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ONTARIO ENERGY BOARD

STAFF SUBMISSION

ASSOCIATION OF MAJOR POWER CONSUMERS IN ONTARIO (AMPCO) MOTION TO REVIEW THE 2008 ELECTRICITY DISTRIBUTION RATES FOR OSHAWA PUC NETWORKS INC.

EB-2008-0099

May 14, 2008

INTRODUCTION

On March 19, 2008 the Ontario Energy Board issued its Decision in the Oshawa PUC Networks Inc. ("Oshawa PUC") application for rates effective May 1, 2008.

THE MOTION

On April 8, 2008, the Association of Major Power Consumers in Ontario ("AMPCO") filed with the Board a Notice of Motion requesting a rehearing of the portion of the decision

regarding cost allocation and specifically the revenue-to-cost ratios[1] approved by the Board, as set out in Table 3 of the decision. AMPCO also requested that the hearing of the motion be combined with the portion of the Hydro One Distribution Rates Application (EB-2007-0681) pertaining to revenue-to-cost ratios as set out in section 7.1 of the Issues List in the Hydro One application.

On May 2, 2008, the Board issued Decision and Procedural Order No. 1 finding, firstly, that AMPCO's Motion meets the threshold test under Rule 45.01 of the Board's *Rules of Practice and Procedure.*

AMPCO's request to combine the hearing of its motion with the revenue-to-cost ratio portion of the Hydro One application was denied since combining the hearings would unnecessarily delay the hearing of the present motion. The Board further decided that the decision is better left to the panel hearing the Hydro One application as the panel hearing AMPCO's motion has no jurisdiction in the Hydro One application.

Among other things, AMPCO's motion asserts that there are several errors that are material and relevant to the outcome of the decision. In particular, AMPCO argues that the Board misinterpreted the Board's *Cost Allocation Report for Electricity Distributors* when applying the Report to the decision.

Board staff's interpretation of AMPCO's argument is that the decision did not reflect the fundamental tenet of utility rate making that cost causality is fundamental to rate setting and that this principle is expressed by class revenue-to-cost ratios at or close to one. AMPCO admits that not every departure from that principle is unjust, but argues that such departures must be justified and generally accompanied by a plan to bring the ratios toward unity.

The Board staff's submission is in four parts:

1. The decision does not mean that large volume consumers must overpay indefinitely.
2. The nature and application of Board policy.

[1] Revenue to cost ratios are depicted in percentage terms or as factors around unity. For example a ratio of 120 can also be depicted as 1.2

3. The *Cost Allocation Report* contemplates application of discretion in any event, especially where there is evidence of significant bill impacts.
4. It is not a necessary condition of just and reasonable rate-making that the forecast revenue-to-cost ratio be equal to unity.

THE DECISION DOES NOT MEAN THAT LARGE VOLUME CUSTOMERS MUST OVERPAY INDEFINITELY

AMPCO submits that as a result of the decision, "large volume customers must overpay for their services on an open-ended time frame."[2]

In its Notice of Motion, AMPCO stated, at page 2, para.1:

"The second period, which starts in 2011, maintains the overpayment at up to the 180% and 115% ranges *indefinitely*." [Emphasis added]

Board Staff submits that the decision does not maintain the overpayment indefinitely and it did not set out revenue-to-cost ratios for 2011.

The Board stated that, "there should be a move of 50% toward the top of the range from what was reported in the Informational Filing 2 (Column A).[3] Under this approach, rates for three classes would be adjusted to achieve the following revenue-to-cost ratios [for 2008]." The Board continued, "The Board expects the Company to achieve the remaining 50% move by equal increments in years 2009 and 2010... …The Board expects the Company to maintain this principle when it applies for rate adjustments in 2009 and 2010."[4]

The revenue-to-cost ratios over the next three years are outlined in the tables that follow.

[2] AMPCO Notice of Motion at 2.
[3] *Oshawa PUC Networks Inc. Decision* (March 19, 2008) EB-2007-0710 at 11.
[4] *Supra* at 14.

Table 1: Revenue-to-Cost Ratios for 2008:

GS 1000 – 5000 kW	257
Large Use	186
Street Lighting	46
Sentinel Lighting	62

Table 2: Revenue-to-Cost Ratios for 2009:

GS 1000 – 5000 kW	218
Large Use	150
Street lighting	58
Sentinel Lighting	66
Other classes	Not specified

Table 3: Revenue-to-Cost Ratios for 2010:

GS 1000 – 5000 kW	180
Large Use	115
Street Lighting	70
Sentinel Lighting	70
Other classes	Not specified

As evidenced in Table 3 above, in 2010 Oshawa PUC will be at the boundary of the approved ranges set out in the Board's *Cost Allocation Report*. The Board allowed this, stating that, "an immediate move to the target ranges would result in unacceptable impacts for customers in some of the remaining classes, and some mitigation is warranted."[5]

The decision does not specify the ratios after 2010 nor does it indicate that revenue will remain higher than allocated cost after 2010. Board Staff submits that the Board has not authorized over-collection "indefinitely" nor has it abandoned an objective of unity for revenue-to-cost ratios.

Board staff invites AMPCO or other parties to demonstrate that the Board has predetermined revenue-to-cost ratios greater than one in or beyond the year 2011. In Staff's submission, the decision does not provide for indefinite overpayment.

[5] *Supra* note 3 at 13.

THE NATURE AND APPLICATION OF BOARD POLICY

The Notice of Motion submits that the Board erred "to the extent that it treated the *Cost Allocation Report* as relieving the Board from the *duty to set rates based on cost allocation to the extent practical"* (emphasis added).[6] Furthermore, AMPCO argues that the movement towards revenue-to-cost unity, according to the *Cost Allocation Report*, "is to be achieved if supported by data quality."[7]

AMPCO's submission therefore seems to be that, notwithstanding other factors and evidence that the Board considers in the hearing of a rate application, it is bound by the *Cost Allocation Report* to set rates based on cost allocation and the unity principle. Board staff invites AMPCO to clarify its position.

The adoption of non-binding forms of regulatory policy (policy statements, guidelines) structures the individual decision making discretion of Board members and thus provides predictability and consistency to decisions. .The *Cost Allocation Report,* as a policy or guideline, is an important component of the Board's decision-making process. In addition to Board policy, the panel is also legally required to consider all the evidence before it and make decisions that it considers to be in the public interest based on the evidence.

In September 2006 the Board issued another policy document titled, "A Report with Respect to Decision-Making Processes at the OEB" ("Decision-Making Report") which sets out the distinctions and interplay of the Board's policy-making and adjudicative functions. Documents such the *Cost Allocation Report* are useful for setting out overall policy direction but the facts of an individual hearing may call for a refined application of the policy in arriving at an adjudicative decision. The Decision-Making Report states, at page 13:

> *"It is also important to bear in mind that the different statutory instruments can and should be used together as part of a comprehensive and coherent approach to energy regulatory issues. In this way, non-adjudicative policy instruments may be used to set the context, framework and policy goals of a given proceeding and*

[6] *Supra* note 2 at 6.
[7] AMPCO Submission on Motion at 8.

