December 5, 2013

The Continuing Fall-out from *Stores Block*: Guidance from the Alberta Utilities Commission on Utility Asset Disposition

Written by: Nigel Bankes

Decision commented on: Alberta Utilities Commission, Utility Asset Disposition, Decision 2013-417, November 26, 2013

In *ATCO Gas & Pipelines Ltd. v Alberta (Energy and Utilities Board)*, 2006 SCC 4 (*Stores Block*), a majority decision of the Supreme Court of Canada (per Justice Bastarache), the Court concluded that the customers of a regulated utility had no property interest in the assets of a utility company that were included in the rate base. Accordingly, when a utility sought the approval of the Energy and Utilities Board (EUB) (now the Alberta Utilities Commission (AUC or Commission)) for the disposition of a rate base asset outside the ordinary course of business, the EUB/AUC had no jurisdiction to require the utility, as a condition of the approval of the disposition, to allocate to the customers of the utility any share of the net proceeds of disposition beyond the depreciated book value of the asset in the utility's accounts. In so ruling the Supreme Court of Canada reversed the long-standing practice of the EUB and its predecessors in sharing such gains between shareholders and customers. That long-standing practice is recounted in this decision at paras 19 – 32.

Since *Stores Block*, the AUC and the Alberta Court of Appeal have continued to struggle with the implications of that decision for other dispositions of rate base assets by regulated utilities. Part of the Commission's response was to initiate the generic proceeding which is the subject of this post. The Commission initiated the proceeding by notice in April 2008 with three principal objectives:

- To provide interested parties an opportunity to advance and defend their interpretation of the *Stores Block* Decision
- To provide interested parties an opportunity to identify and explore the potential implications of the *Stores Block* Decision to utility regulation in Alberta
- To develop a consistent, principled approach to applying the guidance provided by the *Stores Block* Decision, while providing sufficient flexibility to address the specifics of each proceeding.

The proceedings were suspended later that year pending the resolution of certain related matters before the Court of Appeal (*ATCO Gas and Pipelines Ltd. v Alberta (Energy and Utilities Board)*, 2009 ABCA 171 (*Harvest Hills*); *ATCO Gas and Pipelines Ltd. v Alberta (Utilities Commission)*, 2009 ABCA 246 (*Salt Caverns*)). The proceedings recommenced in October 2012 and the Commission released its decision on November 26, 2013.

The decision provides a useful distillation (at para 102, p 32 – 34) of no less than 19 principles which the Commission contends can be derived from the *Stores Block* decision as well as subsequent decisions of the Alberta Court of Appeal and of the Commission itself. The decision also addresses a number of specific issues: (1) does *Stores Block* apply to dispositions in the ordinary course of business? (2) rate base issues, (3) depreciation practices, (4) stranded assets, (5) special facilities tariffs, (6) production abandonment costs, (7) ordinary course of business, and (8) rate base verification.

(1) Does *Stores Block* apply to dispositions in the ordinary course of business?

As noted above, *Stores Block* involved an application for the approval of a disposition that was not in the ordinary course of business. So too did the subsequent Alberta Court of Appeal decisions in *Harvest Hills, Salt Caverns* and *ATCO Gas and Pipelines Ltd. v Alberta (Energy and Utilities Board)* 2008 ABCA 200, leave to appeal to Supreme Court of Canada refused, 32761 (December 4, 2008) (*Carbon*)). In this decision, the Commission, recognizing the property basis of the Supreme Court's decision, concluded that the logic of *Stores Block* must equally apply to assets disposed of in the ordinary course of business. The Commission reasoned as follows:

> [271]…. the Commission considers that the utility asset ownership principles established by *Stores Block* and discussed above must apply to all utility property, regardless of whether the property is disposed of inside or outside of the ordinary course of business. To hold otherwise and find that it is customers that receive the benefit of any gain or bear the risk of loss for utility property other than in the case where it is disposed of outside of the ordinary course of business would mean that customers must have acquired some sort of property interest in those assets, contrary to the findings of the court in *Stores Block*. Indeed, paragraph 44 of the *Stores Block* decision recognizes that there is no authority in the *Gas Utilities Act* (or by implication the *Public Utilities Act*) to allocate gains or losses from the disposition of assets inside the ordinary course of business. It is inconsistent with the principles in *Stores Block* to suggest that customers do, or do not, gain a property interest in utility property, and receive the gains or bear the losses accordingly, depending on the nature of the circumstances of the disposition of the asset.

