



**Reference:** Application, pg. 2, para. 11

**Explanation:** EWW requests that the Comptroller recognize EWW's current risks and its inherent risks previously not identified by allowing EWW to earn a return on the shortfall based on the Weighted Average Cost of Capital ("WACC") approved by the Comptroller in Order 2420.

**Request:**

1. Please further explain why EWW believes it is appropriate to receive a Weighted Average Cost of Capital (WACC) return on this deferral account. In the response, please address the circumstances that led to such a large balance and the revised forecasts of new additions that leads to the balance remaining outstanding for a prolonged period of time. Is it not the intent of the deferral process that investments in lumpy capital projects that include capacity for future customers are to result in modest deferrals that are to be recovered in a relatively short period of time?
2. Why should EWW earn an equity return on part of the deferred balance of an account that is intended not to become too large or remain outstanding for many years? Does this result in an incentive for utilities to invest in excess capital to build rate base?
3. Does EWW's parent company actually fund its subsidiary's deemed equity with equity or with long term debt?
4. Using EWW's formula for long term debt funding, what would the derived interest rate be as at November 1, 2015 and how would that impact the requested CIAC funding request if the deferral account balance were funded at that rate rather than WACC?



5. Is it reasonable to extend the recovery period of the deferral account so as to moderate the requested CIAC increase? Why or why not?

**Response:**

1. Revised forecasts of new additions

In its 2009 – 2011 Revenue Requirements Application (RRA), EWW utilized a preliminary estimate to forecast that it would construct 3 wells in 2010 and 2011 at a cost of \$200K per well (870997 TWs1/TWn1 and 070997 ACs1, respectively).<sup>1</sup> The costs of these wells was forecast to be fully recovered from future developers.

In its 2012 – 2014 RRA, EWW updated its forecast to \$340K per well by considering additional information obtained through a hydrogeology report and by considering actual drilling results.<sup>2</sup>

In its 2015 – 2017 RRA, EWW updated its forecast to develop the 870997 wells to \$1,842K, and the 070997 well to \$809K based on new issues that arose, specifically drilling into 3 aquifers. These increases arose out of unanticipated costs related to additional work necessitated by environmental regulations, site access issues and work required to meet VIHA requirements.<sup>3</sup> In the 2015-2017 RRA, EWW also reassessed the funding of the wells by rate base and developer. It was determined that well 070997, previously 100% developer contribution, was more appropriately paid for on the basis of recovery of 71% from rate base and 29% developer contributions.

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<sup>1</sup> EPCOR Water West 2009-2011 Revenue Requirements Application at para 121

<sup>2</sup> EPCOR Water West 2012-2014 Revenue Requirements Application at para 45 and CWR-EWW-4.0 (2012-2014 RRA)

<sup>3</sup> EPCOR Water West 2015-2017 Revenue Requirements Application at para 62 and CWR-EWW-2.0 (2015 – 2017 RRA)



When establishing the 2012 Contribution in Aid of Construction Rate, EWW utilized its then-current forecast of well development costs (\$1,220K).

EWW estimates that if it had complete and accurate knowledge of the actual costs that would be incurred to develop these wells (\$2,651K), the CIAC rate would have been set at \$11,000 per lot.

Therefore it is bearing significant risk not only with respect to the costs of drilling each well, but also with respect to establishing a rate that recovers these costs.

Large balance

The balance in the deferral account is driven by three drivers:

- (i) The \$1,431K increase in forecast costs to develop the 3 wells.
- (ii) The costs associated with the approved capital projects undertaken to enable growth within the service area. Since 2010, EWW has constructed a new reservoir, installed a new filter at the Drew Road Water Treatment Plant, performed upgrades on Lundine Lane and performed well rehabilitation work at Springhill well RWs1, incurring over \$2,000K for the benefit of future customers. At this point though, less than 65% of these expenditures have been recovered from the trust fund.
- (iii) The much lower than than expected forecasted growth. As an example, in its 2010 CIAC application EWW forecast that 310 lots would be



developed in the 2010/2011 period amounting to deposits of \$1,950K; actual growth saw the development of only 127 lots with deposits of \$820K.