> *the adjudicative process may then be used to identify the adjudicative facts that must be established to make a specific order."*[8]

THE BOARD'S COST ALLOCATION POLICY CONTEMPLATES DISCRETION

The Board has concluded that setting a presumptive range and taking an incremental approach is the most appropriate method for establishing revenue-to-cost ratios. In reaching its decision in the Oshawa PUC case, the Board considered the *Cost Allocation Report,* the evidence before it and the submissions of Oshawa PUC and other parties to the proceeding. Board staff submits that the decision in the Oshawa application does not indicate that the Board has not abandoned the goal of unity outlined in the *Cost Allocation Report.* The Board notes in the decision that moving to a revenue-to-cost framework around unity is still considered ideal.

The *Cost Allocation Report* states:

> "The Board is cognizant of factors that currently limit or otherwise affect the ability or desirability of moving immediately to a cost allocation framework that might, from a theoretical perspective, be considered the ideal. …With better quality data, greater experience with cost allocation modeling and further developments in relation to other rate design issues, the policies will be refined as required."[9]

The *Cost Allocation Report* suggests a cautious approach in implementation of the unity principle and the ranges set out in the Report. The Board has noted that distributors have little experience doing cost allocation studies and lack the mature data to place significant reliance on the outcomes. The *Cost Allocation Report* noted that "This is the first time that most distributors have performed cost allocation studies. As distributors apply this model in subsequent filings they will develop greater expertise in the application of data to the model, which in turn will allow for a greater reliance on the outcomes."[10]

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[8] *A Report with Respect to Decision-Making Processes at the OEB*, Report of the Board (September 2006).
[9] *Application of Cost Allocation for Electricity Distributors, Report of the Board* (November 28, 2007) EB-2007-0667 at 2.
[10] *Supra* at 6.

"As the influencing factors are addressed over time, the Board expects that these bands will narrow and move closer to [unity]."[11] "Accounting and load data can be improved. …[T]he Board anticipates that the installation of smart meters, with their more exact load data, will provide opportunities for better analysis in the future and, as a result, will provide better cost allocators for the cost allocation model."[12] The Board expects modelling improvements with increased data quality and expects distributors to review their allocation factors accordingly.[13]

The *Cost Allocation Report* suggests that a consideration of the effects on other classes of a rapid narrowing of the range for one class, is necessary, as one of the important principles in rate making is the avoidance of rate shock.[14]

The Board stated in the decision that, while moving to a revenue-to-cost framework around unity is still considered ideal, "an immediate move to the target ranges would result in unacceptable impacts for customers in some of the remaining classes, and so some mitigation is warranted."[15]

REVENUE-TO-COST RATIO OF ONE IS NOT A NECESSARY CONDITION OF JUST AND REASONABLE RATES

Board Staff submits that there is a distinction as between the principle of cost causality and the practice of applying cost allocation.

Cost causality is an important aspect of rate setting. However, Board staff submits that the Board has a broad discretion in setting rates and may consider broad public policy factors in making its decision. The Board may set a number of different rates provided that the rates do not discriminate unjustly. Any utility with more than one rate class will have rates that differ among classes.

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[11] *Supra* at 4.
[12] *Supra* at 5.
[13] *Supra* at 6.
[14] *Supra* at 7, 9.
[15] *Supra* note 3 at 13.

Board staff invites AMPCO to demonstrate that the Board decision in EB-2006-0034 (the "LIEN Decision")[16] requires revenue-to-cost ratios of one. Neither the LIEN Decision nor the subsequent factum of the Board filed with the Divisional Court[17] state that the forecasted revenue-to-cost ratio of a rate must equal one or near one in order for the rate to be just and reasonable. The Board's factum made the point that the central tenet of rate-making is cost causality rather than (as argued by LIEN) subsidies to a particular group of utility customers. In referring to the LIEN Decision, AMPCO appears to conflate the issue of rate subsidy (which was the subject of the LIEN case), and rate discrimination generally (which almost all utilities experience to varying extents).[18]

The fact that the Board generally relies on revenue-to-cost ratios in determining rates does not make this rate making technique fundamental to its jurisdiction to set just and reasonable rates. A review of the governing legislation demonstrates that the Board has broad discretion in rate making.

The court in *Enbridge Gas Distribution Inc. v. Ontario Energy Board* held that the Board may consider matters of broad public policy in fixing just and reasonable rates:

> "[T]he expertise of the tribunal in regulatory matters is unquestioned. This is a highly specialized and technical area of expertise. It is also recognized that the legislation involves economic regulation of energy resources, including setting prices for energy which are fair to the distributors and the suppliers, while at the same time are a reasonable cost for the consumer to pay. This will frequently engage the balancing of competing interests, as well as consideration of broad public policy."[19]

The LIEN Decision is not inconsistent with the idea that the Board has broad rate-making discretion. While both the majority and the dissent in the LIEN Decision agree that "cost causality is the basic principle" of rate-making, the LIEN Decision does not

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[16] *LIEN Decision – Rate Affordability Programs* (April 26, 2007) EB-2006-0034
[17] The Factum of the Ontario Energy Board dated September 12, 2007 filed with the Divisional Courts in Court File No. 273/07.
[18] Rate subsidy is commonly referred to as taxation by regulation.
[19] *Enbridge Gas Distribution Inc.* v. *Ontario Energy Board* (2005), 75 O.R. (3d) 72, [2005] O.J. No. 756 at para. 24.

support AMPCO's argument that revenue-to-cost ratios must be established at one or near one in order for rates to be deemed to be just and reasonable. It is important to view the LIEN Decision in its proper context. In Board staff's view, the LIEN Decision was concerned with a rate-setting proposition that sought to depart from standard regulatory principles – such as cost causality – and rest on a social principle such as a customer's ability to pay.

In its Notice of Application, at para 22, AMPCO references a 1971 article by Richard Posner, *Taxation by Regulation*,[20] which it submits would support the thesis that a just and reasonable rate is only found where revenue to cost ratios approach one. The Posner article, like the Bonbright principles cited by AMPCO, is well known in the field of economic regulation. The Posner article argues against using monopoly rates as a means of income redistribution. Board staff submits that Posner does not postulate that all rates that discriminate or cross-subsidize are a form of income redistribution.

Furthermore, Posner acknowledges that there are many different formulae for allocating overhead costs and that, "[w]hichever choice is made makes some customers worse off and some better off than they would be under an alternative arrangement."[21]

AMPCO also relies on Bonbright's *Criteria of a Sound Rate Structure* in paragraph 2 of its submissions, to the effect that avoidance of undue rate discrimination in rate relationships is desirable. In addition to the criterion concerning undue discrimination are criteria about revenue stability and stability of the rates themselves. Accompanying Staff's submissions is an excerpt from C. Phillips *The Regulation of Public Utilities* which summarizes the Bonbright principles and discusses some of the difficulties in applying them. In commenting on the Bonbright criteria, Phillips points out that they are "broad and ambiguous" and that they overlap without offering any rules of priority in case of conflicts.[22]

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[20] Richard A. Posner, "Taxation by Regulation" (1971) 2 *Bell Journal of Economics and Management Science*.
[21] *Supra* at 117.
[22] Phillips Jr., Charles F., *The Regulation of Public Utilities*, 3rd ed. (Arlington, Virginia: Public Utilities Reports, Inc.) at 435.

