ATCO Gas

Disposition of Land in the Harvest Hills Area

December 11, 2007

Alberta Energy and Utilities Board

ALBERTA ENERGY AND UTILITIES BOARD
Decision 2007-101: ATCO Gas
Disposition of Land in the Harvest Hills Area
Application No. 1512932

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ALBERTA ENERGY AND UTILITIES BOARD
Calgary Alberta

ATCO GAS **Decision 2007-101**
DISPOSITION OF LAND IN THE HARVEST HILLS AREA **Application No. 1512932**

1 INTRODUCTION

The Alberta Energy and Utilities Board (Board) received Application No. 1512932 (the Application) dated May 23, 2007 from ATCO Gas (AG). The Application requested approval of the Board pursuant to Section 26(2)(d) of the *Gas Utilities Act*, R.S.A. 2000, c. G-5 (GUA) with respect to the disposition of vacant land located in the Harvest Hills area in Calgary (the Harvest Hills Property).

Notice of the Application was published in the Edmonton Sun, the Calgary Sun, the Edmonton Journal and the Calgary Herald on May 31, 2007. Notice of the Application was also distributed by e-mail on May 25, 2007 to the parties on the ATCO Gas 2005-2007 General Rate Application Phase I distribution list as well as to the parties on the ATCO Gas North Disposition of Red Deer Operating Centre distribution list.

In addition to the Notice of the Application, the Board issued process and scheduling letters in connection with the Application on July 5, 2007, July 10, 2007, August 27, 2007, and October 5, 2007. Processing of the Application ultimately followed the schedule below:

Summary of Process and Schedule

Process Step	Deadline Date
Statement of Intent to Participate	June 15, 2007
AG to inform Board which procedural option AG would prefer	July 13, 2007
Information Requests to AG	July 24, 2007
Responses from AG to Information Requests	August 14, 2007
Interveners file comments on need for intervener evidence, if any	August 20, 2007
Interveners file comments on need for further process	September 14, 2007
Supplemental Information Requests to AG	October 12, 2007
Responses from AG to Supplemental Information Requests	October 22, 2007
Written Argument	October 31, 2007
Written Reply Argument	November 7, 2007

The Board received statements of intention to participate from the following parties: FortisAlberta Inc. (FAI); the Office of the Utilities Consumer Advocate (UCA); the City of Calgary (Calgary); and the Consumers Coalition of Alberta.

The Division of the Board assigned to this Application was C. Dahl Rees, LL.B., Presiding Member, B. T. McManus, Q.C., Member, and D. A. Larder, Q.C., Acting Member.

For purposes of this Decision, the Board considers that the record closed on November 7, 2007.

2 APPLICATION

The Harvest Hills Property is a four acre vacant parcel of land purchased as part of a larger 5.35 acre lot in 1993 for construction of a regulating station. AG stated that the value currently reflected in rate base for the land is $43,500 of which $32,525 would be removed as a result of the disposition. Based on the reply to BR-AG-6, AG revised the removal figure to $37,718.

In the Application AG indicated that it had received indications of serious interest from an arms length buyer and that based upon the current market conditions in that area, it appeared that a sale price could be in the range of $1.6 million. AG considered the disposition value to be sufficiently material so as to be outside the ordinary course of business. AG noted that it intended to conclude the sale at the earliest possible opportunity and prior to the end of 2007.

In a letter dated July 6, 2007, AG noted that it had entered into a commercial agreement with an arms length party for the disposition of the Harvest Hills Property. On July 9, 2007, AG submitted a copy of the land purchase agreement with respect to the Harvest Hills Property. This document indicated a sale price of $1.85 million. The Board notes that one of the conditions of the land purchase agreement was the receipt of regulatory approval from the EUB.

AG indicated that customers would not be negatively impacted by the sale. AG added that the disposition would not affect AG's ability to provide safe, reliable and economic distribution service to its customers and that $37,718 would be removed from rate base with consequent savings on return on rate base, income taxes and maintenance costs. AG stated that the proceeds of the sale, net of applicable expenses, would flow to shareholders, consistent with the findings of the Supreme Court of Canada in the Stores Block Case[1] (Stores Block Decision) as well as the Uniform Classification of Accounts.[2]

In order to not impede the sale of the property, AG was seeking expeditious approval from the Board. In addition, AG was seeking approval from the Board to reflect the gain on the sale in Account 319 – Other Income. This is an account for recording income not provided for in other accounts.

