Alberta Electric System Operator
2012 Construction Contribution Policy
Argument

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Prepared for: Alberta Utilities Commission
Electric Transmission Contribution Policy Proceeding
Application No. 1607193, Proceeding ID No. 1162
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1 Application

1 On June 20, 2012, the Alberta Electric System Operator (AESO) filed the 2012 Construction Contribution Policy Application (Application) with the Alberta Utilities Commission (Commission). The application was submitted in accordance with the scope and schedule established by the Commission in the Electric Transmission Contribution Policy Proceeding initiated in accordance with determinations in Decision 2010-606 on the AESO’s 2010 ISO Tariff Application.

2 The Application develops and describes an approach to establishing the contribution policy for transmission connection projects used to provide system access service to load market participants. More specifically, the Application requests approval of:
   - contribution policy principles,
   - a methodology to determine a point of delivery cost function,
   - a methodology to determine maximum investment levels, and
   - proposed investment levels.

3 The AESO conducted extensive stakeholder consultation during development of the Application. Consultation included distribution of a discussion paper, formation of and meetings with a small working group with broad industry representation, and two general stakeholder consultation meetings. The AESO considers the consultation, especially discussions with the small working group, to be effective and to have improved the thoroughness and overall quality of the Application.

4 As summarized in section 1.4 (pages 7-8, paragraphs 23-25) of the Application, the AESO requests the following:

   (a) approval of the contribution policy principles described in section 3 of the Application as appropriate principles upon which to base the AESO’s contribution policy;

   (b) approval of the methodology used to develop the point of delivery cost function in section 7 of the Application, and approval of the cost function so derived;

   (c) approval of the methodology used to develop maximum investment levels in section 8 of the Application, and approval of the levels so derived as provided in section 9;

   (d) approval of section 8 of the ISO tariff incorporating the proposed maximum investment levels, as provided in Appendix D of the Application, to be effective retroactive to July 1, 2012;

   (e) confirmation that the Application adequately responds to and satisfies the scope of work identified in the Commission’s letter of July 12, 2011; and

   (f) such other relief as the Commission deems appropriate.

5 The process established for the review of the Application included opportunities for information requests and for the submission of intervener evidence. Information requests were received from:
   - the Commission;
   - Enbridge Pipelines (Athabasca) Inc. (ENPIPE); and
   - Office of the Utilities Consumer Advocate (UCA).

6 The AESO responded to the information requests on August 16, 2012. No intervener evidence was submitted.
The AESO provides the following written argument on matters addressed in the Application and raised in information requests. Lack of comment on any specific matter does not necessarily indicate lack of materiality or significance of that matter. In particular, if an information request simply asked for additional information or did not suggest an approach that differed from the AESO’s proposals, that request may not be referenced in this argument. The AESO reserves the right to respond in reply argument to matters raised by other parties which are not addressed in this argument.
2 Contribution Policy Principles

As discussed in section 3 of the Application, the AESO reviewed the contribution policy principles that had been included in its 2010 ISO tariff application, together with those discussed in tariff applications of FortisAlberta and ATCO Electric and in recommendations from AltaLink’s industry consultation process during 2008.

Based on the information reviewed, the AESO established that an optimal contribution policy should address eight principles, with three principles considered primary and the remaining five considered secondary. The AESO submits that an optimal contribution policy:

1. provides effective price signals;
2. maintains intergenerational equity;
3. is based on cost causation;
4. is based on local costs;
5. is robust and sustainable;
6. treats all load market participants equitably;
7. compensates utilities equitably; and
8. is simple, consistent, and transparent.

These contribution policy principles were extensively reviewed and discussed with the contribution policy working group. The AESO considers that a contribution policy that satisfies these eight principles should prove satisfactory when applied to almost all connection projects, although at the same time it is doubtful that any contribution policy will fully satisfy all eight principles in all circumstances.

Several information requests from the Commission further explored the principles proposed by the AESO. In information response AUC-AESO-004, the AESO explained that providing effective price signals and maintaining intergenerational equity have been contribution policy principles for many years and therefore are not in conflict. The AESO also reiterated that none of the primary principles is more important that the others, and that assessment of a contribution policy should reflect “a reasonable balance of objectives” rather than an arithmetical scoring against weighted principles.