In addition to considering objectives besides cost causation, Board staff submits that dated and unverified cost allocation results may not have been an adequate basis on which to apply Oshawa PUC's cost allocation model to yield a revenue-to-cost ratio of precisely unity.

Distributors have little experience doing cost allocation studies and lack the fully-developed data systems that would warrant complete reliance on the outcomes. The Board noted this in its *Cost Allocation Report*:

> "This is the first time that most distributors have performed cost allocation studies. As distributors apply this model in subsequent filings they will develop greater expertise in the application of data to the model, which in turn will allow for a greater reliance on the outcomes."[23]

AMPCO's submission at bullet point 28 states: "if data quality were in issue, one would have expected the panel to direct that the data be improved. However, the panel did not identify any specific problems with the data and did not impose any requirement to improve data quality." In fact, the Board's Report appears to consider that, for the time being, imprecise data is unavoidable in the cost allocation studies submitted by distributors.

Board staff submits that the *Cost Allocation Report*, and the Oshawa PUC decision both anticipate that subsequent cost allocation studies will yield more precise results, and the decision aims in effect to not over-shoot the revenue to cost ratio of unity with an over-correction of rates at this initial stage.

Oshawa PUC's pre-existing rate structure had been in place for more than 10 years. Board staff submits that Oshawa's existing rates did not become unjust and unreasonable upon the publication of the Board's *Cost Allocation Report.* The Board applied a cautious approach to the cost allocations that have come from the first iteration of the new cost allocation principles that it seeks to apply to electricity distributors. Board staff submits that this a prudent approach given the prolonged usage of the previous method of cost allocation.

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[23] *Supra* note 9 at 6.

Over the past two years the Board has worked with the industry to update its cost allocation methods. As the Board notes in the *Cost Allocation Report* the exercise has been challenging. The Board's policy is a reasoned, balanced, and where necessary cautious approach to the introduction of a new cost allocation methodology after a more than 20 year hiatus.

Board staff submits that to be granted the relief sought in this motion, the threshold for AMPCO is to demonstrate that there is undue discrimination to the ratepayers of Oshawa. Board staff invites all parties to make submissions as to whether AMPCO has met this threshold.

~ All of which is respectfully submitted ~

A Report with Respect to Decision-Making Processes at the OEB

September 2006

Introduction

Over the past year the Board has set itself on a course of achieving an efficiency agenda – one that is focused on improving efficiency in the Board's:

- Operational Performance – through business planning and performance metrics;
- Regulatory Outcomes – through performance and incentive mechanisms for the gas and electricity sectors; and
- Decision-making processes – through improving the Board's practices as they relate to hearings.

This paper focuses on reviewing the Board's decision-making process, specifically around the Board's current hearing practices and procedures, and considers how the Board's decision-making processes may respect the need for transparency and openness while at the same time be made more:

- focused on relevant issues;
- timely; and
- results oriented (as opposed to process oriented).

In short, the purpose of this review is to facilitate better decision making by the Board. This review was directed and guided by George Vegh, then OEB General Counsel, with the assistance of two external advisors, Lorne Sossin, of University of Toronto, and Ken Rosenberg, of Paliare Roland Rosenberg Rothstein. Input was obtained from members of the energy regulatory bar and other stakeholders. This report considers how the Board's processes may be improved and how these changes may be implemented. The categories under consideration were adjudicative hearings, the role of staff, the role of parties, and pre-hearing processes.

Summary

Adjudicative Hearings

- Adjudicative hearings should be largely restricted to circumstances where fact finding is required to support an order. Where possible, policy matters should be addressed in codes, rules or guidelines.

- The scope of hearings should be constrained by detailed and clear issues development as early as possible in the proceeding, and prior to the commencement of the pre-hearing processes.

Role of Staff

- Board staff should participate in hearings with the objectives of identifying and evaluating options for the Board's consideration in a proceeding by reference to the public interest. Staff should be required to present its view of the public interest on the record so that parties may respond to it. In very rare cases, staff's participation in a proceeding in this role may be incompatible with its ability to assist the panel in its deliberative process. An example of this is where staff is in a prosecutorial role in a compliance proceeding in Part VII.1 of the Act.

Role of Parties

- Parties to a proceeding should be required to demonstrate how their participation relates to the specific and particular interest of their constituency. This can be achieved through various methods, including asking parties at the commencement of a hearing to indicate which issues they have an interest in and how the issue affects their constituency, and querying an intervenor representative if that representative's participation in cross-examination or argument does not appear to relate to the intervenor's constituency. This requirement can be expressed through greater engagement by the panel in supervising the questions and submissions of parties.

Pre-Hearing Processes

- The Board should make more use of technical conferences and less use of written interrogatories. Board members (who may or may not be members of the panel hearing the proceeding) may attend at technical conferences and make rulings on the relevance of questions, responsiveness of answers, and the need for undertakings;
- The Board should make greater use of written transcripts as a full or partial alternative to oral testimony;
- The Board's expectations for settlement should be identified in a proceeding. Specifically, the Board should, prior to settlement discussions, advise parties which issues the Board believes should be settled and which issues the Board believes should go to a hearing;
- Board Members (other than the panel) should be made available to participate in the settlement of selected issues, such as through an in-chambers settlement conference or to review proposed settlement options and provide insight and perspective on the reasonableness of parties' positions; and
- Parties may be required to file their final offer on issues that the Board identifies should be settled. The panel may review these offers after releasing its substantive decision and may consider it in making cost awards and determining whether all of a utility's regulatory costs may be recovered from customers.

These matters are cumulative in that as a threshold matter, the Board should exercise greater control over the identification of issues that should be addressed in a hearing. After this is in place, staff should be responsible to ensure that the Board has a thorough evidentiary basis to address these issues and clearly address the public interest aspect of these issues. Staff positions should be stated clearly on the public record so that parties may respond to them. Clear issue identification and development is also required to assist parties in their preparation of their cases and, in particular, will allow them to identify clearly how their constituency is impacted by the issues in a proceeding. Parties can then be expected to confine their participation to the issues that directly impact their specific constituency both in the pre-hearing processes (discovery and settlement) and at the

hearing itself. Finally, by the time of settlement discussions, the Board should be in a position to identify which issues are appropriate for a settlement. The expectations of parties with respect to settlement should be made clear and reinforced with incentives and consequences.

Part I -- Adjudicative Hearings

The key focus of this review is oral hearings. It is important to put the role of oral hearings at the OEB in context. This is because oral hearings are only one of a number of ways that the Board makes decisions and pursues its regulatory mandates. For example, in the 2004-2005 year, the Board issued approximately 700 decisions, of which less than five per cent resulted from oral hearings.[1] The remainder resulted from written proceedings or proceeded without a hearing. As well, there are many Board issuances which do not require any type of order or any sort of written or oral hearing. Some of these cover very important parts of the Board's mandate. For example, the Board's 2006 Electricity Distribution Rates Handbook, Natural Gas Forum Report, Smart Meter Report, and Regulated Price Plan Handbook were all developed outside of the adjudicative process.

