Alberta Electric System Operator

2010-2011 Deferral Account Reconciliation

February 7, 2013
The Alberta Utilities Commission
Decision 2013-034: Alberta Electric System Operator
2010-2011 Deferral Account Reconciliation
Application No. 1608444
Proceeding ID No. 1878

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1 Background

1. The Alberta Electric System Operator (AESO) filed an application (application) with the Alberta Utilities Commission (AUC or Commission) on May 11, 2012 to reconcile its deferral accounts for the years 2010 and 2011.

2. In the application, the AESO requested the Commission’s approval of:

   (a) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31 2011

   (b) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2010

   (c) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2009 (second reconciliation)

   (d) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2008 (third reconciliation)

   (e) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2007 (fourth reconciliation)

   (f) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2006 (fourth reconciliation)

   (g) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2005 (fourth reconciliation)

   (h) the AESO’s deferral account balance reconciliation calculations for the period January 1 to December 31, 2004 (fourth reconciliation)

   (i) the AESO’s methodology of allocating deferral account balances to market participants as presented in Section 11 and appendices F through J of the application, for purposes of recovering and refunding outstanding variance amounts from and to market participants receiving system access service under Rate DTS, Rate FTS, or Rate STS of the AESO tariff

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1 Rate DTS: demand transmission service, Rate FTS: Fort Nelson demand transmission service, and Rate STS: supply transmission service.
(j) collection and refund of amounts through the use of a one-time payment/collection option similar to that used for previous years’ deferral account balances

(k) collection and refund of the market participant amounts included in the application as soon as practical on an interim refundable basis, with such amounts subject to adjustment in final approvals following a full regulatory review

(l) the continuation of annual retrospective reconciliations of adjustments to losses relating to years prior to 2006 (notwithstanding the implementation of prospective Rider E for losses in 2006 and later years)

(m) such further and other relief as the Commission may prescribe

3. The AESO stated that the application incorporated all costs paid and revenues collected by the AESO that:

- have not been settled in prior deferral account reconciliation filings
- relate to 2011 or prior years for all costs except those related to losses and to provision of a wind forecasting service, and to 2005 and prior years for costs related to losses
- were accounted for up to December 31, 2011

4. Notice of the application was issued on May 14, 2012. Any party who wished to intervene in this proceeding was requested to submit a statement of intent to participate (SIP) to the Commission by the participation closing deadline of 2 p.m., May 29, 2012. SIPs were filed in response to the notice by the Consumers’ Coalition of Alberta (CCA), EPCOR Distribution & Transmission Inc. (EDTI), AltaLink Management Ltd. (AML), and ATCO Electric Ltd. (AE).

5. The application provided the determination and allocation of a $1.6 million net deferral account shortfall, and included a request for approval of an interim settlement of the deferral account amounts included in the application. The AESO noted that its proposed settlement with customers would be interim and refundable, and subject to adjustment in the Commission’s final decision in respect of the application. The AESO also noted that it was aware of Commission Bulletin 2012-03 which set out the Commission’s approach to the request from the Alberta Minister of Energy to maintain electricity rates. The AESO stated that if interim approval would be delayed in accordance with Bulletin 2012-03 such that final approval would follow shortly thereafter, it may be appropriate to pass over interim approval in favour of proceeding directly to final approval.

6. On June 4, 2012, the Commission directed that an interim settlement would not be approved and established an initial written process to consider the application. In the June 4, 2012, letter the Commission requested that interveners indicate by June 29, 2012 their intentions to file intervener evidence:

7. No interveners indicated an intention to file evidence and therefore the Commission set out a final schedule for written argument and reply argument in correspondence dated July 3, 2012. Argument was filed by the CCA and the AESO on July 17, 2010. Reply argument was filed by the CCA and the AESO on or before July 31, 2012.

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8. The Commission considers the close of record for the application to be July 31, 2012.

2 Methodology and cost/revenue data included in the application

9. In Section 2 of the application, the AESO noted that the reconciliation processes used for the preparation of the application reflected prior Commission decisions and conclusions arising from extensive stakeholder consultations related to the AESO’s prior deferral account reconciliation application. The AESO also noted that it continued to use a software program to automate deferral account reconciliation calculations and that the reconciliation processes used for the application were the same as used for the AESO’s 2008 and 2009 deferral account reconciliation application.