In information responses AUC-AESO-006, -008, and -009, the AESO explained that a price signal should not be excessive and should not lead to sacrificing operability and reliability of a market participant’s facilities or process. In information response AUC-AESO-007, the AESO proposed that a direct flow-through of project costs to the construction contribution paid by a market participant would send a direct and clear price signal.

Finally, in information response AUC-AESO-011, the AESO reiterated that judgment must be used when considering different aspects of a contribution policy, to ensure that the outcome represents a reasonable balance of objectives.

The information responses provided by the AESO support the proposed three primary and five secondary principles as a sound basis upon which to establish the contribution policy. Accordingly, the AESO does not propose any revisions to these principles and submits that they should be approved as filed.
3 Possible Investment Mechanisms

In section 4 of the Application, the AESO identified and reviewed seven possible approaches that could be used to determine investment for load connection projects. The term “mechanisms” was adopted to refer to those approaches.

The AESO evaluated the ability of each mechanism to satisfy the contribution policy principles discussed in section 3 of the Application. The assessments were qualitative rather than quantitative in nature, as the AESO considered it was not practical to more precisely weight and numerically analyze the mechanisms. Nevertheless, the qualitative assessments provide useful comparative information about each of the mechanisms.

The evaluation indicated that the investment coverage and average cost multiplier mechanisms provide the strongest support for the greatest number of principles. Of those two mechanisms, the average cost multiplier provides somewhat stronger support. The AESO accordingly focused on the average cost multiplier for the balance of the Application. However, the investment coverage mechanism also provided useful insight into the selection of a specific multiplier.

The AESO provided additional detail on the assessment of possible investment mechanisms in information response AUC-AESO-014. In information response AUC-AESO-015, the AESO explained that investment mechanisms exist in a broader context of legislation and policy in the jurisdictions in which they are applied, and should not be assessed simply based on their frequency of use. Although the most common investment mechanism in other jurisdictions may be the zero investment approach, it has little in common with prior and existing investment mechanisms applied to transmission connections for loads in Alberta. The AESO’s focus on the average cost multiplier mechanism is more consistent with the prior and existing approach used in Alberta, which provides investment up to a calculated maximum investment level.

The AESO submits that its evaluation of possible investment mechanisms supports the continuation of a maximum investment level approach using an average cost multiplier.
4 Contributions Between Regulated Utilities

In the Application, the AESO provided discussion of and rationale for maintaining the current practice of requiring distribution system owners to pay construction contributions to transmission facility owners.

Based on recent tariff applications and filings, the AESO estimated that transmission facility owners held $501.5 million of construction contributions from market participants. In information response AUC-AESO-012, the AESO estimated that $330.2 million of those contributions were paid by distribution system owners for system access service to multiple end-use consumers. As the AESO noted in the Application (section 5.1, page 24, paragraph 118), the magnitude of the total contributions held by transmission facility owners illustrates the importance of a well-designed contribution policy.

In information response AUC-AESO-013, the AESO estimated there would have been about $100 million less construction contributions currently held by transmission facility owners if the proposed investment coverage had been in place since January 1, 2010.

In section 5.2 of the Application, the AESO included a comparison of requiring and not requiring such contributions between utilities, assessed against the proposed contribution policy principles. The AESO noted that a concept of no contributions between utilities failed to support three contribution policy principles, including two primary principles of providing effective price signals and being based on cost causation. Maintaining the current practice of requiring contribution between utilities provided strong support for two primary principles and partial support for the third, as well as support for several secondary principles.

In section 5.3 of the Application, the AESO assessed the impact on other market participants of requiring contributions between regulated utilities. The AESO concluded (page 27, paragraph 132) that changing from the existing practice of requiring distribution system owners to pay contributions, to one of not requiring contributions from distribution system owners, would introduce inequitable treatment of load market participants which would then require significant mitigation of the resulting issues and impacts.

In information response AUC-AESO-016, the AESO explained that providing investment for, on average, 70% of connection project costs (as proposed in the Application) would reduce the contributions from distribution system owners to the remaining 30% of project costs. The reasons provided in the Application support continuing the practice or distribution system owners paying construction contributions, especially at this reasonable level.
5 Connection Project Data

Consistent with the principle of basing a contribution policy on cost causation, the AESO utilized actual connection project data in the analysis performed for the Application.