3 VIEWS OF THE BOARD

In various applications considering the sale of utility assets or of a utility business the Board has applied the "no harm" test in assessing the merits of the applications. At page 4 of Decision 2003-098,[3] the Board summarized its development of this test as follows:

> Section 101(2) of the [Public Utilities Board Act] PUB Act and section 26(2) of the GUA do not specify the appropriate test for the Board to utilize when considering an application under these provisions. Without specific legislative guidance, the Board has employed a "no-harm" standard or test when evaluating applications to dispose of rate

[1] *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140
[2] Alberta Regulation 546/63
[3] Decision 2003-098 – ATCO Electric Ltd., ATCO Gas North and ATCO Gas South, Both Operating Divisions of ATCO Gas and Pipelines Ltd. – Transfer of Certain Retail Assets to Direct Energy Marketing Limited and Proposed Arrangements with Direct Energy Regulated Services to Perform Certain Regulated Retail Functions (Application 1299855) (Released: December 4, 2003)

> base assets out of the ordinary course of business under section 101(2)(d)(i) of the PUB Act and section 26(2)(d)(i) of the GUA. The Board's no-harm test considers the transaction in the context of both potential financial impacts and service level impacts to customers. The Board also assesses the prudence of the sale transaction. As well, the Board considers whether the availability of future regulatory processes might be able to address any potential adverse impacts that could arise from a transaction.[5]
>
> [5] The Board has considered the general principles of the "no-harm" test in several decisions including: Decision 2000-41, TransAlta Utilities Corporation, Sale of Distribution Business (July 5, 2000); Decision 2001-65, ATCO Gas – North (A Division of ATCO Gas and Pipelines Ltd.), Sale of Certain Petroleum and Natural Gas Rights, Production and Gathering Assets, Storage Assets and Inventory: Reasons for Decision 2001-46; Decision 2002-037 ATCO Gas and Pipelines Ltd. Disposition of Calgary Stores Block and Distribution of Net Proceeds – Part 2; Decision 2000-71 UtiliCorp Networks Canada (Alberta) Ltd. and UtiliCorp Networks Canada Ltd., Sale of Certain Assets to EPCOR Energy Services (Alberta) Inc. and Appointment of EPCOR Energy Services (Alberta) Inc. as Provider of the Regulated Rate Option; and Decision 2002-038 TransAlta Utilities Corporation, TransAlta Energy Corporation, and AltaLink Management Ltd. Sale of TransAlta Transmission Assets and Business to AltaLink.

In describing the no harm test, page 6 of Decision 2003-098 also quoted with approval the following passage from Decision 2000-41:

> The Board believes that its duty to ensure the provision of safe and reliable service at just and reasonable rates informs its authority to approve an asset disposition by a public utility pursuant to Section 91.1(2) of the PUB Act [now Section 101(2)(d)]. Therefore, the Board is of the view that, subject to those issues which can be dealt with in future regulatory proceedings …, it must consider whether the disposition will adversely impact the rates customers would otherwise pay and whether it will disrupt safe and reliable service to customers. As already noted, the Board also accepts that it must assess potential impacts on customers in light of the policy reflected in the EU Act, namely the unbundling of the generation, transmission and distribution components of electric utility service and the development of competitive markets and customer choice. As a result, rather than simply asking whether customers will be adversely impacted by some aspect of the transactions, the Board concludes that it should weigh the potential positive and negative impacts of the transactions to determine whether the balance favours customers or at least leaves them no worse off, having regard to all of the circumstances of the case. If so, then the Board considers that the transactions should be approved.[4]

The Board continues to consider that the above passages outline the basis and application for the no harm test. The no harm test as applied by the Board was also reviewed with approval by the Supreme Court of Canada in the Stores Block Decision. The Board considers it appropriate to apply this test to the asset disposition requested in the present Application.