10. In Section 2.1 of the application, the AESO stated that, in addition to amounts settled in prior deferral account reconciliations for 2004 through 2009, the application incorporated all costs paid and revenues collected by the AESO that:
   - have not been settled in prior AESO deferral account reconciliations
   - relate to 2011 or prior years for all costs except costs related to losses and to provision of a wind forecasting service, and to 2005 and prior years for costs related to losses
   - were accounted for up to December 31, 2011

11. More specifically, the AESO provided details on the inclusion of cost and revenue data and data start and cutoff dates for:
   - the first reconciliations of deferral accounts for 2011 and 2010
   - a second reconciliation of deferral accounts for 2009
   - a third reconciliation of deferral accounts for 2008
   - fourth reconciliations of deferral accounts for 2007, 2006, 2005 and 2004

12. The AESO highlighted significant prior period adjustments in Section 2.1.1 of the application. In Section 2.1.2, the AESO discussed forfeited refunds of generating unit owners’ contributions. Generating unit owners’ contributions are held and administered by the AESO to reduce the working capital that the AESO would otherwise require and therefore reduces the interest expense included in the revenue requirement recovered through rates DTS and FTS. The AESO provided additional detail on the treatment of transmission system losses in Section 2.1.3. In Decision 2011-275, the Commission approved the AESO’s Rider J (wind forecasting service cost recovery) which recovers from wind-power generating units the costs paid by the AESO for provision of a wind forecasting service. In Section 2.1.4, the AESO noted that costs paid by the AESO in 2010 and 2011 related to the wind forecasting service are recovered by the AESO through Rider J and are not subject to retrospective deferral account reconciliation. In Section 2.1.5, the AESO noted that any adjustments related to 2011 or prior years which occurred after December 31, 2011, that were not included in the application, would instead be included in a future deferral account reconciliation application.

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13. The AESO discussed its general use and presentation of data on a “production month” rather than an “accounting month” basis in Section 2.2 of the application. For the years 2004 to 2011, the AESO noted that all costs were presented on a production month basis, with the exception of AESO “own cost” and Rider C amounts, which were presented on an accounting month basis. The AESO summarized its use of production or accounting based presentations of data for each year from 2004 to 2011 in Table 2-2 of the application.

Commission findings

14. The Commission finds that the methodology and data assumptions used by the AESO are consistent with past reconciliations for 2008 and 2009 and as approved in Decision 2009-191\(^4\) and Decision 2011-049.\(^5\) The Commission approves the methodology and data assumptions described in Section 2 of the application as filed.

3 AESO budget process

15. In argument, the CCA expressed concerns with the AESO’s budgeting processes based on its examination of 2011 results for:

- staff and benefit costs
- contract services and consultant costs
- certain capital projects

16. The CCA submitted that “approval by the Board of Directors of significant salary increases outside of the budget process tends to compromise the effectiveness and integrity of the budget process.”\(^6\) On the basis of its assessment of the AESO’s 2011 staff and benefit costs, the CCA recommended that the AESO be directed to institute changes to the budget process as may be necessary to ensure that upcoming budgets are reasonably accurate with respect to staff and benefit costs and address such changes at the time of the next deferral accounts proceeding.

17. The CCA expressed further concern that the AESO had not adequately explained a cost variance arising from an unanticipated change in its eligibility to claim certain types of consultant costs through the Commission’s costs claim process. The CCA submitted that “significant expenditures of this magnitude (8.3%), approved on an ad hoc basis by the Board of Directors, does not inspire a great deal of confidence in the integrity of the budget and fiscal management process.”\(^7\) In addition, the CCA submitted that the AESO had not adequately explained the types of costs incurred under the “other” category of contract services and consultant costs. In light of these concerns, the CCA submitted that the AESO should be directed to institute changes as may be necessary to its budget process to improve the accuracy of upcoming budgets for contract services and consulting costs and to address such changes at the time of the next deferral accounts proceeding.

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\(^6\) Exhibit 68.01, CCA argument, paragraph 10.  
\(^7\) Exhibit 68.01, CCA argument, paragraph 23.
18. With respect to capital projects, the CCA expressed concern that a change in the scope of the network upgrade project had caused a variance in the amount of $2.3 million. The CCA also expressed concern that a variance of this magnitude had been approved by management rather than by the board of directors. In future, the CCA recommended that significant scope changes should be subject to board of directors’ approval.