As a result, an oral hearing is only one of many instruments that the Board has available to implement its mandate. A key challenge for the Board is to choose the best instrument in light of the type of direction that is required by the Board.

In this context, it is helpful to consider the nature of the Board's instruments in more detail.

Under the OEB Act, the Board has the power to make orders, rules, codes and policy directions. The key differences between these instruments relate both to their functions and the process by which they are developed.

[1] Ontario Energy Board, 2004-2005 Annual Report, p. 29.

Orders are used to:

- approve rates for services charged by the utility components of the gas and electricity sector;
- approve gas and electric infrastructure facilities;
- issue and amend licences in the electricity sector; and
- make compliance orders.

On the whole, orders may only be issued after a hearing. Hearings may be oral or in writing. The difference between the two largely turns on the minimum legal rights provided to the participants in a hearing. In oral hearings, parties have the right to file evidence, challenge the evidence of other parties, and make oral submissions. [2] In written hearings, parties are entitled to file written materials and have access to all written materials considered by the Board in making its decision.[3] Orders are made by panels on the basis of an evidentiary record.[4]

The Board may also issue Rules (in the gas sector) and Codes (in the electricity sector). Codes/Rules are fundamentally different from orders; as Evans, Janisch, Mullan and Risk state in *Administrative Law: Cases, Text and Materials*, "The essence of a rule, as opposed to an adjudication, is that the former lays down a norm of conduct of general application while the latter deals only with the immediate parties to a particular dispute."[5] As a result, Codes/Rules are useful tools for implementing policy.

In the Gas Sector the Board has issued the following Rules:

- The Affiliate Relationships Code for Gas Utilities;
- The Code of Conduct for Gas Marketers; and
- The Gas Distribution Access Rule.

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[2] *Statutory Powers Procedure Act*, R.S.O. 1990, C. 22, ("*S.P.P.A*") s. 10.1
[3] *S.P.PA.,* 5(3). It should be noted that these are the minimum statutory requirements; the Board may also make orders respecting additional disclosure requirements as the circumstances require.
[4] *Ontario Energy Board Act, 1998* ("*OEB Act*"), s. 4.3.
[5] J.M. Evans, H.N. Janisch, David J. Mullan and R.C.B. Risk, *Administrative Law: Cases, Text and Materials* (Toronto: Emond Montgomery, 2003), at 675. See Chapter 8 for a discussion of rule making.

In the Electricity Sector, the Board has issued the following Codes:

- The Affiliate Relationships Code for Electricity Distributors and Transmitters;
- The Code of Conduct for Electricity Retailers;
- The Distribution System Code;
- The Retail Settlement Code;
- The Standard Supply Service Code; and
- The Transmission System Code.

Proposed Codes/Rules are circulated for notice and comment, which may be received in writing or through oral submissions. They are often developed through a consultation process where Board staff issue a paper and a proposed rule and meet with stakeholders to collect comments and perspectives. These materials may be issued prior to, during or after the public meetings. Codes/Rules are made by the Board, not panels of the Board.[6]

Finally, the Board may issue policy directions which set out the general approach that the Board plans to take in exercising its statutory powers. Guidelines do not necessarily have a statutory basis, nor are they established through a statutory process. Like rules, guidelines are also concerned with conduct. However, unlike rules, guidelines are not binding. As Professor Hudson Janisch states in the work cited above:

> Terminology here is very fluid as "policy" may include "manuals," "guidelines," "standards" and the like. Nothing turns on the precise term employed. The important thing is that unless an agency is given legislative authority to make binding rules, it must always consider exceptions to its general approach. [7]

The courts have encouraged agencies to adopt policy guidelines in the absence of express statutory authority to bring about greater predictability in decision making. The Supreme Court of Canada upheld the authority of the Canadian Radio-television and Telecommunications Commission to issue policy guidelines, despite the lack of specific statutory authority, as part of its role in implementing the Government of Canada's

[6] *OEB Act, 1998*, ss. 4.3, 44, and 70.1.
[7] Ibid., at 266.

broadcasting policy. According to Chief Justice Laskin: "An overall policy is demanded in the interests of prospective licensees and of the public under such a public regulatory regime as is set up by the *Broadcasting Act*. Although one could mature as a result of a succession of applications, there is merit in having it known in advance."[8]

Other agencies have also adopted policy guidelines without specific statutory authority, the most well-known of which are the guidelines issued under the *Competition Act (Canada)* respecting matters such as mergers, predatory pricing and price discrimination. Again, these guidelines are not legally binding, but a regulatory innovation that serves the goals of clarity and predictability. As the Federal Court of Appeal put it in reviewing these guidelines:

> In addition, the possibility that a reviewing court may not agree with an agency's view of the law is an inevitable risk associated with the administrative practice of issuing non-binding guidelines and other policy documents to shed light on agency thinking and to assist those subject to the regulatory regime it administers. The risk should deter neither the courts from deciding what the law is, nor the agencies from engaging in the often useful exercise of administrative rule making.[9]

The following are examples of policy directions issued by the Board:

- Environmental Guidelines for Hydrocarbon Pipelines and Facilities in Ontario;
- The Report on the Natural Gas Forum; and
- The 2006 Electricity Distribution Rates Handbook

As indicated, there is no specific legislative basis for policy directions or the process to be used to develop them. The Board's practice has been to consult on these directions through a notice and comment process much like that followed for Codes/Rules.

[8] *Capital Cities Communications Inc.* v. *Canadian Radio-television and Telecommunications Commission*, [1978] 2 S.C.R. 141 at 171.
[9] *Canada (Commissioner of Competition)* v. *Superior Propane Inc.*, [2001] 3 F.C. 185, para. 146.

The legal processes for orders, Codes/Rules and guidelines are thus quite different. These differences can also be viewed from a functional perspective. From a functional perspective, the Board's key output is a decision, rule, etc. that provides direction to individual parties and the energy sector as a whole. The key inputs consist of information provided by parties and from other sources. The legal processes differ largely on how that information is collected, processed and ultimately reflected in a decision. This is reflected in the following table.

Type of Decision	Information Collection	Information Processing	Decision
Order	Attested Materials Filed by Parties Precisely Described Relevance Criteria	Focus on Creating Evidentiary Record (intense scrutiny through highly formal rules) Labour intensive for Applicants, Intervenors and Board Staff	Enforceable Remedy aimed at Identified parties; not binding on other parties. Issued by Panel.
Code/Rule	General experience in sector Sectoral Technical Working Groups Driven by Operational Needs of Market Participants	Notice and comment provided either in writing, consultative working groups and/or oral submissions directly to Board members.	Creates generic rights and obligations to guide future behaviour of sector participants. Issued by Board.
Policy Directions	Same	Few Formal Restrictions. Public consultation and stakeholdering through a number of forums.	Provides Direction, Advice, Information or Guidance, does not Bind Board or Parties. Issued by Board.