In applying the no harm test the Board must first consider if the disposition would disrupt safe and reliable service to customers or otherwise affect the quality and/or quantity of services being provided to ratepayers. The Board notes the statement by AG that disposing of this land would not in any way affect AG's ability to provide safe, reliable and economic distribution service to its customers. The fact that the land being disposed of is vacant and has been since it was purchased by AG leads the Board to conclude that the Harvest Hills Property has never been used in providing service to AG's customers. The Board, in BR-AG-3, questioned AG about the

[4] Page 8 of Decision 2000-41 – TransAlta Utilities Corporation Sale of Distribution Business (Application 2000051) (Released: July 5, 2000)

possibility of future use for the Harvest Hills Property. In its response, AG indicated that there are no foreseeable additional facilities that would require the use of the vacant land. The Board also notes that none of the interveners made any submissions regarding service quality reductions as a result of the sale.

Consequently, the Board considers that there would be no harm to customers in terms of service quality and/or quantity as a result of the sale of the Harvest Hills Property.

With respect to the potential for the disposition to adversely impact the rates customers would otherwise pay, the Board notes the statement from AG that rate base, return and taxes will be reduced as a result of the removal of $37,718 from rate base. In addition, AG has indicated that these reductions will result in customer rates being lower than they otherwise would have been.

Calgary asserted that the disposition will result in a financial harm to customers:

> Clearly, the disposition by ATCO of inexpensive acreage for its shareholders' benefit, to be replaced at some future point with more expensive acreage paid for by customers, is *prima facie* harmful to customers.[5]

Calgary also noted the asymmetry of risk and return relating to the vacant Harvest Hills Property and claimed that customers have underwritten the investment by ATCO of the Harvest Hills lands but would not realize any benefits from the sale.[6]

Calgary went on to state:

> Additionally, ATCO has confirmed that following the sale of the Harvest Hills land, it will be purchasing other lands in the upcoming years for its system.[8] Since ATCO is disposing of the Harvest Hills land it purchased for a cost of $9,429.50 per acre,[9] in order for customers to be unaffected by the sale transaction, the cost per acre of the replacement land must be less than or equal to this amount.[7]
>
> [8] BR-AG-5
> [9] BR-AG-6(a), reflecting a reduction in rate base of $37,718 for the 4 acres of land sold.

The UCA referred to the powers of the Board to condition a sale as referred to by the Supreme Court in the Stores Block Decision.

> The Board will recognize the asymmetry inherent in allowing losses-on sale to be borne by customers and gains-on-sale by shareholders. In the opinion of the UCA, this is a situation which cries out for the Board to exercise its "options" or to impose conditions on the approval of sale as contemplated in the SCC Decision and as noted above. Alternatively, the Board must indicate the reasons why it should not exercise its jurisdiction as newly defined.[8]

The UCA noted that the Supreme Court determined that the Board has authority in certain circumstances to require as a condition of approving an asset disposition that the utility "reinvest

[5] Calgary Reply Argument, page 2
[6] Calgary Argument, page 4
[7] Calgary Argument, page 5
[8] UCA Argument, page 5

part of the sale proceeds back into the company in order to maintain a modern operating system that achieves the optimal growth of the system."[9] The UCA stated:

> Without attempting to determine what is the highest and best use of the sale proceeds in order to "maintain a modern operating system", AG has talked in terms of the need for new regulating stations and distributing systems required "…to provide an enhanced level of gas supply reliability and flexibility of operation."[21] The UCA sees no reason why the gain-on-sale should not be used to defray the cost of these or other required facilities.[10]
>
> [21] BR-AG-3(c)

In this particular case, the Board considers that there is evidence of financial harm to customers. In the response to BR-AG-3, AG indicated that it expects that new mains and service line extensions will be required for the area within a 5 kilometre radius of the Harvest Hills Property. In the same response, AG indicated that a new regulating station will be required within the next 5 years approximately 4 to 5 kilometres away from the one on the Harvest Hills Property. AG added that it will "likely have to purchase land" for this new regulating station.