19. The AESO submitted that despite its best efforts, budgets and forecast costs occasionally do not fully accommodate the actual costs needed to accomplish its established business priorities and plans and to continue to meet the AESO’s legislated mandate. At such times, the AESO has controls and procedures in place to determine appropriate actions, which may include approving additional expenditures to accomplish specific business priorities to meet its mandate, or conversely reducing the scope of other business priorities to remain within budget. The AESO stated that its budget review process includes an agreed-upon practice when estimated costs are expected to exceed budgeted amounts. Variances up to 10 per cent above budgeted general and administrative expenditures and up to 20 per cent above budgeted general capital expenditures may be approved by the AESO board and subsequently communicated to stakeholders. Variances above those thresholds are reviewed with stakeholders in advance of a request for AESO board approval.

20. In addition to the above, the AESO explained that it also has the following controls and processes in place to manage its budget:

- Risk management control processes.
- Its business is conducted in accordance with bylaws established by the AESO under Section 10 of the Electric Utilities Act, SA 2003, c. E-5.1.
- The AESO management actively manages the organization’s financial affairs on a timely basis, including convening on a monthly basis to review the AESO’s monthly financial results, the status of corporate goal achievement, and key human resource statistics. The monthly financial review includes a comparison of actual costs to budget amounts with analysis of material variances for general and administrative costs, losses costs, ancillary services costs, and capital, in addition to a comparison of actual costs to budget amounts by department for general and administrative costs.
- The AESO prepares updated financial forecasts of costs for the current year, quarterly reports are provided to stakeholders along with updates on the status of the AESO’s corporate priorities, which both provide transparency of the AESO’s on-going operations.

21. In reply argument, the AESO submitted the following table which shows that over the eight years included in the application, the AESO’s transmission general and administrative costs have been only 1.1 per cent above budget, in aggregate. The AESO submitted that variances of recorded costs from forecast continue to reflect the difficulty of accurately forecasting the AESO’s costs, given the complex nature of the AESO’s activities and the various adjustments to the AESO’s priorities and changes to its mandate that have occurred over the past eight years.

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8 Exhibit 71.01, AESO reply argument, Section 2.1.
9 Exhibit 71.01, AESO reply argument, paragraph 20 and Table 2-1.
Table 1. Forecast and recorded transmission general and administrative costs, 2004 to 2011

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>($ million)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Approved forecast</td>
<td>68.50</td>
<td>66.00</td>
<td>61.40</td>
<td>51.70</td>
<td>41.30</td>
<td>32.20</td>
<td>29.20</td>
<td>24.70</td>
<td>375.00</td>
</tr>
<tr>
<td>Recorded costs</td>
<td>76.8</td>
<td>60.7</td>
<td>58.2</td>
<td>51.3</td>
<td>44.3</td>
<td>31.4</td>
<td>30.3</td>
<td>26.3</td>
<td>379.30</td>
</tr>
<tr>
<td>Over (under), $</td>
<td>8.30</td>
<td>(5.40)</td>
<td>(3.20)</td>
<td>(0.40)</td>
<td>3.00</td>
<td>(0.80)</td>
<td>1.10</td>
<td>1.60</td>
<td>4.30</td>
</tr>
<tr>
<td>Over (under), %</td>
<td>12.10%</td>
<td>-8.10%</td>
<td>-5.30%</td>
<td>-0.70%</td>
<td>7.20%</td>
<td>-2.40%</td>
<td>3.80%</td>
<td>6.40%</td>
<td>1.10%</td>
</tr>
</tbody>
</table>

22. The AESO submitted that Table 1 above demonstrates that on an aggregate basis over the past eight years, its forecasts of general and administrative costs have remained close to actual costs. The AESO also noted that its general and administrative costs have varied both below and above forecast in individual years, indicating the absence of systemic bias in the AESO’s budget process.

23. In reply argument, the AESO noted that its budget review and approval process was initially developed in consultation with stakeholders in 2005 and 2006 and that the AESO has continued to work with stakeholders since then to refine and improve the process in accordance with practices established under sections 2 and 3 of the Transmission Regulation, AR 86/2007. The AESO submitted that its budgets and forecast costs are developed with input from stakeholders to support the AESO’s business priorities and plans and noted that the CCA had not formally participated in the budget review process to date and had never submitted comments on any of the material posted during the budget review processes conducted by the AESO for 2011 or any prior year.

24. The AESO stated that it considered that the structure and approach described above provides an appropriate process to establish and manage the AESO’s budget and submitted that the CCA’s recommendations for changes to its budget processes should be rejected.

