

BOARD ORDER: MGB 036/07

IN THE MATTER OF THE *Municipal Government Act* being Chapter M-26 of the Revised Statutes of Alberta 2000 (Act).

AND IN THE MATTER OF COMPLAINTS respecting Linear Property Assessments for the 2006 tax year filed on behalf of Pan Canadian Energy Services, c/o Encana Corporation

BETWEEN:

Pan Canadian Energy Services, (Encana Corporation) as represented by Wilson Laycraft LLP - Complainant

- a n d -

The Crown in Right of the Province of Alberta (Assessment Services Branch, Ministry of Municipal Affairs) as represented by Brownlee LLP - Respondent

BEFORE:

Members:

T. Robert, Presiding Officer
M. Chilibeck, Member
P. Petry, Member

Secretariat:

M. d'Alquen

Upon notice being given to the affected parties, a hearing was held in the City of Calgary, in the Province of Alberta from December 11 to 14, 2006. The hearing related to complaints to the Municipal Government Board (MGB) regarding assessments prepared by the Designated Linear Assessor (DLA) regarding the following Linear Property Assessment Unit Identifiers (LPAU-IDs):

<u>Tax year</u>	<u>LPAU-ID</u>	<u>Assessment Amount</u>	<u>Description</u>
2006	2178726	\$53,337,690	Gas Turbines Units 1 and 2
2006	2178727	\$16,204,910	Steam Turbine
2006	2178729	\$ 3,164,040	Substation
2006	2178730	\$ 216,610	Power Line

OVERVIEW

The properties under complaint form part of the electric power generation plant known as the Cavalier Generating Station (Cavalier).

The Complainant argues that Cavalier's unique design coupled with unanticipated changes in regulatory and economic conditions have resulted in decreased production, decreased earnings potential, and increased economic, functional and physical obsolescence. The Complainant argues that this loss in value is not accounted for under Schedule C of the "Alberta Linear Property Assessment Minister's Guidelines" (Minister's Guidelines). Therefore, it requests a further reduction under Schedule D.

The Respondent stresses that Schedule C depreciation is "exhaustive" under the Minister's Guidelines, and covers all types of obsolescence except "highly unusual site specific circumstances such as catastrophic failure". Consequently, the Respondent says Schedule D only provides authority to grant additional depreciation due to losses stemming from extraordinary or catastrophic events, which the Complainant has failed to prove. Furthermore, the Respondent argues that even if Schedule D depreciation were warranted in principle, the Complainant's evidence is replete with error and cannot be relied upon.

BACKGROUND

Parties

The Complainant is Pan Canadian Energy Services (Encana), which was assessed in respect of the Cavalier facility. As discussed in DL 155/06, the Complainant elected to have its appeal heard by written submissions alone; accordingly, it neither called witnesses nor made an appearance to present an oral summary of evidence and argument.

The Respondent is the Assessment Services Branch of the Alberta Department of Municipal Affairs, which is responsible for preparing assessments of all linear property in the province of Alberta.

The Minister's Guidelines

Alberta's regulated assessment scheme classifies rate controlled power generation plants as linear property. As such, they are assessed pursuant to rules set out in the "Alberta Linear Property Assessment Minister's Guidelines" (Minister's Guidelines), which are established by Ministerial Order from year to year. The Designated Linear Assessor (DLA) of the Department of Alberta Municipal Affairs is responsible for applying the Minister's Guidelines to prepare the linear assessments.

BOARD ORDER: MGB 036/07

Among other things, the Minister's Guidelines require the DLA to apply depreciation to an asset's "base cost". Base cost is established under "Schedule A" and "Schedule B". Depreciation is then split into amounts under "Schedule C" and "Schedule D". Schedule C depreciation is mandatory and must be determined by reference to prescribed tables. For some properties, including the subject, the DLA also has discretion to apply additional Schedule D depreciation "only on a case-by case basis and only if the operator provides acceptable evidence". The dispute centres on whether the Respondent has provided "acceptable evidence", thus qualifying for Schedule D depreciation.

Previous year's complaint

This is not the first time the Complainant has filed a complaint concerning Cavalier. The MGB heard a similar complaint for the 2004 and 2005 tax years, which resulted in Order MGB 039/06. That Order is now before the Court of Queen's Bench in the context of a judicial review application initiated by the Complainant. As the Court of Queen's Bench has not yet decided the matter, the MGB rendered the current decision without the benefit of the Court's direction in that matter.

Property under Complaint

MGB 039/06 described the property under complaint as follows:

Property under complaint

Cavalier - located in Wheatland County - is a 105 megawatt (MW) natural gas fired combined cycle plant, consisting of two 40 MW rated gas turbines and a 25 MW rated steam turbine. The gas turbines were commissioned in July of 2001 and the steam turbine in April 2003.

At the current hearing, the Respondent clarified that the turbines were in fact modified in scale to two 45 MW gas turbines with Heat Recovery Steam Generators and a 25MW steam turbine nominally yielding 115 MW but listed on the Alberta Electric System Operator (AESO) Current Supply Demand site as 120MW.

Deregulation of Power Market

MGB 039/06 also described the power generation and services market in Alberta as follows:

Hourly Power Generation Market

Alberta began deregulation of its electric power generation market in 1995. This process involved the initiation of an hourly market. Under this system, electrical generating units supply daily offers to sell portions of their capacity with up to seven differently priced blocks of capacity allowed per unit. Offers are then pooled and “stacked” so that a dispatcher may call upon capacity as required for the lowest available price. A unit that is dispatched and operates for an hour receives the AESO price for that hour regardless of the offer price. Thus, a unit can ensure dispatch by offering at \$0.00 and then collect the going AESO price for each hour of operation.

