ATCO Gas and Pipelines Ltd. (North)

Application to Approve 2002 Rates, Amended North Core Agreement and Sale of Beaverhill Lake and Fort Saskatchewan Properties

December 24, 2002

Alberta Energy and Utilities Board

ALBERTA ENERGY AND UTILITIES BOARD
Decision 2002-116: ATCO Gas and Pipelines Ltd. (North)
Application to Approve 2002 Rates,
Amended North Core Agreement and
Sale of Beaverhill Lake and Fort Saskatchewan Properties
Application No. 1283224

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AMENDED NORTH CORE AGREEMENT AND **Decision 2002-116**
SALE OF BEAVERHILL LAKE AND **Application No. 1283224**
FORT SASKATCHEWAN PROPERTIES **File No. 1505-4**

1 INTRODUCTION

By letter dated November 15, 2002, ATCO Gas North (AGN) and ATCO Pipelines North (APN) (hereinafter together referred to as ATCO), operating divisions of ATCO Gas and Pipelines Ltd. (AGPL), filed an application (the Application) requesting the Alberta Energy and Utilities Board (the Board) to approve as final interim rates effective January 1, 2002 and April 1, 2002, and approve the sale of the Beaverhill Lake and Fort Saskatchewan (BHL & Ft. Sask) properties and the allocation of the proceeds to customers. This Application was made as a result of a negotiated settlement between ATCO and the North Core Customer Group (NCC) representing ratepayers. The negotiations were triggered by re-opener clauses in the North Core Agreement as amended January 1, 2000 between the NCC and ATCO (the Agreement). As part of the negotiation process, a number of outstanding issues were folded into the negotiations, enabling the parties to reach a settlement. The Application described the settlement as a "package deal" and requested approval of the Application in its entirety.

The Board issued a Notice of Application on December 2, 2002 to all interested parties of record for the north, which was published in the Edmonton Journal and the Edmonton Sun on December 6, 2002.

2 BACKGROUND

As a result of the Viking sale approved in Board Decision 2001-104, dated December 11, 2001, the Agreement became open for renegotiation. The Agreement, which established rates for the years 1998 to 2002, was originally approved by the Board in Decision U98060, dated March 31, 1998, and later amended by Decision U99107, dated November 12, 1999 and Decision 2000-85, dated December 22, 2000.

The re-opener provisions of the Agreement which were triggered were both "Class 1" re-openers, which are subject to a materiality standard pursuant to which the magnitude of the revenue requirement adjustment (either positive or negative) must exceed $1 million per individual item and $1.7 million in total. The specific re-openers relevant to this case were as follows:

- Changes in revenues or expenses resulting from changes in applicable accounting standards and environmental or tax legislation; and
- Sale of the Viking field.

The North Core Committee met seven times between April 19, 2002 and November 4, 2002 to negotiate a settlement. In attendance at all but the last two meetings was a Board observer.

By letters dated December 12, 2001 and December 19, 2002, both AGN and APN respectively filed an application for approval to decrease the delivery service rates paid by customers on an interim basis by $0.114/gigajoule (GJ), to be effective January 1, 2002. The decrease was proposed as a result of the sale of the producing assets in the Viking field, and both ATCO and the NCC agreed to determine the final impact of the re-openers early in 2002. By Orders U2001-501, dated December 19, 2001 and U2001-543, dated December 20, 2001, the Board approved the interim rates.

By letter dated March 22, 2002, ATCO filed an application for approval to revise its rates to comply with Decision 2001-75[1], dated October 30, 2001, and Decision 2002-035[2], dated March 21, 2002. The Board approved the rates to be effective April 1, 2002 on an interim basis in Order U2002-136, dated March 28, 2002.

Prior to this Application, AGN had submitted Application No. 1278434 (ATCO Gas – Disposition of Beaverhill Lake and Fort Saskatchewan Production Assets), on September 16, 2002, requesting approval of the sale of production properties to NCE Petrofund Corp. The Board had initiated a written hearing process to deal with the application. However, as a consequence of the negotiated settlement of the re-openers and at the request of both ATCO and the NCC, the process for Application No. 1278434 was suspended pending submission of the Application. To expedite the Board's process in this matter, all interventions and information on the record in Application No. 1278434 were rolled over into this proceeding. At the time Application No. 1278434 was suspended, the registered interveners included the members of the NCC, AltaGas Utilities Inc. and Lakewood Oil & Gas Ltd. (Lakewood). Further, at that time, the Information Request process in respect of Application No. 1278434 was almost complete and evidence had been submitted by Lakewood.

