February 14, 2006

Energy Law Bulletin

Supreme Court of Canada Protects Property Rights of Public Utilities

The Supreme Court of Canada rendered an extremely significant decision last week in the long-running struggle between Alberta utilities and their regulator, the Alberta Energy and Utilities Board (AEUB), over the latter's right to allocate to ratepayers profits realized on the sale of former utility assets. In *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)* 2006 SCC 4 the majority opinion of Bastarache J. emphatically rejected the AEUB's arguments that it could make such an allocation in the absence of an express statutory provision granting it the right. In light of similar statutory regimes and regulatory practices across the country, we expect the decision to have a material effect on the on-going relationship between public utilities and their provincial regulators for years to come.

The dispute at the heart of the case concerns the disposition of net proceeds realized by ATCO Gas & Pipelines Ltd. (ATCO) on the sale of land and buildings that had been previously used by ATCO to provide utility service. After accounting for disposition and remediation costs, the net sale proceeds amounted to $6,085,000. At the time of the sale the (depreciated) net book value of the property was only $225,245. In the course of issuing an approval to ATCO allowing it to sell the property, the AEUB concluded that the first $225,245 of the net sale proceeds ought to be allocated to shareholders on account of the net book value of the property. In this way the shareholders were meant to recover their original investment in property they were no longer dedicating to public utility service, less the depreciation amounts nominally recovered in previous rates. The balance of the proceeds was to have been split between ratepayers and shareholders, with ratepayers receiving over $4,000,000 in the form of an offset to ATCO's next revenue requirement (which would have the effect of making ATCO's rates lower than they otherwise would be). Significantly, the AEUB determined that the sale of the property would not cause any harm to ratepayers.

On a successful appeal by ATCO, the Alberta Court of Appeal directed the AEUB to allocate the net sale proceeds of the sale to shareholders, but left open the possibility, in different circumstances, of the AEUB allocating some or all of the accumulated depreciation to ratepayers. (That is, some or all of the difference between net book value and original cost where the sale price is greater than original cost, or between net book value and the sale price where the sale price is less than the original cost.)

The City of Calgary, acting in its capacity as a ratepayer of ATCO, appealed to the Supreme Court of Canada, arguing that the AEUB's allocation of proceeds to ratepayers ought to be restored, while ATCO cross-appealed, arguing that there was no jurisdiction in the AEUB to make any allocation of net sale proceeds, including any amount in respect of accumulated depreciation, regardless of the circumstances.

Having concluded that the AEUB had no express jurisdiction to condition approval of an asset sale application on an allocation of proceeds to ratepayers, a majority of the Supreme Court of Canada dismissed Calgary's appeal, and allowed ATCO's cross-appeal. Bastarache J. summarized the views of the majority in the following words:

> "In my view, allowing the Board to confiscate the net gain of the sale under the pretence of protecting rate-paying customers and acting in the 'public interest' would be a serious misconception of the powers of the Board to approve a sale; to do so would completely disregard the economic rationale of rate setting, as I explained earlier in these reasons. Such an attempt by the Board to appropriate a utility's excess net revenues for ratepayers would be highly sophisticated opportunism and would, in the end, simply increase the utility's capital costs [citation omitted]. At the risk of repeating myself, a public utility is first and foremost a private business venture which has as its goal the making of profits. This is not contrary to the legislative scheme, even though the regulatory compact modifies the normal principles of economics with various restrictions explicitly provided for in the various enabling statutes."

The strong dissenting opinion parts course with the majority decision in a number of important ways, but none so important, arguably, as in the characterization of risk allocation in the rate-setting process. In particular, the majority speaks of a utility's "opportunity" to earn a reasonable rate of return, consistent with the utility bearing the risk of under-earning and having the benefit of any over-earning. In contrast, the dissent opinion suggests throughout that the utility is entitled, as a matter of practice if not law, to the allowed rate of return approved by the regulator regardless of whether the forecasts upon which revenue requirements are based ever come to pass. Interestingly, the extent to which ATCO, through deferral accounts or other such mechanisms, in fact may benefit from over-earning, or is shielded from the risk of under-earning, is never addressed in the decision.

Finally, the allowance of ATCO's cross-appeal raises interesting questions regarding the recovery in rates of depreciation expenses in respect of assets that may potentially or actually appreciate. It can be expected that these and other issues arising from the decision will provide fodder for intervenor groups, regulators and utilities for some time.

Please call Jeff Christian at (604) 631-9115, in Vancouver, if you have any questions about this bulletin, or any of Lawson Lundell LLP's lawyers listed below to enquire about our firm or our energy law practice group.

Chris W. Sanderson, Q.C.: (604) 631-9115 (Vancouver)
Jerry W. Schramm: (403) 781-9475 (Calgary)
Geoff P. Wiest: (867) 669-5544 (Yellowknife)