Emerging Technologies, Stranded Assets: Who Bears the Risk?

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Stores Block & UADR

The Stores Block Decision

- The Supreme Court of Canada Decision was largely the disposition of surplus land (building value not material) outside the ordinary course of business.
- The Decision affirmed the principle that customers pay rates for utility service and do not acquire any property rights in the assets used to provide service.
- As a result, gains or losses on disposition of a surplus asset outside the ordinary course of business accrue to the shareholder.

UADR and Related Decisions

- Since the Stores Block Decision, the AUC has extended the application of these principles to retirement and replacement of depreciable assets where there is no disposition outside of the ordinary course of business.
  - In the Slave Lake Decision, the AUC determined that shareholders should not be entitled to return of remaining capital after an early retirement due to fire. There was no disposition nor was the early retirement voluntary.
  - In the AMI Decision, the AUC determined that shareholders should not be entitled to return of capital in a replacement situation – where replacement of the existing meters with technologically advanced meters would be beneficial to customers (including cost of retired meters).

UADR – Harmful to Customers

The Slave Lake Decision has raised concern in Capital Markets – Increased Risk

- Scotiabank and BMO Debt Market Analysts as well as DBRS and S&P have commented that this Decision represents a shift away from the traditional regulatory compact where shareholders have reasonable assurance of return of capital as it relates to their investment in depreciable utility property.
- A credit rating downgrade or increase in corporate debt spreads would add significant cost leading to higher customer rates. ***The longstanding regulatory compact determined that it is less expensive in the long run for customers to bear the risk of early retirement than to shift this risk to shareholders.***

The AMI Decision is bad policy

- The AMI Decision punishes a utility that proposes a replacement that is beneficial to customers by denying it recovery of remaining capital on the asset being replaced.
- This creates a strong incentive for the utility NOT to advance technology advances and replacements that are in the interest of customers.

Regulatory Compact

- Utilities' have the "obligation to serve". In return, utilities require reasonable assurance that they will be allowed return <u>of</u> capital and a "fair return" <u>on</u> capital while invested.
  - Under this compact, customers bear the risk of early retirement due to any reason (other than imprudence). This includes destruction (Slave Lake) and replacement due to a technological advancement (AMI).
  - This reduces the risk for investors in the debt and equity of the utility which translates into lower rates for customers.
- The return of capital in the event of project termination (other than default) is common in most P3 project agreements. These provisions support very good project credit ratings with very low financing costs that benefit rate / tax payers.
- Any shift away from the this longstanding compact will almost certainly be detrimental to customers.
- Our reading of the Decisions is that the AUC made this shift in risk because they read the Stores Block Decision as leaving them no choice. It was not the result of an assessment that the costs and benefits of such shift was going to be beneficial to customers or in the overall public interest.
- The current situation is untenable and needs to be remedied.