3 PARTICULARS OF THE APPLICATION

In particular, the Application by ATCO requested that the Board approve the rates, tolls, charges and terms and conditions of service for 2002 as determined in accordance with the Memorandum of Agreement dated January 1, 2002 and the amended Agreement included in the Application. ATCO explained the reasons for the re-opener in a settlement brief submitted by letter dated November 26, 2002, as follows:

- Sale of the Viking production assets:

  On December 11, 2001, the Board in Decision 2001-104 approved the sale of the Viking production assets. That sale constituted a re-opener to the Agreement under Clause 6.1, as approved in Decision 2000-85.[3]

[1] Part A: GCRR Methodology and Gas Rate Unbundling
[2] ATCO Gas North; GCRR Methodology And Gas Rate Unbundling - Compliance Filing
[3] Northwestern Utilities Limited - Approval of Rates, Tolls, Charges, and Terms and Conditions of service for Core Customers, and Approval of Amendments to the North Core Agreement

- Legislated income tax rates.

  The Federal and Provincial legislated income tax rates changed in the year 2001 and in the year 2002. This constituted a re-opener to the Agreement under Clause 6.1, as approved in Decision 2000-85.

The following negotiated items, enumerated in sections 1 through 3, including amendments to the Agreement, other adjustments and related matters, will hereinafter be collectively called the "Settlement".

1. Amendments to the Agreement, including:

(a) Clause 4: Amendment provided for a sharing of earnings in excess of 200 basis points above the National Energy Board formula Return for the calendar year 2002. Previously sharing occurred above 300 basis points.

(b) Schedule A: Amendment to include the rates that came into effect January 1, 2002 and April 1, 2002. These rates will be set as final rates.

2. Further matters included in the Settlement, as follows:

(a) an adjustment by ATCO in favor of customers regarding the following amounts:

(i) an amount of $3,200,000 based on estimated income tax rate reductions for 2002;

(ii) an amount of $2,229,000 related to deferred income taxes associated with the 2001 income tax rate change with respect to the 2000 gas cost under-recovery; and

(iii) an amount of $100,000 representing interest on the undistributed portion of the Viking sale proceeds.

(b) an agreed adjustment in favor of ATCO in the amount of $3 million as compensation for the shortfall in recovery of forecast operating and maintenance costs related to production;

(c) a refund to North Core Customers of the net amount of the foregoing adjustments, in the amount of $2,529,000;

(d) abandonment of the AGPL Application for Leave to Appeal Decision 2002-1 (Leave Application) with respect to the Westlock/Lloydminster dispositions;

(e) inclusion of legal fees associated with the Leave Application as a disposition cost for the BHL & Ft. Sask disposition, providing the amount does not significantly exceed estimates;

(f) distribution of net proceeds of $23,036,000 related to the BHL & Ft. Sask disposition to North Core customers, providing the Board approves the sale of the properties;

(g) deferral by AGN of the impact of any unrecovered income tax related to the BHL &Ft. Sask disposition against the North Federal deferred income tax account;

(h) agreement by North Core customers not to pursue any prudence review with respect to the operation of BHL & Ft. Sask assets;

(i) the obligation of Customers to pay for all additional abandonment or removal costs related to BHL & Ft. Sask producing assets; and

(j) payment of all costs relating to the 2002 Re-opener negotiations and disposition of the BHL & Ft. Sask properties from the ATCO hearing cost reserve accounts, based on the Board's guidelines.

3. An agreement to negotiate the methodology for distribution of the proceeds of the Settlement and to submit it to the Board for approval.

