any costs of standard facilities whether above or below the AESO’s maximum investment.

5 Conclusion

In conclusion, and in consideration of the effects of the 12% prepaid O&M charge in the context of the AESO’s contribution policy as discussed above, the AESO submits that:

- (a) the O&M charge should apply only to the cost of facilities in excess of standard (also referred to as “optional facilities”);

- (b) the O&M charge should not apply to the cost of standard facilities whether below or above the maximum investment level determined for a project. and
- (c) the AESO's maximum investment level should not be modified to account for the effect of the 12% O&M charge on interconnection project costs, but should continue to be determined excluding the O&M charge (as in the currently-approved AESO tariff).

If you need any additional information related to this argument, please contact me at 403-539-2465 in Calgary or by email to john.martin@aeso.ca.

Yours truly,

[original signed by]

John Martin
Director, Tariff Applications

cc: Heidi Kirrmaier, Vice-President, Regulatory, AESO