Operating Reserves Contracts

Operating reserves are supplied as capacity availability rather than energy. The Province requires maintenance of operating reserves equivalent to a certain percentage of the demand for electricity at any given time. To this end, AESO acquires operating reserves through a competitive market operated by the Alberta Watt Exchange. Operating reserves are acquired for all hours of the day and are generally priced at a discount to the energy price.

PRELIMINARY ISSUES:

Preliminary Issue 1: Willsay Statements for Judith Athaide, Grant Clarke, and Larry Kennedy

As discussed in DL 155/06, the Complainant elected to have its complaint heard by written submissions alone. Before making this election, the Complainant submitted one page willsay statements outlining in bullet form the topics and conclusions that Judith Athaide, Grant Clarke, and Larry Kennedy were expected to discuss as witnesses before the MGB. Given that the Complainant has now elected not to call these witnesses, the Respondent requested that their will-say statements be removed from the record. The MGB agreed with this request.

Preliminary Issue 2: Confidentiality of portions of the Complainant’s evidence

In preliminary decision letter DL 127/05, the MGB ordered that certain portions of the Complainant’s disclosure be sealed to protect the confidential nature of information that the Complainant claimed could cause serious financial harm if revealed to competitors. The MGB also ordered the Respondent to ensure that any of its witnesses making use of the confidential material file undertakings not to use the information for purposes unrelated to the hearing. The Complainant requested that the MGB order the same documents to continue to be sealed subsequent to the merit hearing. Accordingly, Tabs 6, 8, 9, and 10 of the Cogent Report (Exhibit

BOARD ORDER: MGB 036/07

E-10, formerly Exhibit C2) shall be sealed after the release of this Order pursuant to the provisions of the MGB's Procedure Guide.

Preliminary Issue 3: Consultant's reports commissioned by Respondent in relation to Schedule C of the Minister's Guidelines.

During the preliminary hearings leading up to the merit hearing, the Complainant indicated that it required disclosure of reports commissioned by the Respondent in relation to the preparation of the Schedule C tables. This material includes the report by Gannett Fleming Valuation and Rate Consultants Inc. entitled "Estimation of Accrued Depreciation for Alberta Electric Properties". The Complainant indicated that it was trying to obtain the material by means of a Freedom of Information and Protection of Privacy (FOIP) application. However, it indicated that if its application were to prove unsuccessful, it would request the MGB to order production under section 497 of the *Municipal Government Act*. Prior to the merit hearing, the Respondent indicated that its FOIP request had been successful and placed the Gannett Fleming report (along with similar material obtained through FOIP) before the MGB. Accordingly, there was no need to consider whether the material should be produced by way of an order under section 497.

ISSUES

Issue 1: Is the evidence regarding Cavalier's value as provided by Deloitte & Touche and The Cogent Group Inc. acceptable evidence of additional depreciation deductible under Schedule D of the Minister's Guidelines?

Issue 2: Does the evidence of physical obsolescence, functional obsolescence, and changes in anticipated depreciation pattern and useful life as submitted by the Complainant show additional depreciation value deductible under Schedule D of the Minister's Guidelines?

Issue 3: Should the matter be referred to the Minister under section 516 of the *Municipal Government Act*?

LEGISLATION

In order to decide these matters, the MGB examined the relevant legislation, including the following provisions.

***Municipal Government Act* (Act)**

Section 284(1)(g) defines electric power systems. Section 284(1)(k)(i) then includes electric power systems as linear property.

BOARD ORDER: MGB 036/07

284 (1) *In this Part and Parts 10, 11 and 12,*

(g) *“electric power system” means a system intended for or used in the generation, transmission, distribution or sale of electricity;*

(k) *“linear property” means*

(i) *electric power systems, including structures, installations, materials, devices, fittings, apparatus, appliances and machinery and equipment, owned or operated by a person whose rates are controlled or set by the Public Utilities Board or by a municipality or under the Small Power Research and Development Act , but not including land or buildings,*

Section 292 establishes the DLA’s duty to assess linear property.

292 (1) *Assessments for linear property must be prepared by the assessor designated by the Minister.*

(2) *Each assessment must reflect*

(a) *the valuation standard set out in the regulations for linear property, and*

(b) *the specifications and characteristics of the linear property on October 31 of the year prior to the year in which a tax is imposed under Part 10 in respect of the linear property, as contained in*

(i) *the records of the Alberta Energy and Utilities Board, or*

(ii) *the report requested by the assessor under subsection (3).*

(3) *If the assessor considers it necessary, the assessor may request the operator of linear property to provide a report relating to that property setting out the information requested by the assessor.*

(4) *On receiving a request under subsection (3), the operator must provide the report not later than December 31.*

(5) *If the operator does not provide the report in accordance with subsection (4), the assessor must prepare the assessment using whatever information is available about the linear property.*

Section 293(1)(2) establishes a further duty to prepare assessments by applying the valuation standards set out in the Regulations.

293 (1) *In preparing an assessment, the assessor must, in a fair and equitable manner,*

(a) *apply the valuation standards set out in the regulations, and*

(b) *follow the procedures set out in the regulations.*

BOARD ORDER: MGB 036/07

(2) If there are no procedures set out in the regulations for preparing assessments, the assessor must take into consideration assessments of similar property in the same municipality in which the property that is being assessed is located.

AR 220/2004 – The Matters Relating to Assessment and Taxation Regulation (MRAT)

MRAT establishes valuation standards for various types of property. Market value is the default valuation standard for improvements pursuant to section 5(1)(b). However, section 5(1)(a) identifies certain types of property for separate valuation standards of assessment. These “regulated” standards are the values obtained by following procedures set out in the Minister’s Guidelines.