Commission findings

25. While the CCA identified variances between budgeted 2011 AESO expenditures and final amounts as the basis for suggesting changes to the AESO budget process, the Commission notes the AESO’s statement that general and administrative costs have been only 1.1 per cent above budget, in aggregate over the eight years that are the subject of this proceeding. In addition the Commission accepts the AESO’s submission that the CCA has not actively participated in the AESO’s budget review process. The Commission is satisfied that the AESO has its own budget review process that is open and transparent and provides an opportunity for stakeholders to provide input. Further, as the purpose of this proceeding is to reconcile the AESO’s deferral accounts, the Commission finds that this proceeding is not the correct venue for the CCA to voice concerns regarding the AESO’s budget process.

26. However, the Commission finds that it is within the ambit of a reconciliation of AESO deferral accounts to assess the prudence of final AESO expenditures. Therefore, the Commission has considered specific line item variances identified in the CCA’s argument in separate sections below in this decision.
4 Cost and revenue variances and deferral account balances

27. The AESO identified a net shortfall of approximately $1.6 million (net of Rider C charges and refunds and any prior deferral account reconciliation settlements) to be allocated to customers, comprised of the following annual amounts:

- a surplus of $13.0 million for 2011
- a shortfall of $16.6 million for 2010
- a shortfall of $12.6 million for 2009
- a surplus of $10.0 million for 2008
- a surplus of $4.1 million for 2007
- a surplus of $0.3 million for 2006
- a surplus of $0.3 million for 2005
- a shortfall of $0.1 million for 2004

28. The cost variances for the year 2011 and the period of 2004 to 2010 are discussed in the following sections.

4.1 2011 cost variances

29. The AESO set out its 2011 financial results in Section 3 of the application and 2011 cost variances from the AESO’s approved revenue requirement for 2011 in Section 3.1. As presented in Table 3-1 of the application, the AESO recorded total costs for 2011 of $277.7 million, or 29 per cent higher than the total 2011 approved revenue requirement.\(^\text{10}\)

30. The AESO explained, in Section 2.4 (pages 19-22) of the application, that it considered the application and related proceeding to be the proper venue for the consideration of the prudence of AESO costs incurred with respect to 2011.

31. In argument, the AESO noted that information requests asked for additional information about forecast and actual costs and resulting variances for staffing related costs, contract services and consultant costs and capital costs. The AESO submitted that responses to those information requests revealed no errors or imprudence with respect to those costs in the application, and that no corrections were required as a result of the additional information provided. Accordingly, the AESO submitted that recorded costs included in the application should be approved as filed.

4.1.1 Staff and benefit costs

32. In its application, the AESO explained that the variance in staff and benefit costs reflected the filling of vacant positions and the cost of additional staff in transmission project delivery and transmission operations. The AESO submitted that the additional positions enabled it to deliver an increased number of connection projects during 2011. The AESO also indicated that a portion of the variance reflected the effect of salary increases resulting from end-of-year assessments and the impact of market conditions.

\(^\text{10}\) The AESO provided explanations for significant line item variances shown in Table 3-1. AESO defined significant as line items that were $\pm$7.0 million, which represented approximately 10 per cent of the $65.8 million general and administrative costs component of the AESO’s 2011 revenue requirement as well as line items that were both at least $\pm$0.7 million and at least $\pm$10 per cent of the approved line item amount.
33. For 2011, the AESO recorded staff and benefits costs totaling $39.3 million, representing a variance of $5.4 million compared to the 2011 approved forecast of $33.9 million. In CCA-AESO-01, the AESO provided the following breakdown of the staff and benefit cost variance.

Table 2. 2011 staff and benefits variance breakdown

<table>
<thead>
<tr>
<th>Description</th>
<th>Forecast</th>
<th>Actual</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff positions (FTEs)</td>
<td>353</td>
<td>353</td>
<td></td>
</tr>
<tr>
<td>Vacancy rate</td>
<td>8%</td>
<td>4%</td>
<td>Lower vacancy rate</td>
</tr>
<tr>
<td>Salaries</td>
<td>24.6</td>
<td>28.6</td>
<td>Reflecting lower vacancy rate and increases to maintain competitive salaries</td>
</tr>
<tr>
<td>Benefits</td>
<td>5.2</td>
<td>5.9</td>
<td>Reflecting lower vacancy rate and increases to maintain competitive benefits</td>
</tr>
<tr>
<td>Incentives</td>
<td>4</td>
<td>4.7</td>
<td>Reflecting lower vacancy rate and end-of-year performance assessments</td>
</tr>
</tbody>
</table>