5.1 Project Data

The AESO expanded and updated the 2010 study database which had included data on 64 greenfield projects. For the analysis in this Application, final project costs and updated cost estimates for connection projects were compiled to include 23 additional greenfield load-only projects.

The AESO refined the 2012 analysis by introducing the concept of "maximum DTS", which is the DTS contract level that reflect a project's final or maximum capability when contract levels vary over time (usually referred to as "staged" contract levels). The maximum DTS level represents the largest capacity that a connection project has been configured and designed to serve, and is only associated with greenfield projects.

In addition, the AESO added several data fields and included project data for 128 upgrade projects as part of the 2012 analysis.

In information response AUC-AESO-021, the AESO provided details of the differences between the greenfield project data in its 2010 analysis and the greenfield project data in this 2012 analysis.

5.2 Factors Resulting in Contribution Being Paid

The AESO noted that significant variability in project costs exists in the database, results from many factors including radial line requirements, transmission voltage level, substation configuration, varying geography and construction conditions, and overall project complexity.

In addition to these general factors that give rise to connection project cost variability, the AESO examined factors that resulted in "outliers" — those projects that exhibited the largest differences from average costs. The investigation revealed that each of the outlier greenfield projects involved at least one of the following factors:

- Geographic location can add significant costs to a connection project, especially if a project requires long distances of transmission line.
- Building in advance of bulk system expansion can add significantly to project costs, although some of the facilities built may later be converted to system facilities (with an associated contribution refund).

Both geographic location and building in advance of bulk system expansion were the most frequently observed factors contributing to the high cost of outlier greenfield projects. The following factors were less frequently observed, but still can add significant costs to a connection project:

- Delays in regulatory approvals or due to other unforeseen circumstances can increase costs by, for example, changing the season of construction or causing demobilization and re-mobilization of construction.
- Recently-implemented requirements for participant involvement and additional consultation have added to project costs and timelines.
- Requirements to unexpectedly outsource construction to maintain schedules under abnormal or exceptional circumstances can add to connection project costs, especially during constrained labour market conditions.
- High distributed and indirect costs have contributed to higher costs for more-recent projects.
- Changes in functionality or reliability standards over time can impact connection project costs.
For upgrade projects, outliers always involved the addition of a transformer to a substation. As well, each of the outlier upgrade projects involved a contract capacity increase of 5 MW or less. This produced high per MW costs for the upgrades, which also provided little investment and resulted in relatively large construction contributions. Upgrade project outliers also occurred at substations older than 20 years, suggesting that it may be more expensive to accommodate additional or replacement transformers at older substations.
6 Determination of Cost Function

In section 7 of the Application, using the updated and expanded project database of greenfield and upgrade projects, the AESO developed a point of delivery cost function to represent the average cost of connection projects with two enhancements:

- a revised and simplified inflation factor, and
- incorporation of upgrade projects into the cost function.

6.1 Inflation Index

The AESO made several small modifications to the inflation index used to escalate original project costs to more current cost levels.

The first modification extended the index by a year to recognize that the majority of material and construction costs for a connection project are typically incurred by a transmission facility owner 6 to 18 months prior to the in-service date of the project.

The second modification simplified the composite inflation index to use the EUCPI Transmission and Alberta AHE (correctly referenced in information response AUC-AESO-019) Statistics Canada indices, weighted in proportion to the equipment and labour costs for connection projects in the project database.

The AESO provided further information on the inflation index in information responses AUC-AESO-018, AUC-AESO-019 and AUC-AESO-020.

6.2 Incorporation of Upgrade Projects

The development of the cost function in the Application incorporated upgrade projects, which differed from the development using greenfield projects only in previous applications. The dataset for the proposed cost function includes a combined total of 215 connection projects and is illustrated in Figure 7-6 from the Application.

Figure 7-6 Cost Function Developed From Combined Greenfield and Upgrade Projects

Note: Five data points are outside the bounds of this chart. For all data points, please see Appendix B.
The AESO considers the inclusion of upgrade projects in the cost function development to be reasonable and representative of connection project costs. The resulting cost function will provide moderately more investment for upgrade projects than a greenfield-only cost function, but should not provide greater investment that might dampen the price signal that prompts market participants to consider future capacity requirements.