5(1) The valuation standard for improvements is

- (a) the valuation standard set out in section 7, 8 or 9, for the improvements referred to in those sections, or*
- (b) for other improvements, market value.*

Sections 3(2), 5(2), 6(2) and 7(2) stipulate that procedures set out in the Alberta Linear Property Assessment Minister’s Guidelines must be used to calculate assessments for regulated property, including farmland, railway, linear, and machinery and equipment. For purposes of brevity, only section 8(2) (relating to linear property) is reproduced below.

8(2) In preparing an assessment for linear property, the assessor must follow the procedures set out in the Alberta Linear Property Assessment Minister's Guidelines established and maintained by the Department of Municipal Affairs, as amended from time to time.

2005 Minister’s Guidelines

The “2005 Alberta Linear Property Minister’s Guidelines” (Appendix II of the 2005 Minister’s Guidelines) contain the procedures the Assessor must use to determine assessments for linear property. This process involves calculating the product of four factors:

- Schedule A factor - “base cost”,
- Schedule B factor - Assessment Year Modifier,
- Schedule C factor – Depreciation, and
- Schedule D factor - Additional Depreciation

Section 1.003 describes the purpose of the Schedule A, B, C and D factors. In particular, Schedules C and D are described as follows:

- (c) **Schedule C** – provides the process for determining depreciation or lists the depreciation factor allowed by the *2005 Alberta Linear Property Assessment Minister’s Guidelines*. Schedule C factors are specified to three significant

digits. **The depreciation factors prescribed in Schedule C for linear property are exhaustive. No additional depreciation is allowed except as specified in Schedule D.**

- (d) **Schedule D** - provides the process for determining additional depreciation or lists the additional depreciation factor allowed by the *2005 Alberta Linear Property Assessment Minister's Guidelines*. Schedule D factors are specified to three significant digits. **The additional depreciation for linear property described in Schedule D is exhaustive. No additional depreciation can be given by the assessor.**

Section 2.005 gives more specific direction regarding Schedules C and D for Electric Power Systems. In particular, it indicates that Schedule D depreciation for such property is limited to "highly unusual site specific circumstances such as catastrophic failure".

2.005 Electric Power Systems – Schedules C and D

(a) The depreciation factors prescribed in Schedule C for linear property are exhaustive. No additional depreciation is allowed except as specified in Schedule D.

(b) The Schedule C Depreciation Tables for ACCs beginning with GEN reflect all physical, functional, all economic and net salvage considerations. Schedule D depreciation for ACCs beginning with GEN is only allowed for circumstances not considered in Schedule C. Given the all inclusive nature of the Schedule C depreciation factors for ACCs beginning with GEN, Schedule D depreciation is limited to highly unusual site specific circumstances such as catastrophic failure.

Table 2.1 identifies the Schedule A, B, and C factors for the subject property. The included costs - "ic"- used in Schedule A are identified by reference to the Alberta Construction Cost Reporting Guide (Appendix V of the Minister's Guidelines), while the cost factor –"cf" – is fixed according to year of construction. The Schedule B factor – fixed at 1.202 by Table 2.1 – stipulates the combined year over year change in the value of property components. The Schedule C depreciation tables are set out in the Tables indicated in Table 2.1. Finally, the Schedule D factor is set at 1.00, but the assessor has discretion to allow additional depreciation on a case-by-case basis for some types of property, including the subject property.

BOARD ORDER: MGB 036/07

TABLE 2.1 CALCULATION PROCESS FOR ELECTRIC POWER SYSTEMS ACCs

Notes

...

(f) ** ... For the ACC SST 10 and ACCs beginning with GEN, the assessor may allow additional depreciation (Schedule D) only on a case-by-case basis and only if the operator provides acceptable evidence.

ACC	ACC Description	Schedule			
		A	B	C	D
...					
GEN 300	Other Facilities not Listed-Greater Than 1 and Less Than or Equal to 50 Megawatt Units	<i>ic x cf</i>	1.202	Table 2.28 Column 1	1.000**
GEN 301	Other Facilities not Listed-Greater Than 50 and Less Than or Equal to 100 Megawatt Units	<i>ic x cf</i>	1.202	Table 2.29 Column 1	1.000**
GEN 302	Other Facilities not Listed-Greater Than 100 Megawatt Units	<i>ic x cf</i>	1.202	Table 2.30 Column 1	1.000**

Table 2.28 (reproduced partially below) identifies the Schedule C factors. The table specifies a fixed and immediate factor of 0.750 (25% depreciation) and maximum factor of 0.200 (80% depreciation) after a certain number of years.

TABLE 2.28 SCHEDULE C FACTORS FOR ACCs AS IDENTIFIED IN TABLE 2.1

Chronological Age	Column							
	1	2	3	4	5	6	7	...
0	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
1	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
2	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
3	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
4	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
5	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
6	0.750	0.750	0.750	0.750	0.750	0.750	0.750	...
7	0.733	0.733	0.730	0.728	0.725	0.723	0.719	...
8	0.696	0.695	0.693	0.691	0.689	0.686	0.682	...
9	0.660	0.659	0.657	0.655	0.653	0.650	0.647	...
10	0.624	0.623	0.622	0.620	0.618	0.615	0.612	...
...
25	0.200	0.200	0.200	0.200	0.200	0.200	0.200	...

Issue 1: Is the evidence regarding Cavalier's value as provided by Deloitte & Touche and The Cogent Group Inc. acceptable evidence of additional depreciation deductible under Schedule D of the Minister's Guidelines?