34. In argument, the CCA submitted that it was concerned with both the magnitude of the 2011 staff and benefit cost variances reported and with the adequacy of the AESO’s explanations for the variances relative to budget. After taking into account the impact of the reduced vacancy rate as compared to the budgeted vacancy rate, the CCA suggested that the AESO’s figures indicate that salary increases had caused 11.4 per cent of the overall 15.9 per cent increase in total staff and benefit costs. Given that the AESO’s 2011 budget had already reflected an increase over 2010 actuals of 3.99 per cent, the CCA submitted that the AESO board of directors’ apparent approval of a significant salary increase outside the budget process tends to compromise the effectiveness and integrity of the AESO’s budget process.

35. The CCA also suggested that the halving of the vacancy rate from a budgeted eight per cent to an actual four per cent is also questionable in the absence of any demonstration of the accountability steps taken by the AESO to justify the increased hiring, apart from hiring to fill vacancies.

36. Further, the CCA recommended that the AESO be required to provide support that would demonstrate that the staff and benefit costs reflected market conditions.

37. In reply, the AESO submitted that it had developed its staff and benefit budget using the best information available several months before the beginning of the year for which the budget is prepared. The AESO also explained that it completes thorough compensation survey and analysis work each year using survey information from Mercer, Towers Watson and the Wynford Group. The AESO then applies all the information collected to determine required total compensation changes and then sends these recommendations for AESO board approval.

38. The AESO submitted that at the end of each year, an allocation process is used to allocate general and administrative costs to the AESO’s three functions of transmission, energy market, and load settlement. The AESO noted that for 2011, the allocation amongst these three functions resulted in an increase in the allocation of general and administrative costs for transmission of $8.3 million (or 12.1 per cent) more than the transmission function budget of $68.5 million. The greater variance at the transmission function level arises from increased focus on transmission priorities during the year, which resulted in a greater allocation of corporate general and administration costs to the transmission function. The AESO submitted that the CCA’s argument ignored this effect of the higher allocation to the transmission function. Thus, while the CCA
points to the variance in staff and benefit costs as a cause for concern, the AESO noted that the general salary increase for 2011 was 3.2 per cent, compared to a 3.0 per cent increase approved through the budget review process.

39. The AESO submitted that the processes it used to ensure that its compensation and benefits are competitive are thorough and comprehensive and supported its view that AESO staff and benefit costs reflected market conditions. The AESO also stated that the CCA had not provided satisfactory evidence that the AESO’s costs were unreasonable. Therefore, the AESO submitted that in accordance with Section 46(1) of the Transmission Regulation, these costs must be considered prudent by the Commission.

Commission findings

40. While the CCA expressed concern about the 2011 variance of staff and benefit costs in relation to budgeted levels, the CCA did not suggest that the amounts incurred by the AESO were imprudent. Instead, the CCA considered the magnitude of the observed increase as evidence that changes to the AESO’s budget review process are necessary. The Commission has addressed these recommendations by the CCA in Section 3 above.

41. The Commission considers that the variance in staff and benefit costs is readily explainable by the increased allocation to the AESO’s transmission function as compared to the budgeted high-level allocation to the transmission function established at the time the AESO prepared its initial budget.

42. The Commission finds the explanations given by the AESO for its staff and benefit cost variance to be reasonable and therefore approves the 2011 staff and benefit cost variance as filed.

4.1.2 Contract services and consultants

43. The 2011 contract services and consultant costs were $13.9 million; the 2011 approved forecast was $10.8 million. This represented a variance of $3.1 million or 29 per cent. In AUC-AESO-03(a), the AESO provided the following breakdown of the contract services and consultant variance.

Table 3. 2011 contract services and consultant variance breakdown

<table>
<thead>
<tr>
<th>Description</th>
<th>Budget ($ million)</th>
<th>Actual ($ million)</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive process</td>
<td>0.5</td>
<td>2</td>
<td>-1.5</td>
</tr>
<tr>
<td>Participation in regulatory proceedings</td>
<td>0</td>
<td>0.7</td>
<td>-0.7</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
<td>0.9</td>
<td>-0.9</td>
</tr>
</tbody>
</table>

44. In argument, the CCA submitted that it would have expected that the AESO would have used competitive means to deal with the competitive process project and therefore it did not have a concern with the $1.5 million variance related to that project.