(2) Rate Base Issues

The post-*Stores Block* decisions confirmed that an asset could only remain in a utility's rate base if it was used or required to be used to provide service. The Commission could not order that an asset be continued in the rate base for the sole purpose of capturing revenues from that asset for the benefit of consumers: *Carbon*. Furthermore, a utility does not require the Commission's approval to remove an asset from the rate base (although the utility's decision may be subject to a prudency review). Once an asset is no longer being used (or required for use) it must be removed from the rate base. The subsequent disposition of the asset is for the utility to decide (with the Commission's approval where the disposition is not in the ordinary course of business) with any losses or gains for the account of the shareholders and not the customers (this decision at paras 273 – 279).

In this proceeding, the utility companies took the view (at para 280) that not all of the above principles applied to electrical utilities (*Stores Block* and the post-*Stores Block* Court of Appeal

decisions all dealt with gas utilities). In making this argument the utilities noted that unlike the *Gas Utilities Act*, RSA 2000, c. G-5, s 37 (*GUA*), and the *Public Utilities Act*, RSA 2000, c. P-45, s 90 (*PUA*), the *Electric Utilities Act*, SA 2003, c. E-5.1 (*EUA*) does not in fact use the terms "rate base" and "used or required to be used". The Commission however was having none of this argument:

> [282] … this position is in conflict with the property ownership principles enunciated in *Stores Block*.…
>
> [283] The Commission also observes that while the terms "rate base" and "used or required to be used to provide utility service" are not employed in the *Electric Utilities Act*, the same concepts apply. Section 122 of the *Electric Utilities Act* requires the Commission in setting a tariff to provide an "electric utility" with a reasonable opportunity to recover its prudent costs. An "electric utility" is defined, in part, as a "transmission facility" or an "electric distribution system" that is "used" to provide utility services. An "electric distribution system" is defined as the assets and services "necessary to distribute electricity." A "transmission facility" is a facility that "transmits electricity" and includes "all property of any kind used for the purpose of, or in connection with, the operation of the transmission facility." Therefore, Commission-approved tariffs for electric utilities must provide the electric utility a reasonable opportunity to recover the prudently incurred costs of utility assets that are used in (necessary to) the provision of electric utility service in the same way that Commission-approved tariffs for gas utilities must provide the gas utility with a reasonable opportunity to recover the prudently incurred costs of utility assets included in rate base. The Commission has no authority to include in rates the cost of assets that are not presently used, reasonably used or are likely to be used in the future to provide services to customers regardless of whether the statutory requirement is described as being "used or required to be used" to provide gas utility service or "used" or "necessary to" the provision of electric utility services. Therefore, the Commission finds that the principles related to assets used or required to be used to provide utility service established in the Alberta Court of Appeal cases dealing with gas utility assets apply equally to electric utility assets and, accordingly, the costs of all utility assets of both gas and electric utilities that are no longer used or required to be used for utility service must be removed from customer rates. All revenues generated by, and all costs associated with, such assets that are no longer used or required to be used for utility service are for the account of the utility shareholder.

The *Electric Utilities Act* is not the only utility statute that fails to use technical terms such as rate base and "used and useful" or "used and required to be used". The *National Energy Board Act*, RSC 1985, c N-7 also fails to use these terms. And yet, as with the Commission in this decision, the Federal Court of Appeal (see for example, *British Columbia Hydro and Power Authority v West Coast Transmission Company Ltd et al*, [1981] 2 FC 646 (CA)) has always supported the NEB in its use of rate base concepts in its decisions, thereby confirming the idea that there is, in some sense, a common law of utility regulation.