Complainant's Position

Summary

While the Complainant submitted a short brief and some further supplementary materials, it was content for the most part to rely on the same written submissions that were presented for the MGB's consideration at the prior year's hearing. In essence, its argument remains that the Respondent failed to recognize depreciation allowable under Schedule D to reflect evidence of a further loss in value due to unanticipated changes in regulatory and economic conditions that forced Cavalier to operate in a fashion ill suited to its design. The Complainant claims the evidence presented shows Cavalier was forced to operate as a "peaker" plant during hours when prices and demand were high rather than as a base load plant with an expected capacity factor of over 95%. As a result, it says its earnings potential was severely reduced, resulting in a loss in value beyond that captured under schedule C depreciation.

Cogent Reports

In support of its position, the Complainant points to the Reports supplied by the Cogent Group Inc. The principal author of those reports is Ms. Athaide, a professional engineer with expertise in the area of the Alberta energy market. The Cogent reports suggest that Cavalier was designed in 2000 in response to an Invitation to Bid on Credits (IBOC) put out by the Alberta Energy Supply Operator (AESO). At that time, the AESO indicated that additional generation capacity was required to avoid the possibility of voltage collapse in the Calgary region. As an incentive to build and operate a plant near full capacity, the IBOC contemplated performance based credit payments if Cavalier's energy ratio (generation output over capacity hours) remained above 95%. Thus, Cavalier was designed and built with the expectation that it would be a base-load generating plant.

The anticipated capacity shortage did not materialize. Instead, changes in regulatory and economic conditions resulted in generation supply outpacing demand since 2001, and dramatic drops in electrical energy prices. At the same time, the cost of gas rose dramatically. In the opinion of the authors of the Cogent Report, the combined effect of these changes has been to impair the ability of Cavalier to operate profitably as a base-load generation plant. Since full commissioning in combined-cycle mode, Cavalier's average annual capacity factor has been at or below 40%. In recent years, the Complainant has been able to improve on Cavalier's overall facility usage rate by selling operating reserves. However, the combination of energy and operating reserves has only increased the facility's use to the 50% to 60% range with an average of 59% since 2003.

BOARD ORDER: MGB 036/07

The Complainant does not expect conditions to improve in the future, since the forward market today is trading well below Cavalier's optimal heat rate. Details of Cavalier's heat rate (a key measure of efficiency) in comparison to market heat rates were provided in confidence to the MGB panel and the Respondent. Under such disadvantageous conditions, the Complainant submits that capacity factors will continue to decline, and Cavalier will not recover its fixed operating costs. Accordingly, the Complainant suggested it is highly improbable that the facility will earn positive cash flows before the end of the decade.

Cavalier's Market Value

The Complainant believes that Cavalier's value is nominal as a result of the conditions described above. Furthermore, it suggests Cavalier's assessed value should take its market value into consideration. In this connection, the evidence of Mr. Clark suggests that assessors have always looked at market value as a means to quantify factors that do not exist as a part of the regulated process. Mr. Clark was formerly engaged by the Respondent in a senior capacity to prepare linear assessments.

While the sales approach to estimating market value is not feasible - because sales information for comparable gas fired generating units is unavailable - Cavalier's market value can be estimated by calculating the present value of anticipated future cash flows. Accordingly, the Complainant submitted discounted cash flow projections prepared by Deloitte & Touche LLP, and Cogent Group Inc.

The Deloitte valuation is based on a discount rate of 12.72% to 13.12% and Energy Demand Consulting Associates LTD (EDC) commodity price forecasts. It results in a suggested value between 40.8 and 42.85 million dollars. The Cogent Group valuations reflect 4 different scenarios based on two different assumed operating strategies, two different commodity pricing forecasts prepared by EDC and discount rates of 0, 10, 12, and 15%. Even the most favourable of these scenarios suggests a net present value of all future cash flows of only \$13.3 million. For comparative purposes, the Complainant suggested that Cavalier's current salvage value (net of reclamation costs) would be approximately \$-0.4 to 5.4 million.

Application of Schedule D

In MGB 039/06 and MGB 117/05, the MGB concluded that the intent of Schedule D is to prevent unfair treatment between properties owing to plant specific obsolescence not anticipated under Schedule C. These decisions also found that Schedule D is meant to build flexibility into the depreciation scheme to reflect causes of obsolescence that were not foreseeable but nevertheless affect the rational distribution of included costs over the useful life of an asset. The Complainant acknowledges that the wording of the Minister's Guidelines has changed since the MGB reached these conclusions, but suggests the changes - which state that Schedule D depreciation is limited to highly unusual site specific circumstances such as catastrophic failure - should not alter these findings.

BOARD ORDER: MGB 036/07

As argued above and confirmed by EUB Decision 2000-47, Cavalier is a unique plant designed for a specific environment and a specific set of incentives under the AESO's IBOC. When that environment was altered by regulatory and economic changes, Cavalier suffered poor financial performance that would not have been shared by other plants. In other words, it suffered losses due to site specific circumstances.

As shown by Mr. Kennedy, these circumstances were not anticipated when the Schedule C tables were developed. Mr. Kennedy is a certified depreciation expert employed by Gannett Fleming Inc, who was commissioned to help prepare the Schedule C tables. His report suggests that the Schedule C tables were prepared under the assumption that the facilities they govern would operate near capacity for the foreseeable future. Furthermore, neither operators nor detailed plans of non-regulated generation facilities to be built near Calgary were available when the Schedule C tables were developed. Mr. Kennedy's evidence also supports the view that the regulatory changes made by the Department of Energy uniquely affected a small number of plants that were constructed in the early 2001 – 2003 timeframe (such as Cavalier) and resulted in adjustments to Cavalier's operating status. Accordingly, the Complainant argues that Cavalier suffered site specific loss due to obsolescence that was not foreseen under the Schedule C tables, thereby justifying depreciation under Schedule D.