As is illustrated in this table, the key difference between hearings and other initiatives is that hearings involve intense scrutiny of evidence for the purpose of creating a record upon which a Board panel may make a decision. It has been an effective tool for the Board to find facts that are relevant to support an order aimed at an identifiable company. It is also resource intensive, as the Board and the parties before it aim at ensuring the record is thoroughly and intensively scrutinized.

In other circumstances, where the Board is more concerned with directing outcomes for the sector on a prospective basis, the intensive hearing approach to building a record may not be appropriate. In these circumstances, the Board may be better to draw on its expertise in the area as well as from a range of other sources. That information is not collected through cross-examination, but from broader sources, without the need to have it formally introduced through sworn testimony.

The distinction between these two forms of evidence collection is sometimes referred to as the difference between adjudicative facts and legislative facts. Professor Davis has provided the following seminal description of this distinction:

> "Adjudicative facts are the facts about the parties and their activities, businesses and properties. Adjudicative facts usually answer the questions of who did what, where, when, how, why and with what motive or intent; adjudicative facts are roughly the kind of facts that go to a jury in a jury case. Legislative facts do not usually concern the immediate parties but are general facts which help the tribunal decide questions of law and policy and discretion."[10]

Using this broad (and perhaps over general) distinction between adjudicative and legislative facts, it could be argued that adjudicative facts are best uncovered through hearings in support of party specific findings, and legislative facts are best determined

[10] K. Davis, *Administrative LawTreatise* (1958) at 702. For a discussion of this distinction in the Canadian legal context, see: H.N. Janisch, "Policy Making in Regulation: Towards a New Definition of the Status of Independent Regulatory Agencies in Canada" (1979), 17 Osgoode Hall Law Journal 46 at 76-77.

through non-adjudicative processes in support of general sectoral policy. Most commentators who have considered this issue have argued that the hearing process is severely restricted when it comes to developing policy.

For example, the *Final Report of the Ontario Task Force on Securities Regulation,* which made recommendations about the role of rule making in the context of securities regulation, expressly stated that hearings should not be a mandatory component of the notice-and-comment procedure. Professor Ron Daniels, who authored the report, would only go so far as to endorse "the use of public hearings to the extent they may enhance the development of certain policy instruments in appropriate circumstances."[11]

Others have been more critical of the use of public hearings in rule making. Professor David Mullan, commenting on the history in the United States, where rule making is used much more extensively than in Canada,[12] stated:

> The anxious experimentation with more detailed procedures by Congress and the agencies themselves has demonstrated that the rule-making process should seldom, if ever, be surrounded by all the procedural requirements which attend a court-like adjudication.[13]

Similarly, Professor Hudson Janisch has identified and analyzed the following reasons why rule making (whether through binding rules or through non-binding guidelines) is preferable to an "*ad hoc* order":[14]

- public participation
- legitimacy

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[11] Ontario Task Force on Securities Regulation, *Responsibility and Responsiveness: Final Report of the Ontario Task Force on Securities Regulation* (Toronto: Queen's Printer for Ontario, 1994), at 36.
[12] For a discussion of the American experience, see K.C. Davis, *Administrative Law of the Seventies* (Rochester and San Francisco: LCP BW Publishing, 1976).
[13] D.M. Mullan, "Rule-Making Hearings: A General Statute for Ontario?" prepared for the Commission of Freedom of Information and Individual Privacy, 1979, at 11. See also the discussion at 156–157, where Professor Mullan quotes from the Administrative Conference's recommendation that it "emphatically believes that trial-type procedures should never be required for rule-making except to resolve issues of specific fact."
[14] H. Janisch, "The Choice of Decision-Making Method: Adjudication, Policies and Rule Making" (1992), *Law Society of Upper Canada Lectures* 259 at 266. Professor Janisch is referencing A.E. Bonfield, "State Administrative Policy Formulation and the Choice of Law Making Methodology" (1990), 42 Admin L.R. 121 at 122–131.

- visibility
- comprehensibility
- efficiency
- abstraction
- appropriate factual basis
- initiative
- easier participation
- prospective application
- consistency

The point here is not to criticize the adjudicative process generally or how it has operated at the Board. The hearing process is legally and practically necessary for the Board to determine adjudicative facts. However, it is inappropriate and largely ineffective at developing policy. The limitations in the hearing process in developing policy are demonstrated by the findings in the Board's Natural Gas Forum Report (the "NGF Report"). The NGF Report was a policy exercise aimed at laying out the regulatory framework for the natural gas sector. It identified several issues that contain important policy questions that required resolution. Most of those issues had been identified in adjudicative hearings but could not be pushed to resolution simply through the adjudicative process. Greater direction was required than could be provided by the adjudicative process.

It is also important to bear in mind that the different statutory instruments can and should be used together as part of a comprehensive and coherent approach to energy regulatory issues. In this way, non-adjudicative policy instruments may be used to set the context, framework and policy goals of a given proceeding and the adjudicative process may then be used to identify the adjudicative facts that must be established to make a specific order. A recent example of where the Board has proceeded in this manner is the York Region proceeding.

In the York Region proceeding, the Board identified that there was a serious issue respecting the adequacy of electricity supply to York Region. This determination was made through a non-adjudicative process – by reference to reports and forecasts from the Independent Electricity System Operator and the Board's collection of other publicly available information. The Board then structured a proceeding so that it could determine whether and how to exercise its statutory powers. In doing so, the Board clearly identified the issues it was going to address and the type of evidence it considered necessary to support an ultimate order. This was done through non-adjudicative processes. The Board also used an adjudicative process (in that case a written hearing) to establish the adjudicative facts that identified the specific cause and optimal solutions to the York Region supply situation. It relied upon these facts to order a specific remedy that certain licence holders implement infrastructure solutions to address the issue.

This example demonstrates how the Board may use its adjudicative and non-adjudicative functions in a coordinated and coherent way to produce decisions that are relevant and focussed on key issues. Seen this way, the adjudicative process is used for what it does best – adjudicative fact finding; and the non-adjudicative process is used for what it does best – establishing factual and legal context and issues development.

It is therefore recommended that these practices be more firmly and consistently used by the Board as follows:

- Adjudicative hearings should be largely restricted to circumstances where fact finding is required to support an order. Where possible, policy matters should be addressed in codes, rules or guidelines.

- Hearings should be constrained by detailed and clear issues development prior to the commencement of discovery processes, such as technical conferences and written interrogatories.

Part II - Role of Staff

This part of the paper looks at the role of Board staff in decision making. Within the last several years, the Board has employed a different role for staff and Board Members in the two types of decision making: in non-adjudicative processes and written hearings, staff provide legal, technical and policy expertise and analysis and Board Members take that into account when making a decision. In most oral hearings, staff does not provide this role. The Board relies on parties (applicants and intervenors) to provide substantive input; staff facilitates this input. Specifically, the parties are responsible to put forward and evaluate all options that may be considered by a panel in a proceeding. Thus, in the vast majority of processes at the Board that do not involve oral hearings, there is a division of responsibility within the Board that allows the expertise of the entire institution to be drawn upon to provide input respecting the identification and evaluation of options for the Board to take into account in its decision making. In oral hearings, the universe of possible solutions must come from the parties to the proceeding. The institutional expertise of the Board is not drawn upon by panels.