ATCO also provided the Board with a copy of a side agreement between ATCO and the NCC for information purposes only. The side agreement stipulated as follows:

> In addressing the 2002 capitalization of the meter recalls and meter refurbishments in the north, no party will refer to or rely on the terms of the North Core Agreement to support its position.

and

> Nothing in the North Core Agreement precludes parties from reviewing and testing the continuity of asset account balances and reserve account balances in the context of the next GRA (general rate application) or at the time of the annual review.

4 VIEWS OF THE PARTIES

This Section of the Decision will summarize the positions of interested parties with respect to the Settlement.

Views of ATCO

ATCO noted that matters in issue resulting from re-openers of the Agreement were to be negotiated through the North Core Committee. The Agreement, as amended effective January 1, 2000, was approved by the Board in Decision 2000-85. ATCO submitted that the Settlement identified the matters in issue and resolved them in a manner that was reasonable and fair to all interested parties. The North Core Committee had not identified any other issues (not referred to in the Settlement) that should be addressed by the Board as a result of the re-openers mentioned. In summary, it was submitted that the Settlement agreement, as it related to these issues, was in the public interest and should be approved by the Board.

ATCO stated that the NCC had reviewed in detail the application of ATCO regarding the BHL & Ft. Sask disposition and was satisfied that the net proceeds to be received by customers were sufficient to meet the Board's "no-harm" test based on assumptions and calculations in accordance with Decision 2001-104. It was understood, however, that this determination was made on a "without prejudice" basis and would not be treated as a precedent for the sharing of proceeds for any other disposition. The benefits to be received from this comprehensive

Settlement also included resolution of the Agreement for 2002 and final disposition of the Westlock/Lloydminster sale proceeds that were the subject of an application for leave to appeal to the Alberta Court of Appeal.

ATCO submitted that its abandonment of the Westlock/Lloydminster appeal eliminated the risk that North Core customers would be required to refund to ATCO approximately $3.5 million of sale proceeds previously distributed. ATCO submitted that the resolution of this matter contributed significantly to the benefits to be derived by North Core customers from this comprehensive Settlement.

In summary, ATCO stated that the Settlement arrangements resolved all outstanding matters relating to the Agreement, with the exception of any sharing arising from 2002 revenues, and all outstanding matters regarding the disposition of ATCO's production and gathering facilities.

Views of NCC

The NCC represented all core customer classes and took the position that this comprehensive Settlement was in the public interest and was reasonable and fair to all interested parties.

On behalf of the NCC, ATCO submitted the consent forms, signed by the customer representatives, in conjunction with the Application, which indicated their ratification of the Settlement. By letter dated November 18, 2002, the NCC indicated that the negotiations had resulted in a successful Settlement and that they did not oppose the sale of the BHL & Ft. Sask producing properties.

Views of Lakewood

Lakewood registered as an intervener in the proceeding related to Application 1278434 regarding the proposed sale of the BHL and Ft. Sask. properties.

Lakewood advised the Board that it had a working interest in the BHL producing properties and had recently served a statement of claim against ATCO and its related companies. Lakewood stated that the claim centered on a contract under which ATCO processed and purchased Lakewood's working interest of natural gas from BHL.

Lakewood stated that there had been difficulties between it and ATCO in discussing contract pricing and process fees, resulting in Lakewood filing a statement of claim against ATCO with respect to these matters. Lakewood cited the historical pace of resolution and an adversarial environment created by ATCO as two of the reasons for Lakewood's intervention.

Lakewood also advised the Board that it had royalty interests in BHL and had ongoing discussions with ATCO regarding royalty related matters. Lakewood submitted that some prior royalty errors had been corrected following a written request. However, Lakewood stated that these corrections were not appropriately communicated to Lakewood and had not been adjusted to the appropriate date.

Lakewood stated that terms of future deductions had not been agreed to, and that deficiencies in some royalty contracts had not been fully addressed.

Lakewood considered that the sale of BHL by ATCO might negate or prolong any negotiated settlement process to resolve these issues. Lakewood stated that it would like its various issues with ATCO resolved prior to the sale of the properties.

