

---

# **The “Regulatory Compact” - A Means to Social Justice?**

October 31, 2013

Jeff Christian

---



# Introduction

- “regulatory compact”:
  - ▶ the benefits and burdens imposed on public utilities
- “public utilities”:
  - ▶ monopoly suppliers of essential public services
- “essential public services”:
  - ▶ energy (electricity, natural gas); water; transport (rail, roads, ferrys)

# Monopoly

- One firm produces a commodity for which there are no close substitutes (economic definition)
- Arise through barriers to entry (“natural” or created by law)
- Monopoly issues: inefficient; lack of service; pricing
- *Competition Act* limits
- “regulatory compact” allows

# Origins of Regulatory Compact

- Edward I (1272-1307)
  - ▶ paralysis in trade at outset of reign
  - ▶ “outrageous tolls were taken [in markets] ... to the great oppression of [the] King’s subjects” Coke, 16<sup>th</sup> century judge/scholar
  - ▶ Edward’s response: holders of licences (monopoly) obliged to prove them and, by implication, their social utility

# Origins of Regulatory Compact

- By 1792 (Frank v Tripp) ferryman's monopoly rights, and right to damages where monopoly rights breached was expressly linked to the obligation to serve: common law of public utilities
- Continuing common law development until end of 19<sup>th</sup> century – railroads, electric systems, etc

*From Wrong Side of the Tracks,  
Haar and Fessler, 1986*

# Public Utility Commissions (PUCs)

- Eg BC Utilities Commission, Ontario Energy Board, NWT Public Utilities Board
- First statutory codification of common law in US, late 19<sup>th</sup> century
  - ▶ railway cases: refusal to serve, discriminatory rates
  - ▶ common law processes too cumbersome
  - ▶ PUCs now established in most jurisdictions in North America and Commonwealth
  - ▶ role of courts reduced to appellate/judicial review of PUC decisions

# ***Chastain v BC Hydro* 32 DLR (3d) 443 (1972)**

- BCH is a public utility by virtue of:
  - ▶ monopoly supply
  - ▶ of “service of fundamental importance to the public” (para 23)

# *Chastain v BC Hydro* 32 DLR (3d) 443 (1972) (con't)

- “The obligation of a public utility... is to supply its product to all who seek it for a reasonable price and without unreasonable discrimination between those who are similarly situated or who fall into one class of consumers.” (para 23)
  - ▶ obligation to serve
  - ▶ at reasonable price (ie reasonable per-unit-rate)
  - ▶ without discrimination



## Aside: Relationship to Energy Law

- Energy is of fundamental importance to human society
- Energy is rarely found in economic quantities where people and business are located
- It must be delivered – by pipeline or power line
- Pipelines and power lines are expensive and impose burdens that are not equally distributed
- Providing energy delivery services through monopoly service providers limits imposition on individuals, attracts capital

# Obligation to Serve

- What other businesses are obliged to provide their service to those who want it (outside of HR context)?
- Burden or benefit to a company that is a public utility?

# Obligation to Serve (con't)

## *Utilities Commission Act* RSBC 1996 c 473

- ▶ s 28(1) “On being requested by the owner or occupier of the premises to do so, a public utility must supply its service to premises that are located within 200 metres of its supply line...”
- ▶ s 28(3) “After a hearing and for proper cause, the commission may relieve a public utility from the obligation to supply service... on terms... in the public interest”.

# Obligation to Serve (con't)

- ▶ s 29(1) “On application of a person whose premises are located more than 200 metres from a supply line... the commission may order a public utility... to supply... the service required by that person
- ▶ what factors might be relevant for a PUC in considering application under 28(3) or 29?

# Without Discrimination

- What other businesses are obliged to not discriminate between customers (outside of HR context)?
- Burden or benefit to a company that is a public utility?

# Without Discrimination (con't)

- *Utilities Commission Act* RSBC 1996 c 473
  - ▶ S 59(4) “It is a question of fact, of which the commission is the sole judge, whether, in any case, there is undue discrimination, preference, prejudice or disadvantage in respect of a rate or service”
- What factors might be relevant for a PUC in considering whether service or rate is unduly discriminatory, preferential or prejudicial?

## Aside: Service vs Rate

- Seemingly a clear distinction, at least from consumer perspective
  - ▶ service is what you get
  - ▶ rate is what you pay (per unit eg 12cents/kWh)
- For PUC considering whether service is non-discriminatory or rate is reasonable, can't look at one without looking at other

## Aside: Service vs Rate (con't)

- Reflected in UCA definitions of “rate” and “service”
  - ▶ “rate includes... a rule, practice, measurement, classification or contract of a public utility or corporation relating to a rate’
  - ▶ Implicitly includes so-called “non-rate terms and conditions” eg security deposit requirements
  - ▶ in regulatory world, rate and service are flip-sides of same coin



# Reasonable Price

- What other businesses are told the price they may sell at?
- Burden or benefit to a company that is a public utility?

# Reasonable Price (con't)

## ➤ UCA:

- ▶ s 59(1) “A public utility must not make, demand or receive and unjust, unreasonable, unduly discriminatory or unduly preferential rate for a service...”