Respondent's Position

Summary

The Respondent argues that depreciation is only allowed under Schedule D of the regulated system if there is evidence of highly unusual site specific circumstances. The regulatory and economic changes alluded to by the Complainant are not highly unusual or site specific, but apply to all producers. Further, the market value evidence presented by the Complainant is of no relevance, because the regulated assessment regime for linear property is not based on a market value standard. Rather, the regulated valuation standard identified in MRAT refers to procedures established under the Minister's Guidelines. These procedures are designed to yield a depreciated cost value that is not affected by or designed to approximate market value.

In the alternative, the Respondent argues that even if market value evidence is relevant to depreciation under the Minister's Guidelines, the Complainant's evidence is grossly inaccurate and does not support the claimed market value. Furthermore, the Complainant's valuation method does not distinguish the value of the linear property in question, which consists of certain turbines and related equipment, from Cavalier's value as a business entity.

The significance of market value in a regulated assessment context

In support of its position that the regulated assessment value for linear property is not market value, the Respondent points to the evidence of Mr. Driscoll, formerly employed by the Department of Municipal Affairs as Director, Regulated Standards and Utilities Assessment. He indicated that the regulated value for linear property results from calculating $A \times B \times C \times D$, where A represents included costs (expressed in 1994 dollars), B represents a factor to convert included costs to assessment year dollars, C represents depreciation, and D represents additional depreciation due to extraordinary site specific circumstances such as catastrophic failure. This calculation process is mandatory, as indicated under section 8 of MRAT.

Mr. Driscoll stressed that the “included costs” under A in fact exclude many of the costs that would normally be included if the aim were to approximate market value. In addition, there is a fixed and immediate reduction of 25% under Schedule A, which bears no connection to market value. The Respondent notes that these policy choices are often of great benefit to property owners, because they tend to reduce assessed value below market. It also notes that the policy choice of regulated value instead of market value assists with financial planning, because it eliminates uncertainty resulting from unpredictable market value fluctuations. While this regulated system confers many benefits, it does not entitle the taxpayer to take the benefit of market value when it happens to be lower than regulated value.

In further support of its position, the Respondent points to the previous decisions MGB 117/05 and MGB 039/06, where the MGB found that the Schedule C tables are based on principles of depreciation adopted by the EUB, and account for losses due to a wide range of causes including decommissioning costs, functional, physical, and economic obsolescence. Furthermore, these decisions found that the regulated depreciation scheme embodied by Schedule C spreads the included costs of the asset methodically over its anticipated service life. The complementary role of Schedule D is to reflect causes of obsolescence that were not foreseeable under the Schedule C tables, but nevertheless affect the rational distribution of included costs over useful life. Finally, MGB 117/05 and 039/06 found market value is not the valuation standard for regulated property. Thus, while dramatic changes in market value may be symptomatic of additional depreciation, market value is of no assistance in quantifying that depreciation for the purposes of Schedule D.

The Respondent suggests that the evidence upon which the MGB based the above conclusions was the same (or very similar) to that now before it in the form of reports and oral testimony from Mr. Driscoll, Mr. Shymanski, and Mr. Kennedy. Thus, Mr. Shymansky, a professional engineer with expertise in the area depreciation relative to public utilities, again confirmed that Schedule C tables are based on forecasts regarding a wide range of factors, including economic factors. Similarly, in the Complainant’s view, the Gannett Fleming Report now available to the MGB confirms that Schedule C includes a varied and broad range of depreciation factors to capture all forms of depreciation including physical, functional, economic and decommissioning costs.

BOARD ORDER: MGB 036/07

In view of the above considerations, the Respondent suggests that the Complainant must show the following to justify additional depreciation under Schedule D:

- (1) that an unforeseeable and highly unusual event occurred,
- (2) that the event affected Cavalier uniquely,
- (3) that the event caused a reduction to age life, and
- (4) reliable evidence to quantify the reduction.

The Respondent submits that the market value evidence and evidence concerning market conditions does not meet any of the above conditions. With respect to (1) and (2), regulatory changes are not catastrophic or highly unusual events and apply to all producers equally. Similarly, with respect to predictability, the evidence of Mr. Shymanski suggests that the electricity price spike in 2000 to 2001 was an anomalous result of temporary market imperfections and outright market manipulation. Thus, no sophisticated market participant would have expected the high prices to continue, and contemporary industry forecasts predicted their decline. With respect to (3) and (4), market value is not evidence of a reduction in age life and is of no assistance in quantifying such a reduction. Finally, as covered more fully below, the Respondent argued that even if market value were a relevant consideration, the evidence presented is replete with error and does not support the market value claimed.

Reliability of market value estimates presented by Complainant

The Respondent notes that the Complainant's evidence was neither sworn nor presented in person; therefore, it could not be tested by questioning and must be considered less reliable. Furthermore, the sworn evidence of Mr. Popik calls into question the reliability of the Complainant's Cogent and Deloitte reports. Mr. Popik is a Chartered Accountant, a senior appraiser and a member of the Canadian Institute of Chartered Business Valuators. He has considerable experience in the area of business valuation, including valuation of companies in Alberta's oil and gas sector. Mr. Popik indicated that both the Cogent and Deloitte reports submitted to the MGB are unreliable and permeated with errors. Furthermore, the values they identify are enterprise values, meaning that they are the purported value of the business enterprise, rather than the assessment value of the relevant linear property, namely the LM 6000 turbines.

With respect to the Deloitte work product prepared by Mr. Koller, CA – also an accredited business valuator - Mr. Popik noted that it is a draft document. Thus, it provides even less assurance than a "calculation" valuation report or a "notice to reader" set of financial statements. Furthermore, Mr. Popik's review of the Deloitte methodology and arithmetic reveals errors that when corrected result in a value of approximately 104 to 106 million instead of the Complainant's claimed 40 to 42 million dollars. The mistakes include errors in the calculation of the variable cost per megawatt hour (8 million dollar impact), various losses charges (13 and 5

BOARD ORDER: MGB 036/07

million dollar impacts respectively), and the discount rate derived from the weighted average cost of capital (WACC) (38 million dollar impact).