As explained in information response AUC-AESO-023, incorporating upgrade projects in the cost function development has the following advantages.

1. it improves the price signal provided to upgrade projects;
2. it better reflects cost causation of all connection projects; and
3. it improves the equitable treatment of all load market participants.

The AESO provided further information on the inclusion of upgrade projects in the cost function development in information responses AUC-AESO-022 and AUC-AESO-025.

6.3 Proposed Cost Function

The final cost function based on power curve regression on the 215 data points included in the analysis is:

\[ \text{Average Cost} = 1,976,700 \times \text{MW}^{0.5810} \]

The AESO submits that this proposed cost function provides an appropriate basis upon which to base the investment levels in the Application.
7 Recommended Investment Levels

As discussed in section 8 of the Application, and based on conclusions in section 4 of the Application, the AESO continues to support the use of a multiplier in order to establish maximum investment levels. The AESO considers that a forward-looking contribution policy provides the most appropriate foundation for establishing investment levels, and proposes to use only recent projects to establish a multiplier for setting maximum investment levels.

The AESO examined the impact of various multipliers on investment that would be provided to 68 recent greenfield and upgrade projects. The AESO concluded that investment coverage from 64% to 76% represents a reasonable target range for transmission investment levels. From its analysis, the AESO noted that most of the variable considered have reasonable levels within that range of investment coverage:

- 40% to 50% of projects are fully covered by investment, while 50% to 60% of market participants are required to pay a contribution;
- 64% to 76% of aggregate project costs are covered by investment, while 24% to 36% of project costs are paid by contribution; and
- potential unused investment is limited to 8% to 20% of aggregate project costs.

Within this range of reasonable investment coverage, the AESO proposes that the midpoint of 70% be established as the target investment coverage for transmission maximum investment levels. That target investment coverage is achieved with a multiplier of 1.33 applied to the average cost function to establish investment levels. With a 1.33 multiplier, there is reasonable investment coverage and potential unused investment is limited to 13% of aggregate project costs. A 1.33 multiplier results in 46% of projects with costs fully covered by investment (and therefore with some amount of potential unused investment available) and 54% of projects requiring a contribution to be paid.

Statistics for the proposed multiplier of 1.33 were summarized in Table 8-8 of the Application, reproduced below.

<table>
<thead>
<tr>
<th>Description</th>
<th>Number of Projects</th>
<th>Dollars %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upgrade Projects (42)</td>
<td>20</td>
<td>48%</td>
</tr>
<tr>
<td>Greenfield Projects (26)</td>
<td>11</td>
<td>42%</td>
</tr>
<tr>
<td>Total Projects (68)</td>
<td>31</td>
<td>46%</td>
</tr>
<tr>
<td>Coverage at 2011 Investment Levels</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Increase Over 2011 Levels</td>
<td>210%</td>
<td>210%</td>
</tr>
<tr>
<td>Projects With Unused Investment</td>
<td>31</td>
<td>46%</td>
</tr>
<tr>
<td>Projects With ≥$5 Million Unused Investment</td>
<td>6</td>
<td>9%</td>
</tr>
</tbody>
</table>

The AESO submits that the proposed 70% investment coverage satisfies the primary contribution policy principles of providing effective price signals, maintaining intergenerational equity, and being based on cost causation. In particular, the AESO considers that the proposed investment levels address the concerns of unused investment, while considering investment coverage levels used historically. The proposed 70% investment coverage will also support four of the five secondary contribution policy principles.

Several information requests asked for additional information on the AESO’s recommended investment coverage. In information response AUC-AESO-026, the AESO explained that it is important to use recent
projects to develop investment levels to ensure the contribution policy accommodates changes to the service characteristics, functionality, and standards that apply to system access service, as those characteristics, functionality, and standards change over time. The approach of using recent project costs to establish investment levels should result in a contribution policy that reflects the costs of projects to which the investment levels would apply.