The Board believes that the cost of the new mains and services, the new regulating station and the land on which it will be situated will result in increased costs to customers. The Board notes that land acquisition and construction costs have dramatically increased in recent years due to the economic boom in the province and the shortage of skilled construction personnel. Rates are impacted with respect to land acquisitions by a utility as the result of the inclusion in revenue requirement of return on invested debt and equity, taxes and maintenance costs associated with the land acquisitions. The land acquisition costs for this new regulating station will be higher than the one that is located on the Harvest Hills lot. The Board notes that the Harvest Hills lot was purchased at an average cost of $9,430 per acre.[11] Based on the selling price of the Harvest Hills Property, the cost of the new land will probably be more in the range of $462,500 per acre,[12] which is dramatically different from the cost of land in the area only 14 years ago in 1993. AG will also be incurring construction costs associated with building the new regulating station and the new mains and service line extensions. There may also be customer contributions payable in respect of some of these new facilities under AG's investment policy.

The Board notes that under general regulatory principles, the cost of the new mains and service line extensions, the new regulating station and the land will be included in the rate base of AG, subject to Board approval for the prudency of these costs. This would normally increase the rate base of AG and result in increased rates for customers. The Board considers that customers would be harmed if the sale of the Harvest Hills Property occurs with the net proceeds being credited to the account of the utility's shareholder in light of the foreseeable needs of the utility for similar facilities creating additional operating and other costs for the future as indicated in their information responses. This financial harm could possibility be mitigated through the application of the net proceeds from the sale of the Harvest Hills Property to partially offset the acquisition and construction costs of these new facilities, facilities that are required to maintain a

[9] Stores Block Decision, paragraph 77

[10] UCA Argument, page 7

[11] Original cost of $43,500 plus costs for an environmental audit $3,385 and value assessment $3,564 (as per CGY-AG-1(h)) equals total costs of $50,449 divided by 5.35 acres = $9,430 per acre

[12] Selling price of $1,850,000 divided by 4 acres = $462,500 per acre

modern operating system and continued optimal growth of the distribution system. The Board notes that this finding is supported by paragraph 77 of the Stores Block Decision where the Court stated:

> The Board has other options within its jurisdiction which do not involve the appropriation of the sale proceeds, the most obvious one being to refuse to approve a sale that will, in the Board's view, affect the quality and/or quantity of the service offered by the utility or creates additional operating costs for the future. This is not to say that the Board can never attach a condition to the approval of sale. For example, the Board could approve the sale of the assets on the condition that the utility company gives undertakings regarding the replacement of the assets and their profitability. It could also require as a condition that the utility reinvest part of the sale proceeds back into the company in order to maintain a modern operating system that achieves the optimal growth of the system.

The Board considers that this financial harm in cost is equivalent to the submissions of the UCA and Calgary regarding the asymmetry of risk and return in allowing losses on sale to be borne by customers and gains on sale to be credited to shareholders in the circumstances of the present application.[13] The Board does not consider this to be a fair practice within the general context of determining rates that are "just and reasonable."

The Board notes that no evidence was provided by AG regarding the estimated cost of the new regulating station and the land on which it will be situated. Therefore, the Board considers that the true extent of the financial harm cannot be adequately measured at this time given the uncertainty of the costs of these new facilities. Consequently, the Board believes that the most effective way to proceed with the application would be a conditional sale approval in the manner described in paragraph 77 of the Stores Block Decision. The Board is prepared to allow AG to sell the Harvest Hills Property, under the condition that the gain on sale (which is to be calculated as the sale proceeds less the original cost less prudently incurred disposition costs) be placed in a deferral account. The Board considers that under general regulatory principles, AG is entitled to a return of its investment and is also entitled to recover any prudently incurred disposition costs associated with the sale.

The Board considers that the appropriate forum in which to consider evidence on the estimated costs of the new mains, service line extensions, regulating station and land referred to above, and therefore the appropriate forum in which to address the mitigation of the harm determined in this Decision, is a phase I general rate application (GRA) where a more detailed review of capital expenditure forecasts can occur. To that end, the Board notes that AG's 2008-2009 Phase I GRA was filed on November 2, 2007.