5 BOARD FINDINGS

5.1 Background

The Board's Negotiated Settlement Guidelines contained in IL 98-04 provide the framework for the negotiated settlement process, which is in keeping with the Board's objective of achieving greater regulatory efficiency and effectiveness. Negotiated settlements allow applicants and interveners to agree on just and reasonable rates without resorting to the Board's litigated process. The encouragement to utilize the settlement process should not be viewed by parties as a relinquishment by the Board of its responsibility to uphold the public interest. The negotiated settlement must be supported by cogent rationale and must be reviewed by the Board.

The Board's views with respect to the process and its mandate in the context of a negotiated settlement was discussed in detail in Decision 2000-85, which dealt with the previous re-opener negotiations to the Agreement. As was indicated in that Decision, the Board will examine the Settlement in light of the Negotiated Settlement Guidelines. In particular, the Board is guided by the following principles:

- The settlement process must be fair and open to interested parties and sufficient information must be made available to understand the issues being negotiated. All parties should be provided an opportunity to participate and have their interests considered.
- Applicants have the onus of providing sufficient evidence and rationale to support the settlement.
- When presented with a settlement, the Board will not approve it in part if the agreement is contingent on the Board accepting the entire settlement. If the Board rejects the settlement, it will provide reasons outlining the areas causing concern.
- In determining the acceptability of a settlement, the Board will consider whether the agreement is in the public interest, is reasonable and fair to all interested parties, has a well-substantiated rational basis, and is complete and adequate to support the application.

In this case, the Board has been presented with a Settlement unanimously agreed to by the interested parties with one exception. The exception stems from the intervention by Lakewood to Application 1278434, the sale of BHL & Ft. Sask properties. However, the Board is of the view that the matters raised by Lakewood in its civil action against ATCO and other disputes with ATCO are not matters within its jurisdiction. In terms of matters within the Board's jurisdiction, the Settlement is tantamount to a consensus settlement.

In evaluating a settlement, the Board considers that two main questions arise. First, the Board must examine the settlement process to ensure it was fair and in accordance with the criteria set out in the Negotiated Settlement Guidelines. In particular, the Board considers that it should be satisfied that;

- proper notice had been provided,
- no negative response was received to the notice for objections,

- due process had been provided to participants by allowing for meaningful participation in the process including the funding of interveners' participation,
- Board staff had participated as an observer in the settlement discussions, and
- all parties expressing an interest have signed off on the settlement.

Second, the Board must evaluate the settlement to determine whether there are elements which, in the Board's view, could result in rates that are not just and reasonable. In the usual circumstances of a sale of assets out of the ordinary course of business, the Board must ensure that the customers are saved harmless and does so by using benchmark tests such as one to establish a No-harm threshold. The Board then applies the "TransAlta formula" to allocate proceeds of the sale between customers and shareholders. However, in the situation of a settlement, the Board believes that it should apply this approach with caution. The Board is charged with determining whether the settlement will result in rates that are just and reasonable. The Board is mindful that in a package settlement, as it is in this case, compromises are struck that underpin the acceptability of the agreement among the parties, the scope and importance of which may not be readily apparent to the Board. In Decision 2000-85, the Board established the principle that for unanimous settlements, the Board will only intervene "in circumstances where the settlement is patently against the public interest or contrary to law." In such circumstances, the option that the Board would pursue would be to send the settlement back to enable parties to deal with the element(s) of the settlement with which the Board has concern. The parties could then return to the negotiated settlement process and attempt to resolve the issues of concern. The objective would be resolution of these particular issues and submission of a revised settlement agreement.

Mindful of the foregoing, the Board will consider the specific circumstances surrounding the Application and the Settlement.

5.2 Views Regarding Fairness of the Settlement Process

In reviewing the fairness of the settlement process the Board notes that the following groups agreed with the Settlement:

- Aboriginal Communities[4]
- Alberta Urban Municipalities Association
- AltaGas Utilities Inc
- Canadian Forest Products Limited
- City of Camrose
- City of Edmonton
- City of Grande Prairie
- Federation of Alberta Gas Co-ops
- Gas Alberta Inc.
- Northern Alberta Institute of Technology
- University of Alberta

In addition, the Board notes there were no objections to the public notice or from any of the interested parties of record except that of Lakewood, as noted earlier.