This practice may not facilitate the optimal achievement of the Board's statutory mandate.

The Board has a statutory mandate to exercise its expertise in both adjudicative and non-adjudicative decision making. The practice of isolating its adjudicative function from its institutional expertise is inconsistent with the expectations of a body with substantive expertise which the courts have recognized as meriting deference.

An issue which then arises is how to integrate the Board's substantive expertise in its adjudicative processes to ensure that processes are consistent with the Board's commitment to procedural fairness.

Each of these will be addressed in turn.

(i) Expertise: Adjudicative and Substantive

The distinction between adjudicative and substantive expertise arises in the context of identifying the level of deference that courts accord decisions of tribunals on the grounds that the tribunal is exercising expertise. In determining the tribunal's expertise, a key issue is whether the tribunal is primarily responsible for the resolution of disputes between parties (adjudicative expertise) or the implementation of policy (substantive expertise). Where the tribunal exercises substantive expertise the courts will accord its decisions with greater deference.

Thus, for example, in *Monsanto v. Ontario (Superintendent of Financial Services)*[15], the Supreme Court of Canada considered the degree of deference owing to a decision of the Financial Services Tribunal ("FST") respecting the distribution of actuarial surplus upon the partial wind up of a pension plan. The Court reviewed the statutory mandate and make up of the FST and held, although the FST had an expertise in holding hearings, it did not have substantive expertise deserving of deference. According to the Court:

> "…the Tribunal does not have specific expertise in this area. The Tribunal is a general body that was created under the *Financial Services Commission of Ontario Act, 1997*, S.O. 1997, c. 28 ("*FSCOA*"), s. 20, to replace the specialized Pension Services Commission. It is responsible for adjudication in a variety of "regulated sector[s]" (*FSCOA*, s. 1), including co-operatives, credit unions, insurance, mortgage brokers, loans and trusts, and pensions (*FSCOA*, s. 1). In addition, the nature of the Tribunal's expertise is primarily adjudicative. Unlike the former Pension Services Commission or the current Financial Services Commission, the Tribunal has no policy functions as part of its pensions mandate (see *FSCOA*, s. 22). As noted in *Mattel Canada*, *supra*, and in *National Corn Growers Assn. v. Canada (Import Tribunal)*, [1990] 2 S.C.R. 1324, involvement in policy development will be an important consideration in evaluating a tribunal's expertise. Lastly, in appointing members to the Tribunal and assigning panels for hearings, the statute advises that, to the extent practicable, expertise and experience in the regulated sectors should be taken into account (*FSCOA*, ss. 6(4) and 7(2)). However, there is no requirement that members necessarily have special expertise in the subject matter of pensions. The Tribunal is a small entity

[15] [2004] 3 S.C.R. 54

> of 6 to 12 members which further reduces the likelihood that any particular panel would have expertise in the matter being adjudicated (*FSCOA*, s. 6(3)).
>
> Overall, there is little to indicate that the legislature intended to create a body with particular expertise over the statutory interpretation of the Act. The Tribunal would not have any greater expertise than the courts in construing s. 70(6). Thus, this factor also suggests a lower amount of deference is required to be given to the Tribunal's decisions on the issue of statutory interpretation."

As a result, there are two major indications that a tribunal has substantive expertise: first, a statutory requirement that tribunal members have expertise; and second, that the tribunal has a non-adjudicative policy role.

These two components were also considered by the Federal Court of Appeal in *Canada (Commissioner of Competition) v. Superior Propane Inc.*[16] In that case, the Federal Court of Appeal found that the appointment process of members to the Competition Tribunal was sufficient to inject the requisite expertise in the Tribunal.[17] However, the Court also held that the substantive policy expertise of the Competition Bureau could not clothe the Tribunal with expertise because the Bureau and the Tribunal were not part of an integrated organization. According to the Court:

> "…the Tribunal is an adjudicative body. Just as it has done with the administration of human rights legislation, Parliament has divided responsibility for administering the Competition Act between the Competition Bureau, the policy-making, investigative and enforcement agency, headed now by the Commissioner, and the Tribunal, the adjudicative agency. In this respect, the Tribunal is different from multi-functional administrative agencies, such as securities commissions in many provinces, which typically have wide powers that match their regulatory mandate. The absence of broad policy development

[16] [2001] F.C.J. NO. 455

[17] Specifically, the Court noted that, prior to appointing members of the Tribunal, "the Minister must consult with an Advisory Council comprising not more than ten members, who, the CTA, subsection 3(3) provides, are appointed from those

> "...who are knowledgeable in economics, industry, commerce or public affairs and may include, without restricting the generality of the foregoing, individuals chosen from business communities, the legal community, consumer groups and labour."

> powers is a factor that limits the scope of the Tribunal's expertise: Pezim v. British Columbia (Superintendent of Brokers), [1994] 2 S.C.R. 557, at page 596."

It was therefore the separation of the policy role of the Bureau from the adjudicative role of the Tribunal which limited the scope of the latter's expertise. As the Court noted, the Tribunal is an adjudicative, not a policy body.

Given that the *Ontario Energy Board Act* does not contain a requirement that Board Members may only be selected from a pool of experts, it is helpful to focus on how the non-adjudicative policy making role feeds into a tribunal's expertise. This has been referred to in several cases. For example, in *Mattel*, the Court noted that, in addition to statutory requirements for expert appointments, the Courts will also look to "whether any special procedures or non-judicial means of implementing the Act apply, and whether the tribunal plays a role in policy development" when determining whether a tribunal has substantive expertise. In that case, the Court found that there was some limited expertise in the Tribunal because its "policy-making role is limited in that its function is primarily research oriented, and the CITT cannot elevate its policy recommendations to the status of law."

Similarly, in *Pezim v. British Columbia (Superintendent of Brokers)*[18], the Supreme Court of Canada said the following with respect to securities commissions:

> Where a tribunal plays a role in policy development, a higher degree of judicial deference is warranted with respect to its interpretation of the law. This was stated by the majority of this Court in *Bradco* [*United Brotherhood of Carpenters and Joiners of America, Local 579 v. Bradco Construction Ltd.*, [1993] 2 S.C.R. 316] at pp. 336-37:
>
> > . . . a distinction can be drawn between arbitrators, appointed on an *ad hoc* basis to decide a particular dispute arising under a collective agreement, and labour relations boards responsible for overseeing the ongoing interpretation of legislation and development of labour relations policy and precedent within a given labour jurisdiction. To the latter, and other similar specialized tribunals responsible for the regulation of a specific industrial or technological sphere, a greater degree of deference

[18] [1994] 2 S.C.R. 557

> is due to their interpretation of the law notwithstanding the absence of a privative clause. (emphasis added)
>
> In the case at bar, the Commission's primary role is to administer and apply the Act. It also plays a policy development role. Thus, this is an additional basis for deference. However, it is important to note that the Commission's policy-making role is limited. By that I mean that their policies cannot be elevated to the status of law; they are not to be treated as legal pronouncements absent legal authority mandating such treatment.

