BOARD ORDER: MGB 039/06

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 2004 and 2005 tax years 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:

C. Bethune, Presiding Officer
A. Savage, Member
T. Robert, Member

Secretariat:

D. Marchand

Upon notice being given to the affected parties, a hearing was held in the City of Calgary, in the Province of Alberta from October 31 to November 10, 2005. The hearing related to complaints to the Municipal Government Board (MGB) regarding assessments prepared by the Designated Linear Assessor regarding the following Linear Property Assessment Unit Identifiers (LPAU-IDs):

Tax year	LPAU-ID	Assessment Amount	Description
2004	2178726	$50,960,550	Gas Turbines Units 1 and 2
2004	2178727	$14,155,700	Steam Turbine
2004	2178729	$ 2,763,930	Substation
2005	2178726	$54,309,380	Gas Turbines Units 1 and 2
2005	2178727	$15,085,940	Steam Turbine

2005	2178729	$ 2,945,560	Substation
2005	2178730	$ 203,520	Power Line

OVERVIEW

The properties under complaint make up the electric power generation plant known as the Cavalier Generating Station (Cavalier). Alberta's legislative 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.

Among other things, the Minister's Guidelines require the DLA to apply depreciation to an asset's base cost as established under "Schedule A" and "Schedule B". Depreciation is 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 if "acceptable evidence of loss is provided and documented by the linear property owner". The dispute centres on whether the Respondent has provided "acceptable evidence of loss", thus qualifying for Schedule D depreciation. The Complainant argues that the subject property has sustained a loss in value due to economic obsolescence that ought to be reflected by a reduction under Schedule D. Moreover, it attempts to quantify this loss in value by reference to income approach estimates of current market value.

The Complainant's argument raises the question as to whether the legislation intends economic obsolescence to be covered under Schedule C or Schedule D or both – and, if so, to what degree. In answer to this question, the Respondent argues that Schedule C depreciation is "exhaustive" under the Minister's Guidelines. In other words, it says Schedule C is intended to cover all types of obsolescence, including all economic obsolescence. 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.

BACKGROUND

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. Cavalier takes about 20 million cubic feet per day of natural gas from a neighbouring gas plant to fuel its two GE LM6000 gas turbines.

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 Alberta Electric System Operator (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: Court Reporter/Transcripts

The Respondent requested that the Complainant participate in the cost of the transcripts, as this practice has been followed in previous hearings. The Complainant advised that a court reporter was not necessary and that it did not intend to participate in the cost.

Preliminary Issue 1: Decision

As a general rule, the MGB permits the attendance of court reporters provided that the panel members and parties to the hearing are given copies of the transcript. Absent an agreement to the contrary, the party requesting the services bears the cost. In this case, the Respondent has requested the services of a court reporter, and the Complainant has not agreed to share in the cost. Accordingly, the MGB will not order the Complainant to share in the cost.

Preliminary Issue 2: Rebuttal Material filed late by the Complainant

The Respondent argued that the Complainant's rebuttal material should not be accepted, because it was filed four days after the due date set by the MGB. Thus, the Respondent had only one week to review it and respond rather than the two weeks intended by the MGB. In the alternative, the Respondent argued that portions of the rebuttal are improper, because they raise new issues and should have been filed with the case in chief.

The Complainant advised that the late filing of its rebuttal material was a misunderstanding based on the complex and confusing nature of earlier discussions and correspondence concerning exchanges. The Complainant also submitted that the Respondent had suffered no prejudice, because it still had sufficient time to review the material before the hearing. Finally, the Complainant's witnesses were prepared to give all of their evidence (both in chief and rebuttal) before the Respondent's case, thus eliminating any possible prejudice.

Preliminary Issue 2: Decision

The MGB considered the correspondence and prior decision letters on file concerning the required exchange dates. Review of these materials suggested that the MGB and both parties had accepted October 17, 2005 as the deadline for rebuttal. The Complainant missed this deadline, thus shortening the Respondent's time for review. In view of these circumstances, the MGB was not prepared to admit the written rebuttal submissions.