The Board also notes that paragraph 81 of the Stores Block Decision refers to the ability of the Board in a proceeding to modify and fix just and reasonable rates to "give due consideration to any new economic data anticipated as a result of the sale." In light of this guidance, the Board considers that the disposition of the funds in the deferral account is more appropriately addressed in a proceeding that is focused on setting just and reasonable rates. Accordingly, the Board considers that the disposition of the funds in the deferral account is best considered in AG's 2008-2009 Phase I GRA. The Phase I GRA will include detailed capital expenditure forecasts and impacts on the revenue requirement and hence rates. This information will allow the Board

[13] UCA Argument, page 5, lines 28-29; Calgary Argument, page 3, last paragraph

and interested parties to fully address the disposition of the funds held within the deferral account within a rate making context.

In this Application AG indicated in its response to BR-AG-5 that it is planning on purchasing land elsewhere over the next two to three years. As mentioned above, the Board considers that the price of this new land will be significant and as a result it will increase customer rates. The Board acknowledges that there may be an argument that regardless of where this new land is situated, there is still a financial harm in costs to customers and the asymmetry of risk and return still applies. The Board considers that this issue will be explored in the 2008-2009 Phase I GRA.

The Board considers that the finding of financial harm in this case distinguishes this case from the Board's sale approval in the Calgary Stores Block case.[14] In that case, the Board expressly made a determination of no harm.

The Board believes that the next step in this process is to determine what the actual financial harm is in this case and what the implications of this determination are. The Board considers that it would benefit from more comprehensive submissions on this matter. This would involve discussion of the interpretation of paragraphs 77 and 81 of the Stores Block Decision. The Board would also benefit from submissions on the impact, if any, of the Stores Block Decision on other revenue requirement matters like the determination of appropriate depreciation, salvage and reclamation costs.

In addition, the entire issue of the accounting treatment based on the Uniform Classification of Accounts should be explored in more detail, including whether the gain should be used for reinvestment or as some kind of customer contribution or revenue offset. If the gain is to be used for reinvestment, then the matter of whether or not AG would be eligible for a return on this investment would also need to be explored.

The Board notes that there were other issues raised in the course of this Application which may also become subject to submissions in the GRA. These issues include but are not limited to the following:

- The submission by FAI that if proceeds are deemed by the Board to be re-invested, then these proceeds should still attract a return.
- The submission by Calgary that even if the Board finds no harm, it can still consider the financial implications from the sale in terms of setting AG's rates.

Further, the Board notes that FAI submitted that the Board should enunciate parameters for the interpretation of what is "not in the ordinary course of business". AG did not consider that the setting of such parameters was necessary in the context of this case.[15] The Board notes that individual utilities differ in their sizes and scope of operations to a significant degree. Further, utilities other than AG and FAI are not parties to this proceeding and have not had an opportunity to provide submissions on a matter that might directly affect their operations.

[14] Decision 2001-78, ATCO Gas and Pipelines Ltd. Disposition of Calgary Stores Block and Distribution of Net Proceeds – Part 1 (Application 1243019) (Released: October 24, 2001) and Decision 2002-037, ATCO Gas and Pipelines Ltd. Disposition of Calgary Stores Block and Distribution of Net Proceeds – Part 2 (Application 1247130) (Released: March 21, 2002)

[15] ATCO Gas Reply Argument, page 16

Accordingly, the Board declines to make a determination of parameters as to what does or does not constitute "ordinary course" transactions at this time.

4 ORDER

IT IS HEREBY ORDERED THAT:

(1) The disposition by ATCO Gas of the four acres of vacant land located in the Harvest Hills area in Calgary to Hyatt Auto Sales Ltd. for $1.85 million is hereby approved, on the condition that ATCO Gas will record the gain from the sale (calculated as the difference between the sale price, and the sum of the original cost and the disposition costs) in a deferral account and will apply for disposition of this deferral account in its 2008-2009 Phase I General Rate Application.

Dated in Calgary, Alberta on December 11, 2007.

ALBERTA ENERGY AND UTILITIES BOARD

(original signed by)

C. Dahl Rees, LL.B.
Presiding Member

(original signed by)

B. T. McManus, Q.C.
Member

(original signed by)

D. A. Larder, Q.C.
Acting Member