52 In information response AUC-AESO-030, the AESO explained that the selection of 70% as a target investment coverage represents a reasonable balance of satisfying, to the greatest extent possible, all the contribution policy principles proposed in the Application. In particular, a significantly lower investment coverage level would fail to reasonably satisfy the contribution policy principles of providing effective price signals, maintaining intergenerational equity, being robust and sustainable, and compensating utilities equitably.

The cost function recommended by the AESO and the 1.33 multiplier result in the investment levels provided in Table 9-1 of the Application, reproduced below.

Table 9-1 Proposed and Current Investment Levels

<table>
<thead>
<tr>
<th>Tier</th>
<th>Rate DTS Investment</th>
<th>PSC Factor</th>
<th>Rate PSC Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012 Proposed Maximum Investment Levels</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Substation fraction (for new points of delivery only)</td>
<td>$29 250/year</td>
<td>21%</td>
<td>$6 140/year</td>
</tr>
<tr>
<td>First (7.5 × substation fraction) MW of contract capacity</td>
<td>$52 600/MW/year</td>
<td>21%</td>
<td>$11 045/MW/year</td>
</tr>
<tr>
<td>Next (9.5 × substation fraction) MW of contract capacity</td>
<td>$27 150/MW/year</td>
<td>21%</td>
<td>$5 700/MW/year</td>
</tr>
<tr>
<td>Next (23 × substation fraction) MW of contract capacity</td>
<td>$19 100/MW/year</td>
<td>21%</td>
<td>$4 010/MW/year</td>
</tr>
<tr>
<td>All remaining MW of contract capacity</td>
<td>$12 450/MW/year</td>
<td>0%</td>
<td>$0/MW/year</td>
</tr>
<tr>
<td>2011 Approved Maximum Investment Levels</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Substation fraction (for new points of delivery only)</td>
<td>$50 050/year</td>
<td>21%</td>
<td>$10 510/year</td>
</tr>
<tr>
<td>First (7.5 × substation fraction) MW of contract capacity</td>
<td>$34 000/MW/year</td>
<td>21%</td>
<td>$7 140/MW/year</td>
</tr>
<tr>
<td>Next (9.5 × substation fraction) MW of contract capacity</td>
<td>$12 550/MW/year</td>
<td>21%</td>
<td>$2 635/MW/year</td>
</tr>
<tr>
<td>Next (23 × substation fraction) MW of contract capacity</td>
<td>$7 600/MW/year</td>
<td>21%</td>
<td>$1 595/MW/year</td>
</tr>
<tr>
<td>All remaining MW of contract capacity</td>
<td>$4 100/MW/year</td>
<td>0%</td>
<td>$0/MW/year</td>
</tr>
</tbody>
</table>

54 Investment tiers have remained the same as in the current tariff as they appropriately represent economies of scale in the point of delivery cost function. These investment levels were incorporated into section 8 of the ISO tariff, which was included as Appendix D of the Application.

55 The AESO continues to recommend these investment levels be approved as filed.
8 Impacts of Changes in Contribution Policies on Market Participants

As explained in section 10 of the Application, a change in contribution policy:
- may affect the amount of contribution a market participant must pay for a connection project; and
- may also affect the average rates paid for system access service by all market participants.

With respect to the impact on a market participant connecting to the transmission system, changes to a contribution policy:
- may have a direct financial impact on a market participant;
- will not affect the number or size of system access service requests; and
- may result in questions, arguments, dissatisfaction, and complaints expressed by market participants.

The AESO believes that the changes to investment levels proposed in the Application will alleviate many of these concerns. In particular, the AESO notes that the proposed investment levels will reduce the number of projects for which contributions must be paid, and will also significantly reduce the size of contributions when they are required.

With respect to the impact on all market participants, investment in new and expanding services increases the rate bases of transmission facility owners, compared to the rate base that would exist without such investment. Although the AESO is proposing investment levels that are expected to result in a 64% increase in transmission facility owner investment in new and expanding services, the impact on transmission charges under Rate DTS is expected to be small and gradual.

The AESO estimates that the cumulative impact of increased investment at the recommended coverage over 10 years is about a $1.36/MWh increase in point of delivery charges under Rate DTS. (The increase is presented as a $/MWh amount for comparability to other discussions of average rate increases such as in the AESO 2011 long-term plan; actual point of delivery amounts under Rate DTS will continue to be charged on a $/MW basis as approved in the ISO tariff.)