This ruling did not preclude the Complainant from calling rebuttal evidence to the Respondent's case, since to do so would deny the Complainant a full and fair hearing. The MGB indicated that the Respondent would be entitled to make further objections regarding the Complainant's rebuttal evidence when submitted during the hearing.

Preliminary Issue 3: Rebuttal Evidence of Mr. Kennedy

The Respondent objected to the Complainant calling a witness, Mr. Larry Kennedy of Gannett Fleming, as part of its rebuttal to the Respondent's case.

Preliminary Issue 3 – Decision

After considering the positions of both parties, the MGB issued decision letter DL 166/05 which rejected the Respondent's application for exclusion of Mr. Kennedy's evidence. Decision letter DL 166/05 also made arrangements to allow the Respondent an opportunity to review Mr. Kennedy's evidence and for both parties to speak to it.

Preliminary Issue 4: 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.

Preliminary Issue 4 – Decision

Tabs 6, 8, 9, and 10 of the Cogent Report (Exhibit C2) shall be sealed after the release of this Order pursuant to the provisions of the MGB's Procedure Guide.

ISSUE

1. The main issue is whether the DLA should have granted the subject property additional depreciation under "Schedule D" due to economic obsolescence. This issue raises the following sub-issues:

    a. Is economic obsolescence accounted for under Schedule C? If so, can additional economic obsolescence be covered under Schedule D? If so, how may it be quantified?

    b. In view of sub-issue (a), does the evidence support additional depreciation for Cavalier under Schedule D?

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.

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.

(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 289/99 – 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 4(1)(b). However, section 4(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.

4(1) The valuation standard for improvements is

(a) the valuation standard set out in section 5, 6 or 7, 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 6(2) related to linear property is reproduced below.

6(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.

2003 Minister's Guidelines

The "2003 Alberta Linear Property Minister's Guidelines" (Appendix II of the 2003 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
- 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 *2003 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 can be applied 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 *2003 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.***

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 1.05 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.

TABLE 2.1 CALCULATION PROCESS FOR ELECTRIC POWER SYSTEMS ACCs

		Schedule			
ACC	**ACC Description**	**A**	**B**	**C**	**D**
…					
GEN 300	Less than 50 Megawatt Units	*ic x cf*	1.050	Table 2.28	1.000**
GEN 301	Between 50 and 100 Megawatt units (inclusive)	*ic x cf*	1.050	Table 2.29	1.000**
GEN 302	Over 100 Megawatt Units	*ic x cf*	1.050	Table 2.30	1.000**

** … For ACCs beginning with GEN, the assessor may adjust for additional depreciation (Schedule D) only on a case by case basis, if acceptable evidence of loss is provided and documented by the linear property owner (operator).

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 ACC GEN300

Chronological Age	**Generation Unit Effective Age**							
	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	…

2004 Minister's Guidelines

Similar to the 2003 Minister's Guidelines.

ISSUE: SHOULD THE DLA HAVE GRANTED ADDITIONAL "SCHEDULE D" DEPRECATION IN RELATION TO CAVALIER.

Summary of Complainant's Position

Sub-issue (a) Economic Obsolescence in Schedule C and Schedule D and quantification of "additional loss"

There is no dispute that the Schedule C depreciation tables are intended to cover various forms of obsolescence, including economic obsolescence. However, the Schedule C tables are designed to anticipate future losses; therefore, changes in economic conditions may occur after the tables are created to cause additional unforeseen economic obsolescence. Thus, Schedule C may not cover all sources of economic obsolescence.

The Minister's Guidelines relieve against the over-taxation that could result in such circumstances by allowing for additional depreciation under Schedule D if the taxpayer provides acceptable evidence of further loss due to economic obsolescence. Further losses may be quantified by showing a drop in market value below Schedule C depreciated value. Thus, courts have found that market indices provide indispensable information in quantifying additional depreciation. (County of Strathcona No. 20 v the Alberta Assessment Appeal Board (Alta) and Shell Canada (1995 AJ No 369); British Columbia Forest Products Ltd. Re (1961) 36 WWR 145 (BCSC)).

