June 8th, 2009

A Rock and a Hard Place? A False Dilemma

By Martin Kay Q.C.

Cases Considered:

ATCO Gas and Pipelines Ltd. v. Alberta (EUB), 2009 ABCA 171

In response to the hand-wringing of my colleague Prof. Alice Woolley in her post on this case, the recent decision of the Alberta Court of Appeal on the role of surplus lands (referred to as the "Harvest Hills" case) should not present any obstacle for the orderly setting of fair utility rates.

The essential facts alone should alleviate most concerns. The uncontradicted evidence was that in 1993 the utility acquired a single parcel of land for $43,000.00 for the purpose of building a regulating station. The station was then built on part of the parcel. There was no thought given to subdivision and sale of the surplus portion until an unsolicited offer was made in 2006. The potential need for the surplus land was then considered. None was identified. While a new, additional regulating station was expected to be needed within a 5 km radius within 5 years, the surplus portion was not an appropriate site, based on good engineering design considerations.

The majority of the Alberta Court of Appeal was at pains to point out that there was no basis upon which to complain about the full cost of the single parcel being included in rate base after its acquisition. It was in fact "not possible to purchase a smaller parcel", as the majority speculated (at para. 14). Where an entire parcel has to be acquired, the utility should thereafter be entitled to recover the full cost until it can use or dispose of the surplus land.

Utilities cannot bury assets in a rate base and only withdraw them to sell at a profit. A proposed rate base is fully scrutinized with each new rate case, every few years. An asset cannot be kept in rate base after its usefulness has expired. The majority makes this very clear too. Nor can it be disputed that not keeping the surplus land in proposed rate bases was dependent on value. Whether the value of the asset goes up or down, the test remains: does the asset continue to be used or required to be used to provide utility service. Assets whose costs are to be included in proposed rates are scrutinized by consumer groups and the EUB (now AUC) staff. If an asset no longer has a utility use, then it is no longer included in rate base and any expenses associated with it cannot be recovered through rates.

This strict rule concerning the inclusion of the cost of assets in rates goes to another aspect about which Prof. Woolley complained. There is symmetry in risk and reward, just as the courts assert. If the asset can no longer be included in rate base, the utility must bear any loss associated with its decline of value. Ratepayers bear none of the loss in value, just as they are not entitled to any of the increase in value. The utility does not have the option to leave an asset which is declining in value in rate base because the market is unfavourable. That suggestion is nowhere supported in the evidence, as the majority found. Nor is there any basis upon which to suggest there was any "speculation" (a suggestion which is unsubstantiated and rather unfair, as it would mean the utility knowingly misled the EUB in earlier rate cases).

Not only is risk and reward symmetrical in terms of entitlement to profits and loss, there are a number of features which favour ratepayers. First and foremost, Alberta is an original cost jurisdiction. Ratepayers only paid a rate of return on the acquisition cost of the Harvest Hills land (which, as the Court noted, was considered a prudent acquisition). Customers never pay for the appreciation in land values. As the land upon which the regulating station was built will likely continue to be utilized for a number of decades, ratepayers will bear none of the increase in property values, nor, unlike other assets, is there any depreciation expense for land.

Further, the utility always bears the risk that the regulator may reject the need for a new asset acquired by it or deny that the price paid was appropriate. And, that risk continues: the regulator can change its mind on such questions in subsequent rate cases, based on the evidence then presented.

What was at the heart of this appeal, though, was not the niceties of rate calculation. The real issue was the jurisdiction of the regulator to attach the proceeds generated by the sale or use of what has become non-utility property. The Supreme Court and the Alberta Court of Appeal had dealt with and denied any such jurisdiction in both the *Stores Block* (2006 SCC 4) and *Carbon* (2008 ABCA 200) cases, as the Court of Appeal noted here. Harvest Hills makes three.

Mr. Kay was one of the counsel for ATCO in this case.