As indicated, in the *Superior Propane* case, the Federal Court of Appeal held that the Tribunal did not share the policy expertise of the institution because the Bureau staff's policy function was isolated from adjudicative decision making.

The non-adjudicative and policy roles are particularly important in considering whether it is appropriate for decision makers to be isolated from the institutional expertise of the Board. The Board clearly has extensive non-judicial tools through its rule and code making authority. In fact, because the Board's rule and code making authority imposes rules that are binding on both of panels and industry participants, this authority is much stronger than the non-binding policy powers referred to by the courts in *Mattel, Pezim* and *Superior Propane*.

The key point here is that, when exercising those non-judicial means, the Board decision makers are not quarantined from the rest of the institution. Board Members make the rules and codes after receiving input from staff as well as stakeholders. The ultimate code or rule is the culmination of the work of the institution – both staff and Board Members. The expertise reflected in rule and code making is thus an institutional expertise. It is difficult to argue that this institutional expertise can infuse the adjudicative decisions of the Board if the Board deliberately quarantines the adjudicative decision-making process from that expertise. To the contrary, such an approach would mirror, on a voluntary basis, the mandatory separation of policy functions and adjudicative functions in agencies such as the Competition Bureau and the Competition Tribunal.

There are two key consequences of insulating panels from the institutional expertise of the Board. The first, as indicated, is that the Board may not be able to claim the degree of deference that is accorded expert tribunals.

The second and more fundamental problem is that the Board is not meeting its statutory mandate. If the Board has a policy mandate but exercises only an adjudicative function, it is not meeting the responsibility that the legislature has assigned to it. Dean Landis of Harvard Law School identified the defining feature of administrative processes as follows:[19]

> "The [administrative] process to be successful in a particular field, it is imperative that controversies be decided as 'rightly' as possible, independently of the formal record the parties themselves produce. The ultimate test of the administrative is the policy that it formulates; not the fairness as between the parties of the disposition of a controversy on a record of their own making."

The Board's public interest mandate approach not only runs counter to the approach which would have the Board only adjudicate upon parties' disputed issues, it puts an affirmative duty on the Board to ensure that public interest issues are addressed. This was expressed by the United States Court of Appeal in the context of the Federal Power Commission (the predecessor to the FERC):[20]

> "In this case, as in many others, the Commission has claimed to be the representative of the public interest. This role does not permit it to act as an umpire blandly calling balls and strikes for adversaries appearing before it; the right of the public must receive active and affirmative protection at the hands of the Commission."

This in turn puts a positive duty on staff to identify and evaluate options to present to the panel in a proceeding. The authors of Macaulay and Sprague, *Practice and Procedure before Administrative Tribunals* quote approvingly from a statement by the U.S. Federal

[19] Landis, the Administrative Process (Harvard, 1938) at 39.
[20] *Scenic Hudson Preservation Conference* U.S. App. LEXIS 3514 [32-33]

Trade Commission: "…if the staff fails adequately to present the public interest and to raise all the relevant questions, no one else will".[21] According to Macaulay and Sprague:[22]

> "What is essential to realize is that a tribunal has a duty to provide a balanced record, to test every assumption, to challenge every impact and wring out every issue. *No tribunal* can wait for the apple to fall. It must shake the tree. This balance is obtainable through the active participation by staff in the hearing process."

In other words, for Board staff to proactively put before the Board the public interest position on matters where it is relevant is both a distinct role from that of the parties and is consistent with the Board's statutory mandate and responsibilities. Specifically, in making its decisions, the Board should not be limited to the options put forward by parties or the evaluation of those options by the parties. Panels will benefit from staff's identification and evaluation of options for the Board to consider.

In conclusion on this point, the Board's policy mandate and expertise should inform decisions that result from the adjudicative process. It is therefore inappropriate to quarantine the decision makers from the institutional expertise in making those decisions. The next part of this report reviews the way in which this may be done in a manner consistent with the Board's commitment and legal responsibilities as they relate to a fair and open hearing process.

(ii) Open and Fair Hearings

As an adjudicative tribunal, the OEB must make its decisions in accordance with the statutory and common law rules respecting fairness and due process. The issue is the content of these rights as they relate to positions taken by staff. Specifically, given that staff may assist panels in the deliberative process, the question is whether it is appropriate for the same staff to identify and evaluate options in an oral hearing. In legal terms, the

[21] (Toronto: Carswell, 1988), at 14-8.2.
[22] Ibid., at 14-12.

question is whether this dual role is consistent with the requirements of fairness that attend the Board's hearing process. Addressing this first requires an elaboration of the role of staff being advocated in this report.

The staff role being proposed here is the identification and evaluation of options for consideration by the panel. This involves demonstrating leadership in the hearing room, but not for the purpose of supporting or opposing a party's position. Staff's only driver is the public interest, and they remain neutral as between parties. Their analysis may lead them to see one argument or option as having greater public interest value than another. This is not the same as taking an adversarial position against a party. There are clearly limitations on how adversarial staff may be in pursuing its positions. The courts have noted that tribunal staff, where leading evidence and making submissions, represents the public interest, and therefore have a different responsibility than a private party. The seminal statement in the area is from the British Columbia Supreme Court in *Omenieca Enterprises Ltd. v. British Columbia (Minister of Forests)*:[23]

> "…counsel for the tribunal may be called upon to lead evidence, cross-examine witnesses and make submissions with a view to putting the tribunal as fully in the picture as possible. In so doing, it is important for counsel to proceed in a spirit of disinterested inquiry and to avoid the appearance of partisanship of behalf of any interest. It is undesirable to be too dogmatic in attempting to define the proper functions of counsel to administrative tribunals in all circumstances. The overriding objective is always to ensure that the proceedings are fair and impartial."

Provided that staff are pursuing a public and non-partisan interest, and provided that staff positions are put on the record or otherwise disclosed to the parties, staff involvement both in the hearing and in assisting the Board following a hearing is consistent with the duty of fairness owed to the parties in the circumstances of a Board hearing.

The Supreme Court of Canada described the underlying purpose of the duty of fairness as follows in *Baker v. Canada*:[24]

[23] (1992), 7 Admin. L.R. (2d) 95 (B.C.S.C.) at 99-100.
[24] (1999), 174 D.L.R. (4th) 193 at 211.

> "I emphasize that underlying all these factors is the notion that the purpose of the participatory rights contained with the duty of procedural fairness is to ensure that administrative decisions are made using a fair and open procedure, appropriate to the decision being made and its statutory, institutional, and social context, with an opportunity for those affected by the decision to put forward their views and evidence fully and have them considered by the decision-maker."