45. However, the CCA indicated that it was concerned with respect to the regulatory and other costs because the AESO had not explained the nature of these costs. The CCA recommended that the AESO provide an explanation of these costs in its reply argument so that the Commission would be able to determine the proper treatment of these costs.
46. In reply argument, the AESO explained that due to the Commission’s denial of the AESO’s cost claims in three regulatory proceedings and due to the Commission’s view that “the AESO’s costs are best recovered through its own tariff application,” the AESO no longer submits cost claims in respect of its participation in regulatory proceedings for need and facilities applications. The AESO further submitted that starting with its 2013 budget, the AESO will include the forecasted costs of such regulatory proceedings in its budget.

47. The AESO explained that the other variance category included contract services and consultant variances from all other AESO departments. The AESO submitted that it uses contract services and consultants to assist in the completion of tasks that require specialized skills that are neither resident in the AESO nor required by the AESO on an ongoing basis, and to address workload peaks.

48. In conclusion, the AESO submitted that its budget process is thorough and comprehensive and provides reasonably accurate budget amounts for contract services. Further, the AESO submitted that the CCA had not provided satisfactory evidence that the AESO’s costs were unreasonable. Therefore, in accordance with Section 46(1) of the Transmission Regulation, the AESO submitted that these costs must be considered prudent by the Commission.

Commission findings

49. The Commission agrees and confirms its findings in Decision 2011-489 that cost claims for regulatory need and facilities applications are best recovered through the AESO’s own tariff. The Commission also finds the cost variance related to the AESO’s participation in regulatory hearings to be reasonable and finds that this application is the correct venue for the AESO to apply for recovery of these costs. The Commission finds that the explanations given by the AESO for its contract services and consultant cost variance to be reasonable. Accordingly, the Commission approves the 2011 contract services and consultant cost variance as filed.

4.1.3 2011 capital projects

50. The actual 2011 capital costs for projects undertaken were $12.2 million; the 2011 approved forecast was $6.5 million. This represented a variance of $5.7 million or 88 per cent. Section 4.1.3.1 considers the CCA’s comments in respect of life cycle projects, the energy management system (EMS) project is considered separately in Section 4.1.3.2 below.

4.1.3.1 Life cycle projects

51. In CCA-AESO-02(a), the AESO provided the following breakdown and explanations with respect to life cycle projects:

Table 4. 2011 life cycle projects variance breakdown

<table>
<thead>
<tr>
<th>Lifecycle project</th>
<th>Component of $5.7 million funding increase</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oracle application server upgrade</td>
<td>$1.2 million</td>
<td>Project timing advanced to take advantage of an incremental 13% software discount</td>
</tr>
<tr>
<td>Network upgrade</td>
<td>$2.3 million</td>
<td>Variance primarily the result of increased project scope due to complexity</td>
</tr>
</tbody>
</table>

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52. The CCA did not express any concern with the $1.2 million cost variance for the Oracle application server upgrade project. As explained by the AESO, this cost related to project timing being advanced to take advantage of a 13 per cent software discount.

53. With respect to the network upgrade life cycle project, the AESO noted that it had explained in information responses that budget estimates for the network upgrade project were developed early in the project lifecycle and had an inherent degree of uncertainty in them. The AESO stated that, because it had recognized that the level of uncertainty for this project was higher than normal, it had included a proof of concept phase in the scope of the project in order to validate both the budget estimates and the capability of the proposed technology. The AESO further explained that a change order, which itemized increases in scope, schedule and budget to address these considerations, was developed at the end of the proof of concept phase and was subsequently approved by AESO management.

54. The CCA submitted that although certain steps were taken to allow for scope changes for the network upgrade project, it was concerned by the magnitude of the $2.3 million variance. Specifically, the CCA expressed concern about the fact that a scope change of this magnitude would be approved by management rather than by the board of directors. In future, the CCA recommended that significant scope changes should be subject to board of directors’ approval.

55. In reply argument, the AESO confirmed that subsequent to the AESO management approval discussed in CCA-AESO-02(b), the network upgrade project change was approved by the AESO board in May 2011. The AESO submitted that this approval was consistent with, and required by, the AESO policies and practices that address the AESO board approval of capital projects. The AESO further stated that, in accordance with the AESO policies and practices, significant scope changes that have material financial impacts are generally brought to the AESO board for approval on a case-by-case basis, following approval by the AESO management.