The evidence of Mr. Clark is consistent with this position. Mr. Clark was formerly employed by the Respondent to prepare linear assessments and develop the regulated rate assessment process, amongst other duties. He testified that Schedule D depreciation is available for reduced capacity utilization resulting from economic obsolescence for various types of regulated property. Further, section 293 of the Act requires that assessments be prepared in a fair and equitable manner and take into consideration similar property in the same municipality. Therefore, Cavalier must be afforded the same consideration as other regulated property.

Sub-Issue (b) Evidence of additional loss for Cavalier

In Cavalier's case, the evidence establishes that the Schedule C tables for the 2003 and 2004 Minister's Guidelines were drafted and the facility planned before certain shifts in regulatory and economic conditions, including dramatic increases in operating costs and a surplus in province-wide generation capacity. Furthermore, Cavalier suffered a decline in value due to these circumstances that can be measured by its low returns and low market value. The relevant

Schedule C tables do not cover losses due to these factors. Therefore, additional depreciation must be granted under Schedule D.

In support of its position, the Complainant pointed to at least three categories of evidence: (1) evidence concerning the creation of the tables, (2) evidence concerning unexpected developments in market conditions since the creation of the tables and the planning of the facility, and (3) evidence concerning Cavalier's poor financial performance and consequent low market value.

Category 1: The creation of the Schedule C tables

Mr Kennedy is a Certified Depreciation Professional employed by Gannett Fleming Inc., the consulting company that prepared the Schedule C tables on behalf of the Department of Alberta Municipal Affairs. Mr. Kennedy's letter outlines the following points.

- The Gannett Fleming depreciation tables were generated in 2000, based on information known at that time.
- The Gannett Fleming tables were developed for an unregulated plant, but it was contemplated that an electric generation deficit would exist in Alberta for a number of years.
- No plant of Cavalier's size or type existed when the tables were conceived; neither was any such plant as yet announced.
- The market conditions existing in the 2003 and 2004 for stand alone electric generating plants are completely changed from market conditions affecting the unregulated units as of 2000.
- Given significant changes in operating conditions and markets, deprecation parameters should be updated. This is particularly evident in the circumstance of significantly changed market place form the economic environment that existed at the time the Gannett Fleming tables were originally developed.
- Changes to the economic environment require a more frequent review of depreciation parameters than was anticipated at the time the Gannett Fleming tables were constructed.
- Sufficient time and changes in the economic conditions have occurred since the Gannett Fleming tables were developed in 2000 to require the provision of additional depreciation in the circumstances of Cavalier.

Category (2): subsequent changes in market conditions

The Report prepared by the Cogent Report Inc. provides further detail as to changes in market conditions that have resulted in economic depreciation. These changes include the following regulatory initiatives.

- The Pool Price Deficiency Regulation. This Alberta regulation directed the AESO not to include energy imported or exported from the province in the calculation of the hourly power

price. The effect was to counteract the influence of high California prices on power generated and supplied within the Alberta market (November of 2000).

- The Dispatch Risk Rule. This AESO regulatory initiative prevents suppliers from offering power at prices reflecting cost and commercial drivers and then restating offered volumes when prices decline to remain in-merit (December 2000).
- Transmission Policy: This revised policy regulating transmission loss credits and charges for power suppliers will reduce the loss factor differential between generators located in generation surplus areas and generation deficit regions (Policy codified Summer 2004 for implementation January 2006).

Other significant changes involve major shifts in market fundamentals. A prominent example is an increase in Alberta's power supply that has outstripped increases in consumption and load. This trend is consistent with Alberta's unexpectedly high reserve margins. Typically, regulated electricity jurisdictions plan to maintain a reserve margin of about 18%. Alberta's reserve margin at the end of 2003 was about 39% and remained about 39% to the end of 2004. Based on projections for additions to supply capacity in the report by Energy Demand Consulting Associates Ltd. (EDC) (Exhibit C2, Tab 2), the reserve margin is expected to remain above 30% through 2008 and rise to 35% in 2016. In other words, if the proposed generation projects as risked by EDC proceed, Alberta will be oversupplied well beyond the end of the decade.