With respect to the Cogent material prepared by Ms. Athaide - the Complainant's expert engineer and utilities consultant - Mr. Popik noted that it is not only unaudited, but contains material errors in methodology and arithmetic. While some of these errors were corrected in response to Mr. Popik's critique, the corrected material itself contains further material errors and inconsistencies. Some of these include:

- failure to account for future tax savings from capital cost allowances (CCA) in respect of undepreciated capital cost (UCC);
- use of stale dated (Oct 2004) price forecast information;
- gross overstatement future estimates of general and administrative expenses due to Excel formula error;
- inconsistencies between historical estimates of general and administrative expenses;
- inclusion of non cash accruals such as depreciation on purported "statement of cash flows";
- failure to reconcile opening and closing cash balances on what are purportedly statements of cash flows.

Furthermore, Mr. Popik noted that Encana's annual report and audited financial statements are silent with respect to any impairment suffered by the Cavalier facility and in fact speak to its strong performance in the third quarter of fiscal 2006 and its ability to act as a natural hedge.

The Respondent concluded that even if Cavalier's enterprise market value were of relevance in a regulated assessment environment, the evidence provided is too unreliable to determine what that value might be.

Findings

- The market value evidence presented by the Complainant is too unreliable to determine the market value of Cavalier.
- The market value evidence presented by the Complainant is not "acceptable evidence" showing additional depreciation as contemplated under Schedule D.
- The regulated assessment value of Cavalier is not equivalent to the lesser of market value or Schedule C depreciated value.

Reasons

Guidance concerning the application of Schedule C and D depreciation for electric power systems is set out under section 2.005, which indicates:

BOARD ORDER: MGB 036/07

(a) The depreciation factors prescribed in Schedule C for linear property are exhaustive. No additional depreciation is allowed except as specified in Schedule D.

(b) The Schedule C Depreciation Tables for ACCs beginning with GEN reflect all physical, functional, all economic and net salvage considerations. Schedule D depreciation for ACCs beginning with GEN is only allowed for circumstances not considered in Schedule C. Given the all inclusive nature of the Schedule C depreciation factors for ACCs beginning with GEN, Schedule D depreciation is limited to highly unusual site specific circumstances such as catastrophic failure.

The Complainant suggests Cavalier suffered from unusual market and regulatory developments that affected Cavalier in a site specific fashion. Furthermore, it suggests that market valuations conducted by the consultants Deloitte & Touche and Cogent Group Inc reflect a dramatic additional loss in value. Even if it could accept that the regulatory and market factors cited by the Complainant were highly unusual, site specific, and akin to catastrophic failure, the MGB cannot accept the market value evidence presented as proof of loss allowable under Schedule D. There are two main reasons for this conclusion, each of them independent of the other.

The first reason is that the Cogent and Deloitte and Touche material is too unreliable to support any conclusions as to Cavalier's market value. It is unaudited and – in the case of Deloitte – marked “for discussion purposes only”. Furthermore, those responsible for the Complainant's estimates were not available to answer questions concerning them, or to clarify errors and inconsistencies noted by Mr. Popik. Indeed, as shown by Mr. Popik, both the Cogent and the Deloitte work products contain errors that erase any probative value they might otherwise have had. With respect to Deloitte, these errors relate to the variable cost per megawatt hour, and the discount rate derived from the weighted average cost of capital (WACC). With respect to the Cogent statements, even the revised material contains unsettling material inconsistencies, including those pertaining to General and Administrative expenses. Also unexplained is the use of accrual accounts on what are purportedly statements of cash flows. In this regard, the MGB notes that the income approach to value is based on the discounted present value of future cash flows.

The second reason is that whereas the Deloitte and Cogent reports focus on market value, the regulated assessment value for linear property is not market value. Rather, linear property assessment is based on a principle that “included” costs in the Construction Cost Reporting Guide (CCRG) must be depreciated over the anticipated useful life of the asset. As indicated by Mr. Driscoll, and discussed more fully in the prior orders MGB 039/06, and MGB 117/05, there is no reason to suspect that market value bears any specific relation to depreciated included costs.

In this connection, the MGB observes that the Act specifically distinguishes between market value properties and regulated properties. This distinction is highly reasonable for linear property, because regulated properties such as electric generation plants do not trade often

BOARD ORDER: MGB 036/07

enough to facilitate a comparable sales approach; furthermore, income approach valuations are subject to uncertainty, are not easily compiled, and require the application of considerable professional judgment. The whole scheme of the linear assessment regime is designed to promote efficiency and predictability through use of the relatively simple depreciated cost based model set out in the Minister's Guidelines.

In view of the above comments and the reasoning in MGB 039/06 and MGB 117/05, with which the MGB is still in agreement, a case for additional depreciation under Schedule D cannot be quantified by reference to market value. Rather, evidence must be provided to show that "highly unusual site specific circumstances" mean the Schedule C tables are not operating as intended to distribute included costs over the asset's useful life. The MGB notes that unlike previous years' complaints, the Complainant has attempted to address this issue through the evidence of Mr. Kennedy. That evidence is considered under the following issue.

Issue 2: Does the evidence of physical obsolescence, functional obsolescence, and changes in anticipated depreciation pattern and useful life as submitted by the Complainant show additional depreciation under Schedule D of the Minister's Guidelines?