Commission findings

56. The Commission finds that the AESO has in place policies and procedures to address significant material and scope changes with respect to capital projects. In the case of the AESO’s network upgrade project, the Commission is satisfied that the AESO followed the correct procedure to obtain board of directors’ approval for the $2.3 million variance.

4.1.3.2 Energy management system (EMS) project

57. The CCA observed that the AESO spent $1.2 million in 2011 on its EMS project, and noted that vendor delivery issues had resulted in a more than 10 per cent variance in the cost of Phase II of the EMS project. Noting this variance, the CCA questioned why mitigation plans and contractual safeguards had not been put in place ahead of time, rather than after there was a 10 per cent cost overrun in Phase II. The CCA submitted that, in its reply, the AESO should explain why it could not have anticipated and avoided the $0.3 million Phase II cost overrun for the EMS project.

58. In reply, the AESO made the following observations with respect to the issue of transferring risk to vendors using contractual safeguards:

42. The AESO uses appropriate contractual safeguards with vendors to avoid cost increases associated with vendor delivery and related issues. However, the AESO has
found that if significant contractual safeguards transfer an unreasonable level of risk to the vendor, vendor proposals (and, subsequently, costs) can be driven to be as much as 50% higher than proposals with more limited risk transfer. For the EMS Phase II project, the AESO considered the risk associated with the project could be managed appropriately with limited safeguards. This approach proved successful, with the project incurring a capital cost variance of 7% ($0.2 million variance on a Phase II capital budget of $2.8 million).  

59. The AESO stated that it has incorporated and continues to incorporate safeguards on a case-by-case basis (such as development of an expectation model that must be met by the vendor) into its ongoing vendor management capability and vendor agreements, as considered necessary and appropriate to manage risks associated with vendor supply.

Commission findings

60. The Commission finds that no evidence has been submitted to show that the AESO did not manage its vendor risks for the EMS project effectively. The Commission accepts the AESO’s explanation that a balance must be struck between demanding contractual safeguards and incurring additional costs to secure those safeguards. The Commission finds the cost variance for the Phase II EMS project to be reasonable and approves the cost variance as filed.

4.2 2010 to 2004 cost variances

61. The AESO set out its 2010 financial results in Section 4 of the application and 2010 cost variances from the AESO’s approved revenue requirement for 2010 in Section 4.1. As presented in Table 4-1 of the application, the AESO noted that it recorded total costs for 2010 of $23.3 million, or three per cent higher than the total 2010 approved revenue requirement.  

62. The AESO described its processes for additional reconciliations of deferral account balances for 2009 (second reconciliation), 2008 (third reconciliation), and 2007 to 2004 (fourth reconciliations) in sections 5, 6, 7, 8, 9 and 10 of the application respectively. The AESO provided additional explanations for line item variances exceeding specific thresholds set for each year.  

63. The AESO explained in Section 2.4 (pages 19-22) of the application that it considers the application and related proceeding to be the proper venue for consideration of the prudence of AESO costs incurred with respect to 2010. As well, where significant adjustments to 2009 or prior year costs are included in the deferral account reconciliation, the application and related proceeding are the proper venues for consideration of the prudence of those adjustments.

Commission findings

64. Consistent with past practices, the Commission is in agreement with the AESO that deferral account reconciliation proceedings provide the proper venue for the consideration of the prudence of AESO expenditures.

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12 Exhibit 71.01, AESO reply argument, paragraph 42.
13 The AESO provided explanations for significant line item variances shown in Table 4-1. The AESO defined significant as line items that were ±$7.0 million, which represented approximately 10 per cent of the $66 million general and administrative costs component of the AESO’s 2010 revenue requirement as well as line items that were both at least ±$0.7 million and at least ±10 per cent of the approved line item amount.
14 For these thresholds see Exhibit 69.01, AESO argument, Section 3 Cost and revenue variances.
65. No parties identified concerns arising from the AESO’s 2004 to 2010 variance explanations. The Commission has reviewed the AESO’s revenue and cost variance explanations for the years 2004 to 2010 and finds no cause to question the reasonableness of either AESO revenues or costs over the 2004 to 2010 period.

5 Allocation of deferral account balances to customers

66. The AESO submitted that deferral account balances and adjustments are allocated to customers in the same manner as in previous deferral account reconciliation applications. The allocation to customers is discussed in Section 11.1 of the application.

67. The AESO described that the 2004 to 2011 deferral account balances (except for losses) are allocated to individual customers based on each customer’s percentage of total revenues collected through the rates in place during the period and that balances are allocated on a production month basis, by rate and rate component.