The regulatory changes and oversupply situation outlined above have led to a dramatic decline in power prices. Between June 2000 and June 2005, Average power prices fell from $106.73 per MWh, to $55.14. During this same period, fuel prices have increased dramatically, resulting in higher costs, lower revenues and decreased competitiveness.

Category (3): Cavalier's underutilization, poor financial performance and low market value

Cavalier was designed in 2000 to be a base-load generating plant with an expected capacity factor in excess of 95%. 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 utilization to the 50% to 60% range with an average of 59% since 2003.

When operated at less than full capacity, a power plant operates at less than optimal efficiency and therefore requires a greater volume of fuel to generate energy. This circumstance has helped to raise Cavalier's variable cost of generation above the average power price for most hours. Low power prices resulting in a low capacity factor and low operating efficiency have resulted in negative operating income every year since 2002. Further 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 for the purposes of this hearing.

Conditions are not expected to improve in the future. Thus, the forward market today is trading well below Cavalier's optimal heat rate. In such an environment, it is expected that Cavalier's capacity factor will decline and Cavalier will not recover its fixed operating costs. It is therefore highly improbable that the facility will earn positive cash flows before the end of the decade.

Although there have been no comparative sales of gas fired generating units, the Complainant believes that the Cavalier's value is nominal as a result of the above factors. Confidential discounted cash flow projections prepared by Rob Koller, a chartered accountant specializing in business valuation, loss of income claims, and damage quantification, were submitted to the MGB as Appendix 8 of the Cogent Report and suggest a market value range between 40.81 – 55.0 million. Therefore, the Complainant requested that the MGB set Cavalier's assessment at an amount within this range.

Summary of Respondent's Position

Sub-issue (a): Economic Obsolescence in Schedule C and Schedule D and quantification of "additional loss"

The Minister's Guidelines, in section 1.003 (c), state definitively that:

> The depreciation factors prescribed in Schedule C are exhaustive.

The word "exhaustive" implies that the Schedule C depreciation tables are all inclusive. Thus, economic obsolescence is completely accounted for under Schedule C.

The evidence of Mr. Shymanski of Barry Shymanski Regulatory Consulting Ltd. supports this interpretation. Mr. Shymanski is a professional engineer with considerable experience regarding depreciation of electrical and gas utilities in Alberta. He testified that the Schedule C tables for the subject generation plant – which first appeared in the Minister's Guidelines for 2000 – were calculated based on principles of depreciation adopted by the Alberta Energy and Utilities Board (EUB). Furthermore, he said the EUB considered all types of depreciation, including physical, functional and economic depreciation. Capacity utilization and the changing regulatory environment for electric power generation relate to economic depreciation and were amongst the factors the EUB considered when establishing the tables. Mr. Shymanski's testimony is backed by EUB decisions that formed the basis of the depreciation factors for Cavalier as well as other similar plants.

As indicated by the Complainant, Schedule D is intended to cover additional losses in value not covered under Schedule C. However, Mr. Shymanski's evidence shows that economic obsolescence is already accounted for under Schedule C. Therefore, there is no room for additional depreciation for economic obsolescence under Schedule D. Furthermore, the valuation standard for linear property is not market value, but rather a regulated standard. Therefore, market value evidence is irrelevant to quantification of "additional loss" under

Schedule D. This interpretation is supported by the evidence of Mr. Driscoll, employed by the Respondent at the relevant time as Director, Regulated Standards and Utilities Assessment. According to Mr. Driscoll, schedule D is only intended for use in very rare circumstances, such as an explosion, flood or similar catastrophe. It does not allow for losses in market value unconnected to such events.

Sub-Issue (b): Evidence of additional loss for Cavalier

The Complainant's evidence regarding changes in market conditions and market value is irrelevant, because the valuation standard for Cavalier is not market value. Thus, the Complainant's argument does not recognize the important distinction between the valuation standards for "regulated" and "non-regulated" properties. The "non-regulated" assessment standard is market value; however, as linear power generation property, Cavalier is subject to the non-market "regulated" valuation standard embodied by the specific calculation procedure set out in Appendix II of the Minister's Guidelines.

