

Legal Foundations for PBR

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Does AUC Have the Ability to Approve a Form of PBR

- Two types of regulatory regimes: (1) tribunal has unfettered discretion to fix rates; (2) tribunal has specific statutory directions as to how rates are to be fixed.
- pre-1996, Alberta public utility statutes contained specific directions, eg. rate base must be determined, reviews must be carried out every 3 years, all rates and tariffs must be pre-approved by regulator.
- Today, AUC has powers under GUA and EUA to approve just and reasonable rates that provide for incentives.

Electric Utilities Act

Purposes of the Act

5 The purposes of this Act are

- (h) to provide for a framework so that the Alberta electric industry can, where necessary, be effectively regulated in a manner that minimizes the cost of regulation and provides incentives for efficiency.

Tariff contents

- 120(1)** A tariff must describe how it may change over the period for which it is intended to have effect.
- (2)** A tariff may provide
- (a) that it is in effect for a fixed period or an indefinite period;
 - (b) for maximum rates;
 - (c) for increases or decreases in the rates to correspond to
 - (i) increases or decreases in fuel costs, taxes or other costs and expenses,
 - (ii) price indices, rates of inflation or similar measurements, and
 - (iii) other related costs or expenses approved by the Commission;
 - (d) for incentives for efficiencies that result in cost savings or other benefits that can be shared in an equitable manner between the owner of the electric utility and customers.

- 121(1)** On giving notice to interested parties, the Commission must consider each tariff application.
- (2)** When considering whether to approve a tariff application the Commission must ensure that
- (a)** the tariff is just and reasonable,
 - (b)** the tariff is not unduly preferential, arbitrarily or unjustly discriminatory or inconsistent with or in contravention of this or any other enactment or any law, and
 - (c)** if the regulations so require, the tariff incorporates the standard of liability imposed by the regulations made by the Lieutenant Governor in Council under section 94, or that the Commission has, in accordance with those regulations, considered and imposed a standard of legal liability that it considers appropriate.
- (3)** A tariff that provides incentives for efficiency is not unjust or unreasonable simply because it provides those incentives.
- (4)** The burden of proof to show that a tariff is just and reasonable is on the person seeking approval of the tariff.

122(1) When considering a tariff application, the Commission must have regard for the principle that a tariff approved by it must provide the owner of an electric utility with a reasonable opportunity to recover

- (a) the costs and expenses associated with capital related to the owner's investment in the electric utility, including,
 - (i) depreciation,
 - (ii) interest paid on money borrowed for the purpose of the investment
 - (iii) any return required to be paid to preferred shareholders of the electric utility relating to the investment
 - (iv) a fair return on the equity of shareholders of the electric utility as it relates to the investment, and
 - (v) taxes associated with the investment

if the costs and expenses are prudent and if, in the Commission's opinion, they provide an appropriate composition of debt and equity for the investment.

Gas Utilities Act

Incentives

- 45(1) Instead of fixing or approving rates, tolls or charges, or schedules of them, under sections 36(a), 37, 40, 41, 42 and 44, the Commission, on its own initiative or on the application of a person having an interest, may by order in writing fix or approve just and reasonable rates, tolls or charges, or schedules of them,
- (a) that are intended to result in cost savings or other benefits to be allocated between the owner of the gas utility and its customers, or
 - (b) that are otherwise in the public interest.
- (2) The Commission may specify terms and conditions that apply to an order made under this section.

Will the Courts Review PBR decisions?

- Correctness vs. reasonableness

“the methodology for setting rates and the allocation of proceeds derived from those rates, a polycentric exercise with which the CRTC is statutorily charged and which it is uniquely qualified to undertake.”: *Bell Canada v. Bell Aliant Regional Communications*, 2009 SCC 40, paras. 38, 56; *Calgary (City) v. Alberta (Energy and Utilities Board)*, 2010 ABCA 132, para 63.

- Reasonableness review

“...is concerned mostly with the existence of justification, transparency and intelligibility within the decision-making process. But it is also concerned with whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law.”
Dunsmuir v. New Brunswick, 2008 SCC 9, [2008] 1 S.C.R. 190 at para. 47.

- Procedural fairness

Administrative agencies are masters of their own procedure as long as the requirements of procedural fairness are met.

How to reconcile Just and Reasonable Rates and Incentives?

- Just and reasonable rates

"Under the regulatory compact, the regulated utilities are given exclusive rights to sell their services within a specific area at rates that will provide companies the opportunity to earn a fair return for their investors. In return for this right of exclusivity, utilities assume a duty to adequately and reliably serve all customers in their determined territories, and are required to have their rates and certain operations regulated."

ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board), 2006 SCC 4, at paras. 63, 68 and 70

The administrative tribunal must "balance the interests of the customers with the necessity of ensuring that the regulated entity is allowed to make sufficient revenues to finance the cost of the services it sells to the public."

Bell Canada v. Canada (CRTC), [1989] 1 S.C.R. 1722 ("*Bell Canada 1989*"), at 1748

"The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise."

Edmonton (City) v. Northwestern Utilities Ltd., [1929] S.C.R. 186 (S.C.C.), at 192- 93

"In the end, where a cost of service method is used, the utility must recover its costs over a reasonable period of time, regardless of any impact those costs may have on customers or consumers." (see *Hemlock Valley Electrical Services Ltd. v. British Columbia (Utilities Commission)* (1992), 12 B.C.A.C. 1 (B.C. C.A.), at 20 -21)

Transcanada Pipelines Ltd. v. National Energy Board, 2004 FCA 149, para 43

"Granted, the Court has never strictly held that a utility must have rates in hand before it can claim that the adoption of a new method of setting rates will necessarily produce an unconstitutional taking, but that has been the implication of much the Court has said."

Verizon v. FCC, 535 U.S. 467 (2002): 53

How to Achieve "Just and Reasonable" + "Incentive" Rates

- Cost plus contract vs. Fixed price contract
- Incentives for efficiency (longer test periods, earnings sharing, X factor, Z factors, financial reviews, pure price cap regulation)
- Rules of the game must be clear to preserve incentive qualities (more risk=more reward) and safeguard service quality.
- Professor Stephen Littlechild, who was the original proponent of PCR in the U.K. and also presided over its implementation, viewed the X factor as “a number to be negotiated.”

- Fair procedures, maximum transparency, rational connection to purposes, acceptable outcome
- Just and reasonable incentive rates (opportunity to earn, open-ups)
- Are unexpected levels of performance the fault of regulator or management?
- Regulatory efficiency