[4] Comprised of Treaty 8 First Nations of Alberta, Assembly of First Nations and Maskwachiys Cree

In this case a staff member of the Board monitored the negotiated settlement meetings, except the last two meetings. The role of the staff member is to advise the Board as to the fairness of the process, while keeping the substance of negotiations confidential. In this case the staff member advised the Board that the process was open, fair and inclusive, with all affected parties being invited to participate. The staff member further advised that parties to the meetings made effective use of the process to deal with the large amount of technical information, that intervener groups availed themselves of technical experts to provide analysis and to assist them with their negotiations, and that all significant issues that would normally arise in a GRA appeared to have been explored.

In view of these considerations, the Board finds that the Settlement was arrived at fairly and in accordance with the Negotiated Settlement Guidelines. Nonetheless, the Board must evaluate whether or not any of the elements to the Settlement raise a concern for the Board and whether or not the Settlement appears fair and reasonable as between the customers and ATCO.

The Board has chosen to review and consider the Settlement as indicated hereinafter. The Board recognizes that it does not have before it the precise elements considered by the parties to the Settlement. However it has utilized the methods described herein to provide a general test of reasonableness. The Board would note that it is presently considering the issue of the appropriate level of information, evidence and analysis that will be required to be filed in support of future applications for approval of negotiated settlements, and that the Board's requirements in this area may well be refined subsequent to the issue date of this Decision.

Technical Analysis of the Settlement

The re-opener to the Agreement was the result of two elements. The first was a reduction of the income tax rates that affected the income tax for 2002 and deferred income taxes associated with 2000 gas cost under recovery. The actual income tax for 2002 is unknown, however, the Board was able to compare the amounts filed for 2001 and the Deferred Gas Account recovery filing for 2000. These amounts serve as an acceptable surrogate for purposes of the Board's general test of reasonableness in these circumstances the Board concludes that the amounts of $3.2 million and $2.229 million to be refunded to customers are within the range that is reasonable, and that they adequately account for the change to the income tax rates.

The parties also agreed that $100,000 would be refunded to customers in recognition of the interest applicable to a portion of the Viking sale proceeds (approximately $9 million), which were paid out in November 2002 rather than with the bulk of the proceeds, which had been paid out in March 2002. The Board considers this to be reasonable.

The second element to trigger the re-opener was the sale of the Viking producing properties. As mentioned earlier, interim rates had been approved effective January 1, 2002. In the Settlement the parties agreed that the interim rates could be set as final rates for 2002. The information filed in the Application indicates that the interim rates, effective January 1, 2002, were derived by taking $0.163/GJ from a 1997 cost of service study (COSS) related to production and subtracting $3.9 million of allocated costs, which resulted in a value of 0.134/GJ. This latter value was further reduced to 85% to represent the proportion of company owned production from the Viking properties, resulting in $0.114/GJ being used as the rate reduction.

The Board does not have at its disposal the 1997 COSS to examine the reasonableness of the Settlement as it pertains to fixing the rates effective January 1, 2002 as final. However, a rough comparison of values as described by ATCO in the Application to the information filed in the Viking sale, Application No. 2001017, would indicate that the diminishing factor of 85% is within a range that is reasonable.

The Board also notes that two other items agreed to by the parties affect the finalizing of the rates in the Settlement. One is in the amount of $3 million as agreed compensation to ATCO for a shortfall in recovery of forecast production operating and maintenance costs. The Board has some reservations with respect to this item, as it is basically akin to an increase in the revenue requirement and therefore would be counter to a rate reduction in recognition of the removal of assets from rate base. However, the Board notes that the Settlement is to be reviewed as a package, and the fact that one element of the Settlement may be problematic does not mean that the Application must be denied. Another item potentially affecting 2002 rates is the amendment to the Agreement whereby the sharing formula threshold is lowered by 100 basis points from 300 to 200 for 2002, the final year of the Agreement. Taken together, the three items just discussed (the interim rates resulting from the Viking sale, the recovery of production operating costs and the reduction in the sharing threshold) likely indicate some give and take between the parties in reaching the Settlement. The Board also acknowledges that the parties, when reaching an accord, will have considered the impact of all the elements of the Settlement.