68. The application did not include any allocation of transmission system losses deferral account balances because, effective January 1, 2006, transmission system losses are no longer subject to retrospective deferral account reconciliation. Deferral account balances associated with losses for 2004 and 2005 are allocated to customers based on each customer’s hourly production multiplied by the pool price in the hour summed over each production month. The losses methodology is consistent with the allocation methodology approved in previous reconciliation applications.

69. After deferral account balances are allocated to each customer, additional revenue already paid by or refunded to each customer (through Rider C or in prior deferral account reconciliation settlements) is subtracted or added by rate and rate component. The remaining balance is the amount of the deferral account charge or refund attributed to the customer on a production month basis, by rate and rate component.

70. In Section 11.1 of the application, the AESO explained that the results of the deferral account allocation for each customer who received system access service under Rate DTS, Rate FTS or Rate STS has been included in appendices F, H, I and J in annual customer summaries and customer allocation detail. Customer confidentiality has been protected by assigning a number to each AESO direct-connect customer as had been done in previous deferral account reconciliation applications.

71. In summary, the AESO submitted that the allocation of deferral account balances and adjustments to customers was completed in the same manner as in previous deferral account reconciliations applications and that no information requests raised concerns with the allocations, therefore the allocation to customers should be approved as filed.

Commission findings

72. The Commission finds that, as in past deferral account reconciliation applications, the AESO provided extensive information on the allocation of deferral account balances to individual AESO customers. Additionally, as with past applications, the AESO indicated its willingness to make available to individual customers additional details regarding how
allocations were determined. No parties other than the AESO discussed the allocation of deferral account balances to individual customers in argument or reply.

73. In view of these considerations, the customer allocations for the 2004 to 2011 periods as set out in appendices F, H, I and J of the application are approved as filed.

6 Outstanding directions

74. In Section 13 of the application, the AESO updated the status of two outstanding directions, Direction 14 from Decision 2010-60615 and a direction from paragraph 211 from Decision 2011-049,16 both dealing with the alignment of deferral account reconciliation processes and the design of Rider C. The AESO stated that it will consult with stakeholders on all matters identified in these two directions in preparation for the AESO’s next comprehensive tariff application, and will report on its discussions and propose any resulting changes to the deferral account reconciliation process or the design of Rider C in that application. The AESO expected to begin consultation for its next comprehensive tariff application in mid-2012.

75. The CCA concurred with the AESO’s proposed approach to refining Rider C in order to mitigate the significant rate impacts of prior period adjustments on individual customers.

Commission findings

76. The Commission finds that, with respect to issues regarding the design of Rider C and alignment with deferral account reconciliation processes, it is the expectation of the Commission that the AESO be prepared to submit results of discussions and any proposed changes to the deferral account reconciliation process and/or the design of Rider C in time for its next comprehensive tariff application.

7  Order

77. It is hereby ordered that:

   (1) The settlement of the deferral account balances set out in the 2010 to 2011 application is approved as filed.

Dated on February 7, 2012.

The Alberta Utilities Commission

(original signed by)

Mark Kolesar
Vice-Chair

(original signed by)

Bill Lyttle
Commission Member
## Appendix 1 – Proceeding participants

<table>
<thead>
<tr>
<th>Name of organization (abbreviation)</th>
<th>counsel or representative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alberta Electric System Operator (AESO)</td>
<td>C. Moline, J. Martin, M. Mitchell</td>
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<tr>
<td>AltaLink Management Ltd. (AML)</td>
<td>Z. Lazic, D. Morris, D. Fischbach, E. Tadayoni, J. Yeo, J. Piotto, K. Evans, T. Kanasoot</td>
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<tr>
<td>ATCO Electric Ltd. (AE)</td>
<td>L. Keough, J. Grattan, S. Parhar, T. Martino, B. Yee</td>
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<tr>
<td>Consumers’ Coalition of Alberta (CCA)</td>
<td>J. A. Wachowich, A. P. Merani, R. Retnanandan</td>
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<tr>
<td>EPCOR Distribution &amp; Transmission Inc. (EDTI)</td>
<td>G. Zurek, L. Reid, D. Tenney</td>
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The Alberta Utilities Commission

**Commission Panel**
- M. Kolesar, Vice-Chair
- B. Lyttle, Commission Member

**Commission Staff**
- S. Ramdin (Commission counsel)
- S. Karim
- J. Halls
- W. MacKenzie