(3) Depreciation Practices

The Commission examined its depreciation practices to see if they were consistent with *Stores Block*. The Commission concluded that its practices, including the use of mass property accounts (grouping homogenous assets for depreciation purposes) and the use of reserve true-ups (periodic reassessments based on depreciation studies which may require customers to pay additional amounts where inadequate depreciation had been collected) were consistent with *Stores Block*. The Commission noted that its

> [299]… mandate is to fix just and reasonable rates and in doing so it is permitted to exercise its discretion to allow for the amortization of reserve differences in rates in the same way that it is permitted to exercise its discretion to establish deferral accounts to deal with forecasting uncertainties for other kinds of costs.

(4) Stranded Assets

A stranded asset is an asset that ceases to be used or required to be used before it comes to the end of its economic life (i.e. before the utility has fully depreciated the asset). The Commission affirmed that such assets should be removed from the rate base (at para 303). The Commission further affirmed that such extraordinary retirements should be for the account of the utility (and not its customers).

(5) Special facilities charges

Under some circumstances a utility may provide a customer with services (and facilities) that are additional to the regulated service. In this decision the Commission confirmed that the risks associated with providing such additional services should be for the account of the utility (at para 311).

(6) Production abandonment costs

Some gas utilities own their production assets. These assets are properly included in the rat base for so long as they are producing. Once they cease to produce they cease to be used and useful and therefore no longer belong in the rate base. However, there may still be costs associated with these wells until the wells can be properly abandoned and the well sites and surface rights properly remediated. To what extent should the utility be able to recover costs associated with assets no longer in the rate base?

Perhaps surprisingly, the AUC in Decision 2011-450 disallowed recovery for production abandonment costs for ATCO Gas. That decision was then subject to a review and variance application as a result of which the Commission in Decision 2012-156 referred the treatment of such costs to this proceeding. The Commission gave the same direction in relation to a similar application from AltaGas (Decision 2012-311). In the current proceeding the Commission allowed recovery of these costs and offered significantly more guidance to utilities on this issue:

> [317] The Commission panel has reviewed the decisions related to production abandonment costs from the perspective of its findings in this proceeding regarding depreciation methods, including the treatment of salvage, post-retirement costs and ordinary retirements. Based on those findings, the Commission finds, consistent with its findings above, that it may include the production abandonment costs in customer rates if those production abandonment costs result from causes reasonably assumed to have been contemplated in prior

> depreciation provisions, and normally expected to occur when the plant reaches the end of its expected service life. The evidence filed in the proceeding leading to Decision 2011-450 showed that production abandonment costs had been included consistently in depreciation studies related to the production facilities when they were in rate base. The inclusion of production abandonment costs in rates for these assets is an accepted component of the net salvage calculation. Indeed, production abandonment costs for assets no longer in rate base were included in settlement agreements between customer groups and the utility demonstrating that recovery of these production abandonment costs is an accepted component of the net salvage calculation. Therefore, the Commission varies Decision 2011-450 to the extent necessary to include the disallowed production abandonment costs in revenue requirement for the years in question. Similarly, the Commission approves the inclusion of production abandonment costs for AltaGas in revenue requirement for the years for which revenue requirement was determined in Decision 2012-311.

(7) Ordinary course of business

There is a distinction to be made between the removal of an asset from the rate base and the disposition of that asset. The *Carbon* decision determined that a utility does not require the prior approval of the Commission before it removes an item from the rate base. The Commission may second-guess the prudence of the utility in making this decision but no prior approval is required. The disposition of an asset requires the approval of the Commission but only if the disposition is outside the ordinary course of business: See *GUA*, s 26, *PUA*, s 101 (and s 101 of the *PUA* does potentially apply to electric utilities, see *PUA* s 116(1)). The penalty in each case is severe – the disposition is void. Understandably therefore the utilities in this proceeding sought some additional guidance from the Commission in the interpretation of this requirement. The Commission proved reluctant to provide that further guidance but it did reaffirm the criteria endorsed in a previous decision and the Commission also invited each utility to apply for prior approval of a dollar value below which transactions would be presumed to be disposition in the ordinary course.