In establishing its capital programs, EWW relies on 3<sup>rd</sup> parties to provide growth data and other projections that are important in managing and operating a water utility. Since the expenditures can be significant and may have long lag times for recovery, it is reasonable to provide compensation through the Weighted Average Cost of Capital to ensure that future development will occur. In addition to the long time frame associated with growth, EWW is also exposed to risk of recovery. Construction of wells is inherently risky in that there is the potential that the well will produce less than expected and drilling wells in difficult terrain may result in higher than expected costs. Finally EWW notes that to the extent that funds are placed into development projects EWW also face risks associated with opportunity costs.

#### Deferral Process

No, the deferred capacity charge program in contrast to deferral accounts, is not defined by modest deferrals recovered within short time periods.

Deferral accounts are in place to capture differences between actual and forecast revenues or costs and are renewed as part of each RRA. Deferral accounts can result in amounts owing to or from the ratepayer. Amounts accumulated in the deferral account in the current RRA are approved by the Comptroller and settled in the next RRA. EWW currently utilizes four deferral accounts: Consumption, Property Tax, Interest and Hearing Cost. These deferral accounts do not earn a return on equity as there is no risk of recovery.



The deferred capacity charge program was first established under Order No. 672 dated February 9, 1982 through the creation of a Deferred Capacity Trust Fund (DCTF). The trust fund is an actual bank account held in trust at a major bank. Amounts in the trust account have been deposited by developers seeking to connect to the EWW water system. EWW must file with the Comptroller a separate application showing the costs it has incurred on capital growth projects. The Comptroller must approve the actual expenditures before any amounts can be released from the trust account.

The intent of the deferred capacity charge program is that growth projects are prefunded by developers with amounts being placed in a trust account. The utility then constructs the growth project using its own funds and resources. Upon completion of the project the utility applies to the Comptroller to recover its funds.

The deferred capacity charge program was not designed to consider the impacts of: a) deficits in the trust account; b) higher than forecast costs; and c) lower than forecast growth. EWW is applying to recover its costs plus a reasonable return on investment since the amount due is neither modest nor forecast to be recovered in a short period of time.

2. Equity return

EWW should earn an equity return on part of the deferred balance because investment in water infrastructure is essential to growth and absent a utility's investment, the development would not likely occur. Developers are not prepared to provide funding for capital projects, which by their nature have long lead times, and are not prepared to wait for recovery of their investment through the sale of developed properties, which by their nature have long lag times.



EWW believes that its request for a return on its investment is fair and reasonable for all stakeholders considering its obligation to provide service and the unusual circumstances that it is currently facing.

Incentive to invest

No.

EWW, developers, business owners, and home owners will all gain from the construction of capital projects within the service area. For EWW specifically, its gains will occur from the growth in new customers seeking water service.

For the benefit of stakeholders and other readers funds received by EWW via the trust fund are recorded as a contributed asset. A contributed asset is an offset to property, plant, and equipment, therefore rate base would not increase.

EWW's request for WACC is appropriate considering the current circumstances related to having a large balance accumulating over a number of years.

Once the trust account returns to its natural balance, EWW will no longer earn a return of interest or equity on the deficit.

As the regulator of privately owned water utilities in the province of British Columbia, the Comptroller's role is to ensure that a utility has not built excess rate base. EWW believes that the Comptroller has fulfilled its role.

3. EWW is funded by its parent company via a Contributed Surplus (equity) of \$1,800,000. A utility should be operated based on the Stand-Alone principle therefore this question appears to have no bearing.
  
4. The Weighted Average Cost of Debt (the derived interest rate) at November 1, 2015 is 5.79%. The CIAC funding request would drop by \$400 per lot if the deficit was funded at 5.79%.



5. No, it is not be reasonable to extend the recovery period.

The application has been prepared based on a forecast of 14 lots per year with a maximum supply capacity of 52.4 L/s. EWW forecasts a supply deficiency will be created in 2028. The recovery period has therefore already been extended to the maximum degree possible.

Neither is it reasonable to adjust the lot forecast to a lower figure, thus extending the recovery period to additional years. Such a move would increase the lead/lag period, increasing risk.