In addition to being irrelevant, the Complainant's income approach valuations and other market value evidence are also flawed for the reasons presented by Mr. Sheldon Fulton, P.Eng. Mr. Fulton is a consultant with Forte Business Solutions Ltd. and has extensive expertise in the workings of Alberta's electrical generation market. He testified that Cogent's analysis is both selective and incomplete with respect to its implication that the facility has suffered a loss in value.

The Cogent Report is selective in that it improperly represents the income earning potential of the facility by using the anomalous prices that occurred during construction rather than prices that prevailed during the prior planning period. Cogent's analysis is also incomplete in that it fails to consider properly the alternatives for operation of the facility as a competitive unit to other base-load units. The Cogent Report indicates that the facility was built to produce electricity at a 90% utilization factor and to receive additional revenues as a result of its proximity to the Calgary market through specific payments for location. However, Cogent's analysis is based on Cavalier's actual operation as a mid-market or peaking unit selling both capacity and energy in response to short term (hourly and daily) fuel, energy and ancillary service prices. Had the Complainant chosen to operate the facility in a different manner, its loss in earning potential would not have occurred.

FINDINGS

1. The valuation standard for the subject property is a regulated value that considers economic obsolescence.
2. The valuation standard for the subject property does not equate to market value.
3. Further depreciation under Schedule D may only be granted in relation to obsolescence that (a) was not anticipated under Schedule C and (b) relates to plant specific features. Such obsolescence may result from catastrophic events, but may also have other causes.

4. Insufficient evidence was provided to indicate how the Schedule C tables account for economic obsolescence or how unanticipated events would affect their applicability to the subject property.
5. The market value evidence presented is insufficient to quantify additional depreciation for Cavalier under Schedule D.

DECISION

The complaints are denied and the assessments of the subject properties are confirmed.

REASONS

Sub-issue (a): Economic Obsolescence in Schedule C and Schedule D and quantification of "additional loss"

The MGB accepts Mr. Shymanski's evidence to the effect that all anticipated economic obsolescence was taken into consideration when the EUB and their derivative Schedule C depreciation tables were calculated. Thus, to some extent, Schedule C was intended to cover economic obsolescence. Questions remain as to how much economic obsolescence was foreseen under Schedule C and whether additional economic obsolescence may be recognized under Schedule D.

The Minister's Guidelines indicate that Schedule C is "exhaustive". The Respondent takes this to mean that Schedule C covers all obsolescence and that no further depreciation for economic obsolescence may be granted under Schedule D. However, the note under table 2.1 of the Minister's Guidelines contradicts such a conclusion:

> For ACCs beginning with GEN, the assessor may adjust for additional depreciation (Schedule D) only on a case-by-case basis, if acceptable evidence of loss is provided and documented by the linear property owner (operator).

Thus, the Minister's Guidelines clearly contemplate situations where additional depreciation may be granted under Schedule D. Whatever the Respondent's policy, there is no indication in the legislation to support the position that these situations must be limited to catastrophic events or that they exclude loss due to economic obsolescence. Having said this, both parties agree that the legislation did not intend to "double count" the same obsolescence by granting a reduction both under Schedule C and then again under Schedule D. Therefore, it is reasonable to conclude that further depreciation under Schedule D may only be granted in relation to obsolescence that was not anticipated under Schedule C.

This finding should not be interpreted to mean that Schedule D is simply intended to "update" Schedule C in relation to all linear properties. Although the MGB appreciates the benefits of frequently updated guidelines, the decision to update the Minister's Guidelines is presumably a

policy decision to be undertaken by the Minister of Alberta Municipal Affairs (Minister) rather than the DLA or the MGB. Furthermore, the Minister's Guidelines specify that evidence must be considered on a case-by-case basis, which suggests that Schedule D is intended to cover plant specific obsolescence or obsolescence pertaining to a small subclass of properties. Therefore, the MGB concludes that the intent of Schedule D is to prevent unfair treatment between properties because of plant specific obsolescence not anticipated under Schedule C.