A major component of the Settlement resulted from the inclusion of the sale of the BHL & Ft. Sask producing properties, which was initially being dealt with in a separate process. In the Settlement the parties have agreed that the sale should be approved and that the North Core customers will receive $23,036,000. This is a fixed amount net of the costs of disposition and return of the net book value of the assets to the shareholders. To test the reasonableness of this amount to be paid out to customers, the Board considered its approved methodology to calculate a no-harm threshold and the "TransAlta formula" used in past decisions by the Board. The Board is satisfied that the agreed amount to be paid to customers in the Settlement will fulfil the Board's requirement that the customers should receive an amount no less than the no-harm threshold, and that the sharing of the proceeds from the sale can be determined to be of the same order of magnitude as that which would result using the "TransAlta formula."

One other rate item was agreed to in the Settlement. The rates approved effective April 1, 2002 on an interim basis were agreed to be set as final rates. The rate changes that resulted in establishing the rates effective April 1, 2002 were initiated by Decision 2001-75. Subsequently the Board issued Decision 2002-035 wherein the Board noted:

> In the Application, ATCO indicated that the Company believed it had an agreement with the North Core Committee (NCC) to implement the changes to its rate schedules as identified in the Application on an interim, refundable basis pending resolution of the re-opener to North Core Agreement resulting from the sale of the Viking producing properties. [5]

The Board further stated:

> Based on review of the Mock Application, the Delivery Rate Application, and comments of interested parties, the Board is satisfied that, with incorporation of the directions in this

[5] Decision 2002-035, p. 2

> Decision, the ATCO proposals for determination of the GCRR and revision to delivery rates on a going forward basis effective April 1, 2002 are appropriate and consistent with the directions in Decision 2001-75. [6]

The Board approved the rates on an interim basis in Order U2002-136 pending completion of negotiations between ATCO and the NCC. The Board considers that ATCO and the NCC have resolved the Viking re-opener issue and therefore the Board is prepared to accept the request to set as final the rates effective April 1, 2002.

The Settlement included a number of other considerations, as noted in Section 3 of this Decision report, which the Board believes provide further indications of the balancing of the interests of ATCO and the NCC. The Board will not specifically address each item, but accepts that they form part of the overall Settlement for which ATCO has requested approval in its entirety, and which is supported by the NCC.

The Board has considered the various components of the Settlement and is satisfied the Settlement reflects an overall balance as between ATCO and its customers. The Board is satisfied that the rates to be set as final are just and reasonable.

Based on the amounts to be credited to customers and to ATCO, the net amount to be paid out to customers totals $25,565,000. The Board notes that ATCO and the NCC will negotiate the specific distribution methodology and submit it to the Board for approval.

6 ORDER

IT IS HEREBY ORDERED THAT:

(1) The Application is approved in its entirety.

(2) ATCO shall submit to the Board, within 30 days after Closing of the sale of the Beaverhill Lake and Fort Saskatchewan properties, a filing for acknowledgement that will provide a final statement of the proceeds from the sale.

(3) ATCO shall submit to the Board, within 40 days after Closing of the sale of the Beaverhill Lake and Fort Saskatchewan properties, an application for approval of the methodology for distribution of the proceeds of the Settlement among customers (subsequent to negotiation with the NCC, as noted above).

(4) The ATCO Gas and Pipeline Ltd. – North Rate Schedules attached as Schedule A to Order U2001-501 and Order U2001-543 are hereby approved as final on consumption on and after January 1, 2002.

(5) The ATCO Gas – North Rate Schedules attached as Schedule A to Order U2002-136 are hereby approved as final on consumption on and after April 1, 2002.

[6] Ibid, p. 10

(6) The ATCO Pipelines – North Rate Schedules attached as Schedule B to Order U2002-136 are hereby approved as final on consumption on and after April 1, 2002.

Dated in Calgary, Alberta on December 24, 2002.

ALBERTA ENERGY AND UTILITIES BOARD

(original signed by)

B. T. McManus, Q.C.
Presiding Member

(original signed by)

C. Dahl Rees
Acting Member

(original signed by)

Michael J. Bruni, Q.C.
Acting Member