Complainant's Position

Mr. Kennedy's report addresses the unanticipated effects on depreciation due to unforeseen market changes. Thus, he indicates that the Schedule C tables were developed in the year 2000 under market conditions requiring all electric generating facilities to run at high utilization rates. Furthermore, he said the changes in electric generation supply and demand, and the increased cost of natural gas were not foreseen when the Schedule C tables were created. Such changes have a significant impact on age life, since the cycling of the units required to provide peaker service as opposed to base load service requires frequent heating and cooling, resulting in a significantly increased amount of wear and tear on the gas turbine units and even more dramatic life-shortening effect on the steam turbines.

With respect to the gas turbine units, Mr. Kennedy states that the Schedule C tables are based on an R3-30 IOWA curve with an economic life of 30 years and a net salvage percentage of -10%. Adjusting those parameters for economic conditions and peaker operating status as of 2005 would result in reduction of average service life from 30 to 20 years, and cause an interim retirement activity resulting in the use of an R0.5 IOWA curve. The same net salvage percentage of -10% would apply. Mr. Kennedy concluded that an additional depreciation allowance of 20% was justified for application to the gas turbine units.

With respect to the steam turbine unit, Mr. Kennedy recommends a further allowance for functional obsolescence. In his view, the steam turbine is not suited to peaking operation, rendering it functionally obsolete. Accordingly, the additional expenditure relating to its installed cost should be deducted under Schedule D.

Respondent's position

The Respondent drew the MGB's attention to the following aspects of Mr. Kennedy's evidence, which reduce the degree of reliance one may place on its conclusions.

- Mr. Kennedy did not give evidence under oath and was not present to answer questions arising from his report.
- Mr. Kennedy's evidence regarding increased wear and tear due to operation as a peaker plant was not backed by reliable documentation such as engineering reports. Neither was there any evidence as to the number of starts and stops that Cavalier experienced as a peaker plant.
- Although Mr. Kennedy's report cites examples of facilities where increased gas prices have decreased the age life of facilities, this evidence is contradicted by that of Mr. Shymanski. Mr. Shymanski showed that the examples in Mr. Kennedy's report were either not comparable (because they were oil fired facilities) or else experienced an increase in age life rather than a decrease.
- Contrary to the evidence of Mr. Kennedy, Mr. Andrews' discussion of manufacturer's information suggests that Cavalier is well suited to operation as peaker plant in combined cycle mode. Mr. Andrews also noted literature that touts the ability of Cavalier's equipment to start easily and quickly. Mr. Andrews is a professional engineer with experience in electric and gas utilities management and design.
- Mr. Andrews testified that the steam turbine in fact increases the efficiency of Cavalier and reduces its heat rate by some 20%, making it more competitive.
- Mr. Andrews established that Cavalier has run at full capacity several times during the year and earned significant revenue from the sale of electricity into the grid.
- The Complainant's annual report makes no reference to material impairment – rather; it suggests Cavalier is a valuable asset to the company and provides a natural hedge to reduce overall risk. Furthermore, it says Cavalier and other power plants have generated significant revenue for the company in the third quarter.

Accordingly, the Respondent suggested that Mr. Kennedy's evidence and conclusions should be given little weight.

Findings

- On balance, the evidence before the MGB is insufficient to show additional depreciation due to unanticipated wear and tear resulting from unusual site specific events.
- On balance, the evidence before the MGB is insufficient to show additional depreciation due to unusual site specific events and a change in the rational distribution of costs over age life.

Reasons

The MGB has indicated in prior orders that evidence showing an unforeseen decrease in age life or other factors affecting the appropriate distribution of costs over age life due to site specific factors would be suitable evidence to support further depreciation under Schedule D. The MGB heard evidence on this point for the first time in the current hearing.

That evidence is conflicting. On the one hand, Mr. Kennedy - who helped to prepare the Schedule C tables - indicates that the change in conditions such as electricity supply and the cost of gas uniquely affected Cavalier. He says Cavalier was designed to run as a combined cycle, gas fired, baseload plant in response to specific incentives established by AESO to meet energy needs in the Calgary area under the economic conditions of the day. In giving this opinion, he is backed by that of Ms. Athaide and the Cogent material.

Mr. Kennedy goes on to say that the changes in economic conditions were not foreseen when the Schedule C tables were prepared, and resulted in the decision to operate Cavalier as a peaking facility. He says this type of operation tends to shorten the age life of gas fired facilities such as Cavalier, and renders the Schedule C factors inadequate. Mr. Kennedy recommends application of a different depreciation curve and a shorter age life to yield a further 20% reduction under Schedule D. In addition, he indicates that Cavalier's steam turbine is functionally obsolete for peaker plant operation, and recommends 100% depreciation under Schedule D.

On the other hand, Mr. Shymanski - a professional engineer with extensive experience in the area of utilities depreciation - suggests that there is no support for Mr. Kennedy's conclusion that a R0.5 Iowa Curve would be appropriate or that capital will be retired and replaced to the extent required for a 20 year life. His evidence and that of Mr. Andrews also refer to industry forecasts apparently pointing to conclusions regarding future economic conditions that are inconsistent with the assumptions Mr. Kennedy suggests form the basis for the Schedule C tables. It is unfortunate that Mr. Kennedy was not present to clarify this circumstance. The evidence of Mr. Andrews also suggests that Cavalier's turbines are well suited to performance in peaker facilities, and that the start up of the steam turbine has been a major advance in the Cavalier's ability to compete. This evidence tends to conflict with the Complainant's view that the steam turbine is functionally obsolete.

On balance, the MGB prefers the evidence put forward by the Respondent. This evidence was sworn and provided in person. In the case of Mr. Shymanski, it also successfully cast doubt on many of Mr. Kennedy's conclusions, including his conclusions regarding the expected life span of facilities as affected by high gas prices and mode of operation. As noted by the Respondent, there was also little in the way of engineering reports or similar documentation concerning starts and stops experienced by Cavalier and the relative wear and tear caused by such operation compared to continuous base-load operation.