The above paragraph adds to the reasoning in Board Order MGB 117/05, ATCO Power Ltd. and Alberta Power (2000) Ltd. v. The Designated Linear Assessor for the Province of Alberta, where the MGB concluded that the intent of Schedule D was 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.

While this evolution in reasoning would in no way change the outcome of the decision in Board Order MGB 117/05, it represents a more complete view of the legislation and its intent, because it recognizes there may be at least two types of unanticipated obsolescence.

Type 1. Obsolescence occurring from an unforeseen event that affects all plants subject to a given Schedule C table;
Type 2. Obsolescence occurring from an unforeseen event or special circumstance pertaining to a particular property that makes it a "poor fit" for the Schedule C table to which it is subject.

In connection with the first type of obsolescence, the effects of unforeseen events are shared by all property owners and result in equal treatment. Such obsolescence may be corrected as a matter of policy when it is deemed expedient to do so. In contrast, unanticipated obsolescence relating to a specific property only (type 2) goes more fundamentally to the fairness of assessment, since ratepayers are affected unequally. It is this second type of unanticipated obsolescence that the MGB believes of particular relevance for further depreciation under Schedule D.

The finding that Schedule D may authorize further depreciation when there is "acceptable evidence of loss" due to sources of economic obsolescence that were not anticipated for a given property raises the question of how that loss should be quantified for the purposes of assessment, and the relevance of market value evidence in that regard. These matters are addressed below.

<u>Regulated valuation standards, Economic obsolescence and market value</u>

The Complainant argued that market value evidence serves to quantify the "additional loss" to be included under Schedule D. In other words, the Complainant contended that assessment for linear property generation equipment should be reduced to market value where market value is

shown to be lower than the Schedule C depreciated cost. The Respondent resisted this contention, arguing that market value is irrelevant to the regulated regime, which is based on a simple mathematical formula.

The MGB finds that "additional loss" should be interpreted within the context of the regulated assessment regime of which Schedule D forms a part. It is clear from Mr. Shymanski's evidence that the core concept of the relevant regulated valuation standard centres on the rational distribution of included costs over the anticipated useful life of an asset. Furthermore, the evidence of Mr. Driscoll suggests that this pattern of distribution bears no particular relationship to market value. This evidence is not surprising, as there appears no more reason to expect Schedule C depreciated value to approximate market value than to expect an asset's depreciated "book value" for cost accounting or income tax purposes to approximate market value. Therefore, without definitive wording in the Minister's Guidelines, the MGB is unprepared to accept that "additional loss" under Schedule D is the difference between market value and depreciated Schedule C value.

The MGB reviewed County of Strathcona No. 20 v the Alberta Assessment Appeal Board (Alta) and Shell Canada (1995 AJ No 369) as well as British Columbia Forest Products Ltd. Re (1961) 36 WWR 145 (BCSC) cited by the Complainant to support the proposition that market indices provide indispensable information in quantifying additional depreciation. However, the MGB notes that in the BC Forest Products case, the Assessor was required to determine the value of the property (a saw mill) as a "going concern". Similarly, the relevant standard in the County of Strathcona case was "fair actual value". By way of contrast, the valuation standard in the current circumstances is not based on market value but rather the distribution of included costs over the anticipated life of the asset. There is insufficient evidence to link changes in market value to a quantifiable additional loss under the regulated standard; neither would there appear any foundation to superimpose market value on the regulated standard either in logic or in legislation.

A more reasonable interpretation given the current regulated valuation standard is that "additional loss" under Schedule D is intended to cover the difference between Schedule C depreciation and depreciation based on similar principles to those underpinning the relevant Schedule C table, but also taking into account proof of unique circumstance(s) that render that table a poor fit for the asset involved. This interpretation means that what is required to quantify "additional loss" under Schedule D is evidence as to how circumstances that are not contemplated under Schedule C might affect the regulated depreciation scheme differently for the particular asset involved. Thus, an explanation is required as to (1) how the depreciation model embodied by Schedule C accounts for various sources of economic and other obsolescence when calculating age life and the distribution of included costs over age life, (2) what particular circumstances render the relevant Schedule C table a poor fit for the asset involved and (3) how the depreciation scheme should be modified by Schedule D to account for depreciation not anticipated for the subject in Schedule C.