As to the former, the Commission affirmed that the criteria articulated in an earlier decision continued, in the Commission's view, to provide adequate guidance to utilities. That previous discussion provided as follows:

> [318] With respect to the disposition of assets the Board notes that the GU Act provides little specific direction. The Board confirms that it must first determine whether the disposition of an asset is outside the ordinary course of business for a utility. The proceeds of disposition, NBV [net book value], frequency and type of sale would be among the factors considered by the Board in that determination. The quantum, and materiality (in relation to the total rate base) of the proceeds of disposition and the NBV would all be considered. … The Board would be willing to consider setting a threshold level for asset sales below which the Board would treat sales as being in the ordinary course of business for the duration of the Settlement. …The final determination whether a disposition is outside the ordinary course continues to rest with the Board.

As to the second, the AUC reminded the other utilities that it had approved a $1.5 million threshold for ATCO Gas and stated (at para 322) that "Each other utility may apply for a

monetary threshold guideline applicable to their company in determining if a transaction is within or outside of the ordinary course of business."

(8) Rate base verification

The real kicker in this decision is the Commission's direction to utilities to reaffirm on a continuing basis that everything that they claim belongs in the rate base, really does belong there. This particular injunction flows from the Alberta Court of Appeal's decision in *Carbon* wherein it stated that:

> [23] The words "used or required to be used" are intended to identify assets that are presently used, are reasonably used, and are likely be used in the future to provide services. Specifically, the past or historical use of assets will not permit their inclusion in the rate base unless they continue to be used in the system. The fact that the Carbon storage facility was previously used to provide service may provide some context, but it is largely irrelevant to whether that asset should remain in the rate base.…
>
> [25] [T]he only reasonable reading of s 37 is that the assets that are 'used or required to be used' to provide service are only those used in an operational sense.…
>
> [29] The *Act* does not contain any provision or presumption that once an asset is part of the rate base, it is forever a part of the rate base regardless of its function. The concept of assets becoming "dedicated to service" and so remaining in the rate base forever is inconsistent with the decision in *Stores Block* (at para 69). Such an approach would fetter the discretion of the Board in dealing with changing circumstances. Previous inclusion in the rate base is not determinative or necessarily important; as the Court observed in *Alberta Power Ltd. v Alberta (Public Utilities Board)* (1990), 72 Alta. L.R. (2d) 129, 102 A.R. 353 (C.A.) at pg. 151: "That was then, this is now."

While the utility in that decision contested the Commission's ability to force an asset to remain in the rate base if it were not physically being put to use or potential use, the Commission in subsequent proceedings and in this proceeding has interpreted these comments to impose an active duty on the utility to identify assets that do not belong in the rate base. Thus, instead of waiting for an intervenor to identify unused assets and make the argument that the asset should be deleted from the rate base (surely a difficult task in many cases) the Commission has now turned the onus over to the utilities. Thus in this decision the Commission has ruled as follows:

> [327] In order to give effect to the court's guidance that the "rate-regulation process allows and compels the Commission to decide what is in the rate base, i.e. what assets (still) are relevant utility investment on which the rates should give the company a return," the Commission directs each of the utilities to review its rate base and confirm in its next revenue requirement filing that all assets in rate base continue to be used or required to be used (presently used, reasonably used or likely to be used in the future) to provide utility services. Accordingly, the

utilities are required to confirm that there is no surplus land in rate base and that there are no depreciable assets in rate base which should be treated as extraordinary retirements and removed because they are obsolete property, property to be abandoned, overdeveloped property and more facilities than necessary for future needs, property used for non-utility purposes, property that should be removed because of circumstances including unusual casualties (fire, storm, flood, etc.), sudden and complete obsolescence, or un-expected and permanent shutdown of an entire operating assembly or plant. As stated above, these types of assets must be retired (removed from rate base) and moved to a non-utility account because they have become no longer used or required to be used as the result of causes that were not reasonably assumed to have been anticipated or contemplated in prior depreciation or amortization provisions. Each utility will also describe those assets that have been removed from rate base as a result of this exercise. At this time, the Commission will not require the utilities to make additional filings to verify the continued operational purpose of utility assets. (footnotes omitted)