# Reasonable Price (con't)

## ➤ UCA:

▶ s 59(5) “... a rate is “unjust” or “unreasonable” if the rate is

- (a) more than a fair and reasonable charge for service of the nature and quality provided by the utility
- (b) insufficient to yield a fair and reasonable compensation for the service provided by the utility, or a fair and reasonable return on the appraised value of its property
- (c) unjust and unreasonable for any other reason”

# Reasonable Price (con't)

## ➤ UCA:

- ▶ s 58 “The commission may... after a hearing, determine the just, reasonable and sufficient rates...” and must “by order, set the rates”.

## Reasonable Price (con't)

Observations??

# ***Hemlock Valley v BCUC***

## **1992 CanLII 5959 (CA)**

- The upside (to a public utility) of the “regulatory compact”
- Despite broad discretion to set rates, CA set aside BCUC decision phasing in a rate increase, remitting back to BCUC

# ***Hemlock Valley v BCUC***

## ***1992 CanLII 5959 (CA) (con't)***

- HVES: “once the commission had settled the content of the rate base and determined a rate of return which is both just and reasonable, it cannot fix a schedule of rates which yields less revenue than would be required to provide that rate of return on its rate base” (para 46)

# Hemlock – What was going on?

- Revenue requirement: sum of annual costs utility incurs to provide service
- Rates set to allow recovery of revenue requirement (forecast revenue = revenue requirement)
- Revenue requirement includes operating costs, interest on debt, depreciation etc
- Also includes “return on equity” aka “cost of capital” aka “profit”



# Hemlock – What was going on? (con't)

- Return on equity = rate base x rate of return
- Rate base = \$366,511 = net book value of capital assets = capital cost less depreciation
- Rate of return = 13%
- Return on equity = \$366,511 x 13% = \$47,646.43

# Hemlock – What was going on? (con't)

- Phasing in rate increase over three years would have meant that HVES could not earn its allowed return on equity in years 1 and 2
- Illustration:
  - ▶ shortfall in year 1 =  $\frac{2}{3} \times \$48,000 = \$32,000$
  - ▶ shortfall in year 2 =  $\frac{1}{3} \times \$48,000 = \$16,000$

# ***Enbridge Gas v Ontario Energy Board 2005 CanLII 4951 (SCDC)***

- Revenue requirement (and rates) does not necessarily include all costs incurred by a utility
- Costs must be in regard to assets (or activities) that are “used and useful”
- Costs must be prudent

# ***Enbridge Gas v Ontario Energy Board***

## **2005 CanLII 4951 (SCDC) (con't)**

- Enbridge a natural gas distributor, pays to have gas shipped to its distribution system
- At issue were costs incurred to ship gas with new carriers rather than old (TransCanada)
- OEB disallowed \$11 million in costs as being imprudent

# ***Enbridge Gas v Ontario Energy Board***

## **2005 CanLII 4951 (SCDC) (con't)**

- CA set aside decision because OEB erred in considering the prudence test:
  - ▶ rebuttable presumption of prudence
  - ▶ can use hindsight to rebut presumption eg costs higher than anticipated
    - “phase 1” of prudence enquiry
  - ▶ may not use hindsight in phase 2
    - prudent: reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made (para 10)

# Where are the Cases on Discrimination and Obligation to Serve?

- Obligation to serve – few cases given PUC's powers to determine on a go-forward basis
- Discrimination – as above, except:
  - ▶ Lifeline rates look at customer circumstance – allowed under 59(5)?

# ***Memorial Gardens [1958] SCR 353***

- CPCN = Certificate of Public Convenience and Necessity
- Without a CPCN, a person may not construct or operate a public utility plant/or system (s.45 UCA)
- The barrier to entry, and the primary mechanism by which public utilities are afforded their “monopoly” service rights

# ***Memorial Gardens [1958] SCR 353***

## **(con't)**

- Colwood trying to protect its cemetery turf, challenges Memorial Gardens CPCN
- Victoria/Saanich also challenges - why?
- Adjacent property owners – why?
- Are cemeteries an essential public service?
- Is there argument for allowing cemeteries to have monopolies?
- Did any of the competing cemeteries have a monopoly?



# Recap

- Regulatory compact imposed upon monopoly suppliers of essential public services, where “monopoly” supply is necessary or preferable to market (attracts capital, minimizes impact)
- Three key elements:
  1. Obligation to serve
  2. Reasonable price
  3. No (undue) discrimination
- Tool for social justice/reform?

Presented by: Jeff Christian



#### **Vancouver**

Suite 1600 Cathedral Place  
925 West Georgia Street  
Vancouver, British Columbia  
Canada V6C 3L2  
(T) 604.685.3456  
(F) 604.669.1620

#### **Calgary**

Suite 3700, 205-5<sup>th</sup> Avenue S.W.  
Bow Valley Square 2  
Calgary, Alberta  
Canada T2P 2V7  
(T) 403.269.6900  
(F) 403.269.9494

#### **Yellowknife**

P.O. Box 818  
200, 4915 - 48 Street  
Yellowknife, Northwest Territories  
Canada X1A 2N6  
(T) 867.669.5500  
(F) 867.920.2206  
Toll Free: 888.465.7608