BOARD ORDER: MGB 036/07

In view of the above, the MGB finds that on balance the evidence suggests that the change in regulatory and economic conditions and operation as a peaker plant did not produce additional depreciation that can be claimed under schedule D. This conclusion would follow even if it were to be assumed that the change in regulatory and economic conditions cited by the Complainant could be regarded as site specific and highly unusual. Accordingly, the MGB finds that the Complainant has not established a basis for further depreciation under Schedule D.

ISSUE 3: Should the matter be referred to the Minister under section 516 of the Act?

Complainant's request

The Complainant suggests that the circumstances warrant an independent review by the Minister, and requested the MGB to refer the matter to the Minister for that purpose.

Decision on issue 3

The MGB declines to exercise its discretion to forward the matter for the Minister's review under section 516 of the Act.

Reasons

The MGB might consider referring the matter to the Minister if:

- (1) the Complainant were to show that its assessment was unfair in relation to competing properties, but
- (2) the Complainant was nevertheless unable to quantify the amount of an appropriate reduction due to the opaque nature of policy driven regulated depreciation tables.

Neither of these conditions applies under the current circumstances. First, the MGB has found that the evidence before it is insufficient to establish a loss in value relative to other properties. Second, the Complainant had an able witness, who - having participated in their creation - was in a position to explain the derivation and application of the Schedule C tables. Evidence was also put forward by the Respondent in this regard. Accordingly, the MGB declines to exercise its discretion to forward the matter for the Minister's review under section 516 of the Act.

FURTHER CASE LAW

As in the hearing resulting in MGB 039/06, the parties submitted a substantial body of case law, which the MGB reviewed before making its decision. All the cases presented embody useful principles and arguments; however, in attributing weight to the authorities submitted, the MGB took into account that many deal with older legislation or legislation from other jurisdictions where the valuation standard is not the current regulated standard for linear property in Alberta.

BOARD ORDER: MGB 036/07

DECISION

In view of the foregoing findings and analysis, the Complaint is denied and the assessments confirmed.

No costs to either party.

Dated at the City of Edmonton, in the Province of Alberta, this 28th day in March 2007.

MUNICIPAL GOVERNMENT BOARD

(SGD.) T. Robert, Presiding Officer

BOARD ORDER: MGB 036/07

APPENDIX "A"

APPEARANCES

NAME	CAPACITY
For the Respondent:	
C. Zukiwski	Legal Counsel, Brownlee LLP
T. Marriott	Legal Counsel, Brownlee LLP
K. Durkin	Legal Counsel, Brownlee LLP
A. Kosak	Legal Counsel, Brownlee LLP
D. Andrews	Witness for the Respondent
R. Popik	Witness for the Respondent
B. Shymanski	Witness for the Respondent
D. Driscoll	Witness for the Respondent

APPENDIX "B"

DOCUMENTS RECEIVED BY THE MGB:

NO.	ITEM
A1	Supplemental Brief of the Complainant
A-2	Development of Depreciation Accrual Factors for Use in the Determination of Fair Assessment Values for the Cavalier Electric Generation Plant (Gannett Fleming)
A-3*	Willsay Statements: Judith Athaide, Grant Clarke, Larry Kennedy
A-4	An Update to the Report Titled "Valuation Considerations for the EnCana Cavalier Power Generating Facility dated July 29, 2005
B5	The Cogent Group Review of the Report of Douglas Andrews – September 25, 2006
B6	Rebuttal Evidence of Larry E. Kennedy
C7.1	Letter from S. White to G. Ludwig dated September 25, 2006, with attached information regarding depreciation for electric generating properties
C7.2	Alberta Municipal Affairs – Estimation of Accrued Depreciation for Alberta Electric Properties (Gannett Fleming)

BOARD ORDER: MGB 036/07

C8	Additional Evidence of Larry E Kennedy Arising from FOIP Disclosure
D9.1	Valuation Considerations for the Cavalier Power Generating Facility – Comments by the Cogent Group Inc. on the Sur-rebuttal provided by C-FAR & Associates dated November 3, 2006 – November 10, 2006
D 9.2	GE Energy - LMS 100 - Defining Flexible Power
E10	Valuation Considerations for the EnCana Cavalier Power Generating Facility – Report of the Cogent Group Inc. – July 29, 2005
E11	Valuation Considerations for the EnCana Cavalier Power Generating Facility – Rebuttal of the Cogent Group Inc. – October 21, 2005
E12	Brief of the Complainant, Encana
E13	Rebuttal Report – Grant Clark – October 21, 2005
E14	Letter form Deloitte to Wilson Laycraft dated October 21, 2005 RE: Encana Cavalier generating Facility – Comments on the Kinston Ross Pasnak LLP Report Dated October 5, 2005
R1	Respondent’s Argument
R2	Respondent’s Volume of Legislation
R3	Respondent’s Volume of Authorities
R4	Report of Barry Shymanski – September 5, 2006
R5	PanCanadian Sur-rebuttal – November 3, 2006
R6	PanCanadian Sur-rebuttal – November 10, 2006
R7	Report Dated November 3, 2006 – C-Far & Associates
R8	Report of Dan Driscoll – September 5, 2006
R8A	Poster
R9	Supplementary Report of Dan Driscoll – November 10, 2006
R10	Report of Douglas Andrews – September 5, 2006
R11	Report dated September 5, 2006 – Kingston Ross Pasnak
R11-A	Executive Summary – Kingston Ross Pasnak

* Lists exhibits struck as a result of preliminary application.