The above interpretation is consistent with a regulated depreciation regime based on allocation of costs over the useful life of an asset. It is also consistent with the evidence of Mr. Driscoll and Mr. Shymanski (amongst others) that the Schedule C tables do not attempt to replicate market value but that their underlying calculations take various forms of obsolescence - including economic obsolescence – into consideration. Similarly, it is consistent with authorities cited by the Complainant to the effect that abnormal economic obsolescence has historically been considered a potential ground for assessment reductions (John Dickie for Canadian Occidental Petroleum Ltd v. MD Foothills No 31 [1989] AAAB NO 80/89; Northern Lite Canola Inc v. Sexmith (Town) Board Order MGB 156/97; Irrigation Power Canal Co-operative Ltd. v. Warner (County No. 5) 1998 AJ No. 33, 1998 ABQB 170).

The above interpretation also implies that market value alone is of no assistance in quantifying "additional loss" under Schedule D. Simply put, market value and depreciated cost value are conceptually distinct. They are calculated according to different rules and may result in widely divergent figures. Nevertheless, market value is still of relevance in determining whether obsolescence has occurred, since a change in market value may indicate the presence of obsolescence. Similarly, a change in market value relative to other similar properties may indicate the presence of obsolescence that affects one property uniquely. The point is simply that market value evidence alone does not help to quantify "additional loss" in the context of the regulated regime set up under the Minister's Guidelines. There was nothing in the argument or evidence of the Complainant that convinced the MGB that Schedule C anticipates a one to one ratio between the relationship of the depreciation identified in Schedule C and a market value loss. The MGB was convinced that economic obsolescence is built into Schedule C based on a policy decision reflected in the table itself.

Sub-Issue (b): Evidence of additional loss for Cavalier

Mr. Kennedy was clear that the Schedule C tables set depreciation parameters based on conditions in 2000, when both demand and the price of electricity were high. He also indicated the tables did not anticipate the subsequent shifts in economic and regulatory circumstances documented in the Cogent Report; furthermore, no plant of Cavalier's size or type had yet been constructed or announced when the tables were conceived. Finally, the Cogent Report suggests that the regulatory and other changes have forced Cavalier to operate at least to some degree as a generation support facility rather than a base load generating plant, resulting in lower than anticipated net revenues. To some extent, the unanticipated events established by the evidence (eg, the falling price of electricity) would affect all linear generation property. On the other hand, it appears that Cavalier – as a smaller gas fired plant built to take advantage of credits available under the previous regulated regime – may have been affected to a greater extent than other linear generation properties, thus causing an inequity not intended by the legislators. Accordingly, it appears that there was potential for economic obsolescence not anticipated under Schedule C that might qualify for additional depreciation under Schedule D.

The difficulty faced by the MGB is to quantify "additional losses" within the regulated regime established by the Minister's Guidelines. The market value estimates submitted by the Complainant are of little use in this regard, since – as indicated above - there is no reason to suspect that market values should approximate regulated values. Neither can it be supposed that a percentage drop in market value would equate to a percentage increase to the (appropriately modified) Schedule C depreciation, or that some other specified relationship between market value and Schedule C depreciation applies. Indeed, in order to quantify the alleged loss in value within the depreciated scheme, further evidence would be required as to factors such as the following.

- The specific relationship between the schedule C factors and the various sources of obsolescence;
- How the specific factors identified by the Complainant (such as regulatory changes and changes in supply and demand) would cause inequitable treatment of the subject in relation to other regulated properties;
- How much of the alleged inequity was inherent in the original structuring of Schedule C and how much is due to factors not anticipated within that Schedule;
- How that inequity should be corrected having regard for the treatment of other properties within the regulated scheme.

Unfortunately, Mr. Kennedy was largely silent on such matters; further, while Mr. Shymanski and EUB Decision U97065 shed limited light on the derivation of the EUB and Schedule C tables, the information provided was insufficient to quantify potential additional losses due to the factors identified by the Complainant. In short, the MGB is not convinced there is appropriate evidence before it to quantify a reduction and is unwilling to grant an arbitrary amount. Accordingly, the complaint is denied and the assessments confirmed.