For comparison, the AESO’s currently-approved Rate DTS is equivalent to an average rate of $22/MWh, of which about $5/MW is attributable to the point of delivery charge. The $1.36/MWh increase estimated with the proposed investment levels therefore represents an increase of about 6% in Rate DTS over a 10-year period.

In addition, changes to the cost function may also impact rates, regardless of whether the actual amount of investment recovered through rates changes.

In 2006, the AESO aligned the construction contribution cost function with the rates cost function. In the AESO’s subsequent 2007 and 2010 comprehensive tariff applications, the base cost functions provided the cost causation basis for both investment and the point of delivery charge in Rate DTS. Assuming such alignment will continue, revisions to the cost function as proposed in the Application may affect the average rates paid for system access service when that cost function is incorporated into the AESO determination of Rate DTS in its next comprehensive tariff application.

Although the AESO provided information on potential rate impacts that will result from a change to the cost function, the AESO is not requesting any change to its rates at this time. The AESO anticipates that the use of an updated cost function for rate design purposes will be examined in the comprehensive tariff application it will file in March 2013, in accordance with directions included in Decision 2010-606 on the AESO’s 2010 ISO tariff application.
In information response AUC-AESO-031, the AESO noted that having the same cost causation basis does not mean the identical cost function must be used at all times for both the maximum investment levels and the design of the point of delivery charge in Rate DTS. In particular, the AESO notes that a construction contribution is paid for a service at a point in time and is not subject to later change, while Rate DTS charges for that service will be paid for many subsequent years and will be subject to changes reflecting revisions and updates to the cost function.

The AESO continues to support the changes in the cost function for contribution policy purposes outside of a proceeding where the rate design impact of the cost function will be tested.
9 Implementation

In section n11 of the Application, the AESO requests that the proposed investment levels be approved to be effective retroactive to July 1, 2012. The AESO maintains that retroactive implementation of the 2012 investment levels to July 1, 2012 would avoid the potential for delays and inefficiencies that could result from a later implementation.

In information responses ENPIPE-AESO-001 and ENPIPE-AESO-002, the AESO calculated the investment available to example projects assuming different project permit and license dates and different investment level implementation dates. However, the AESO does not propose that the recommended investment levels be retroactively applied to re-calculate contributions prior to July 1, 2012. Those contributions were determined under previously-approved policies, which were based on the best information available at the time of those Commission approvals. The AESO considers that market participants made project decisions based on the prior contribution policies that applied to their projects at the time those decisions were made.

The AESO considers that an effective date that is retroactive to shortly after the filing of the Application is a reasonable approach in the current circumstances. The filing of the Application provided a clear price signal to market participants, who could then make project decisions based on the extensive information included in the Application.

At the same time, the retroactive implementation maintains intergenerational equity and provides a cost causation basis earlier than waiting for the regulatory process to complete. All load market participants are treated equitably by establishing a clear and firm date, and such a date provides simplicity, transparency, and consistency for the administration of the AESO’s tariff.

In information response UCA-AESO-001, the AESO discussed the potential for market participants to delay projects until the 2012 construction contribution policy proceeding has concluded. The AESO considered that project delays are not common, but are problematic and create inefficiencies when they do occur.

The AESO considers that the cost function for contribution policy purposes should be updated without waiting for the AESO’s next tariff application to:

- ensure the contribution policy is based on the best information currently available, and
- incorporate upgrade projects into the cost function, which the AESO considers to result in a cost function that better reflects cost causation for all connection projects.

The AESO considers the limited risk of further changes to the cost function in the AESO’s next tariff application is outweighed by the advantages of implementing the proposed refinements to the cost function, especially given the comparability to the time period between cost function changes in the recent past.

The AESO accordingly submits that the proposed investment levels should be approved to be retroactive to July 1, 2012, as proposed in the Application.
10 Conclusion

The AESO submits that no substantive matter has been raised in information requests that require correction or revision to the proposals included in the AESO’s 2012 Construction Contribution Policy Application.

Having consideration for all the foregoing, the AESO submits that its Application should be approved as filed, and that the relief requested in section 1.4 (pages 7-8) of the Application should be granted in full.