Alternative Remedy

The MGB notes that an alternative remedy it would consider were it requested to do so in similar circumstances might be to refer the matter to the Minister under section 516 of the Act to be dealt with under sections 571 and 324. The Minister might then review the Schedule C tables to determine how an alleged inequity caused by failure to anticipate obsolescence under Schedule C should be cured, having regard for policy considerations best known to the Minister. However, the Complainant made no such request; neither were submissions received in relation to the duties and powers of inspectors appointed under section 571.

Further Case Law

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.

No costs to either party.

Dated at the City of Edmonton, in the Province of Alberta, this 5th day in April 2006.

MUNICIPAL GOVERNMENT BOARD

(SGD) C. Bethune, Presiding Officer

APPENDIX "A"

APPEARANCES

NAME	**CAPACITY**
For the Complainant:	
G. Ludwig	Legal Counsel _ Wilson Laycraft LLP
J. Athaide	of the Cogent Group Inc.
R. Koller	of Deloitte & Touche LLP
G. Clark	of Assessology Inc.
L. Kennedy	of Gannett Fleming Inc.
For the Respondent:	
C. Zukiwski	Legal Counsel, Brownlee LLP
T. Marriott	Legal Counsel, Brownlee LLP
B. Sjolie	Legal Counsel, Brownlee LLP
R. Popik	of Kingston Ross Pasnak
D. Driscoll	of Assessment Services Branch,
B. Gettel	witness for the Respondent
B. Shymanski	witness for the Respondent
S. Fulton	witness for the Respondent

APPENDIX "B"

DOCUMENTS RECEIVED AT THE HEARING AND CONSIDERED BY THE MGB:

NO.	**ITEM**
C1	Brief of the Complainant
C2	The Cogent Group Inc. Report with Tab 6 - sealed with Tab 8 - sealed with Tab 9 - sealed with Tab 10 - sealed
C2 - A	Hardcopy of C2's PowerPoint
C3	Grant Clark – Resume
C4	Grant Clark of Assessology Inc., Assessment Evaluation Report
C5	Judith Athaide – Resume
C6	Will Say Statements
C7	Larry Kennedy – Resume
C8	Rob Koller – Resume

C9*	Complainant's Rebuttal
C10*	Rebuttal prepared by Garnett Fleming Inc
C11*	Rebuttal prepared by Deloitte & Touche LLP
C12*	Rebuttal prepared by Assessology Inc.
C13*	Rebuttal prepared by Cogent Group Inc.
C14	Expanded Will Say of Grant Clark
C15	Appendix 4 - A Pro-forma Cash Flow Valuation for the Cavalier Facility
C16	" Where are we headed?" (Chart in color)
C17	Letter from Gannett Fleming dated May 24, 2005
R1 - P	History of Correspondence- Relative to Preliminary Matters
R1	Respondent's Argument
R2	Respondent's Volume of Authorities
R3	Respondent's Volume of Documents
R4	Respondent's Volume of Legislation
R5	Dan Driscoll – Report
R6	Sheldon Fulton – Report
R7	Brian Gettel – Commentary
R8	Kingston Ross Pasnak – Report
R9	Randy Popik – Resume
R10	Barry Shymanski – Commentary
R11	Cogent Group Inc. Report (Comments)
R12	Article - Will Daubert become standard for expert evidence?

* Lists exhibits not accepted (Exchanged outside the time limit imposed by the MGB.)

APPENDIX "C"

DOCUMENTS RECEIVED AFTER THE HEARING AND CONSIDERED BY THE MGB:

NO.	ITEM
C18	Final summary of the Appellant
C19	Resume of Larry Kennedy
C20	Rebuttal to the Final Argument (Complainant)
C21	Rebuttal Re: Board Order MGB 117/05 (Complainant)
C22	Letter from Larry Kennedy dated October 17, 2005
R13	Evidence Summary and Final Argument (Respondent)
R14	Rebuttal Summary and Argument (Respondent)
R15	Further Rebuttal Summary and Argument (Respondent)