The Court listed a number of factors to be considered in identifying the content of the duty of fairness in any particular case. The analytic framework employed by the Court to evaluate the duty of fairness is based on a contextual assessment of the tribunal and its operations. As the Court observed in *2747-3174 Quebec Inc. v. Quebec*:[25]

> "As is the case with the courts, an informed observer analysing the structure of an administrative tribunal will reach one of two conclusions: he or she either will or will not have a reasonable apprehension of bias. That having been said, the informed person's assessment will always depend on the circumstances. The nature of the dispute to be decided, the other duties of the administrative agency and the operational context as a whole will of course affect the assessment. In a criminal trial, the smallest detail capable of casting doubt on the judge's impartiality will be cause for alarm, whereas greater flexibility must be shown toward administrative tribunals. As Lamer C.J. noted in *Lippe, supra, at p. 142,* constitutional and quasi-constitutional provisions do not always guarantee an ideal system. Rather, their purpose is to ensure that, considering all of their characteristics, the structures of judicial and quasi-judicial bodies do not raise a reasonable apprehension of bias. This is analogous to the application of the principles of natural justice, which reconcile the requirements of the decision-making process of specialized tribunals with the parties' rights. I made the following comment in *IWA v. Consolidated-Bathurst Packaging Ltd., [1990] 1 S.C.R. 282, at pp. 323-24:*
>
> > "I agree with the respondent union that the rules of natural justice must take into account the institutional constraints faced by an administrative tribunal. These tribunals are created to increase the efficiency of the administration of justice and are often called upon to handle heavy caseloads. It is unrealistic to expect an administrative tribunal such as the Board to abide strictly by the rules applicable to courts of law. In fact, it has long been recognized that the rules of natural justice do not have a

[25] (1996),42 Admin. L.R. (2d) 1 at para. 45:

> fixed content irrespective of the nature of the tribunal and of the institutional constraints it faces."

In addition to the attention paid to the institutional context of the tribunal and its operations, another clear point arising from the case-law is that the content of the duty can change depending upon the impact of the decision on the party to a proceeding. As the Court held in *Baker*:

> "The more important the decision is to the lives of those affected and the greater its impact on that person or persons, the more stringent the procedural protections that will be maintained. This was expressed for example by Dickson J. (as he then was) in *Kane v. Board of Governors of the University of British Columbia*, [1980] 1 S.C.R. 1105 at p. 1113, 110 D.L.R. (3d) 311:
>
> > 'A high standard of justice is required when the right to continue in one's profession or employment is at stake…A disciplinary suspension can have grave and permanent consequences upon a professional career.'
> > …
> > The importance of a decision to the individuals affected, therefore, constitutes a significant factor affecting the content of the duty of procedural fairness."

As a result, it is too simplistic to identify a single duty of fairness that the Board must meet in all of its proceedings. Some Board decisions have a greater impact on persons than others. It is therefore best to identify the content of the duty of fairness by reference to the impact of different types of Board decisions on the rights of various parties.

There is considerable case-law and academic discussion on the role of staff in administrative proceedings and how the boundaries of that role are different depending on the nature of the proceeding. For example, where staff acts as a prosecutor in a proceeding, the duty of fairness requires that staff not assist in the deliberative process. The Supreme Court of Canada put it as follows in *2747-3174 Quebec Inc. v. Quebec*:[26]

[26] (1996),42 Admin. L.R. (2d) 1 at 125:

> "This is not to say that jurists [i.e., lawyers] in the employ of an administrative tribunal can never play any role in the preparation of reasons. An examination of the consequences of such a practice would exceed the limits of this appeal, however, as I need only note, to dispose of it, that prosecuting counsel must in no circumstances be in a position to participate in the adjudicative process. The functions of prosecutor and adjudicator cannot be exercised together in this manner."

In this decision, the Supreme Court of Canada endorsed the following quotation from the Ontario Court of Appeal in *Sawyer v. Ontario (Racing Commission)*[27]

> "But there is no doubt that his role was to prosecute the case against the appellant and he was not present in a role comparable to that of a legal assessor to the Commission as discussed by Schroeder, J.A. in *Re Glassman and Council of Colleges of Physicians & Surgeons*, [1966] 2 O.R. 81 at p. 99 ["*Glassman*"]. He was counsel for the appellant's adversary in proceedings to determine the appellant's guilt or innocence on the charge against him. It is basic that persons entrusted to judge or determine the rights of others must, for reasons arrived at independently, make that decision whether it or the reasons be right or wrong. It was wrong for the Commission, who were the judges, to privately involve either party in the Commission's function once the case began and certainly after the case was left to them for ultimate disposition. To do so must amount to a denial of natural justice because it would not unreasonably raise a suspicion of bias in others, including the appellant, who were not present and later learned what transpired."

Both of these decisions related to cases where the tribunal's counsel was both a prosecutor and an advisor: these two functions were held to be incompatible.

Where staff is not in a prosecutorial role, the legal requirements are different. As indicated earlier, this is largely because the law imposes different types of procedural restrictions on tribunals where different rights of a person before it are at stake. Where, such as in the case of a prosecution, a person's career and livelihood are at stake, the courts will impose greater restrictions on tribunals. Where the Board acts in its function as an economic regulator, these restrictions are reduced. Specifically, in this context, the courts' concern with tribunal practices has tended to focus more on ensuring that staff submissions are disclosed to the parties. In other words, the courts do not require that

[27] (1979), 24 O.R. 673 ("*Sawyer*") at 676

staff not make submissions in proceedings; rather, the emphasis is that parties are made aware of and have an opportunity to respond to staff submissions.

For example, in the *Glassman* decision referred to by the Ontario Court of Appeal in *Sawyer*, the College of Physicians & Surgeons retained independent counsel to advise on matters of law. Although the advice would be provided in prosecutions, the counsel was not a prosecutor. Counsel provided legal advice on the record and parties were given the opportunity to respond. Counsel was also present during the course of deliberations. The Court of Appeal held that the requirement for disclosure of counsel's advice was sufficient to meet any concerns about a denial of natural justice. In coming to this conclusion, the Court explicitly relied upon its earlier decision in *R. v. Public Accountants Council Ex p. Stoller.*[28] In that case, the Court again held that, in a non-prosecutorial position, counsel in the hearing may continue to advise the decision maker: "I point out again that on the authorities, a case such as this is not comparable to a trial where there is a prosecutor and an accused."[29]

Thus, in the non-prosecutorial context, the courts' emphasis has been on ensuring that parties have the right to know and answer the case they have to meet. This involves a requirement that a decision maker not base his or her decision on facts which are not on the record and parties have the opportunity to respond to legal and policy arguments that are considered by the decision maker. The Supreme Court of Canada characterized this right as follows in *Consolidated Bathurst Packaging Ltd.* (1990), 42 Admin L.R. 1 at 38:

> "Since its earliest development, the essence of the *audi alteram partem* rule has been to give the parties a 'fair opportunity of answering the case against [them]…It is true that on factual matters the parties must be given a 'fair opportunity…for correcting or contradicting any relevant statement prejudicial to their view'…However, the rule with respect to legal or policy arguments not raising issues of fact is somewhat more lenient because the parties only have the right to state their case adequately and to answer contrary arguments. This right

[28] [1960] O.R. 631.
[29] *Sawyer*, at . 698. For a more recent example of the restrictions in disciplinary proceedings, see: Ahluwalia v. College of Physicians and Surgeons of Manitoba, [1999] M.J. No. 55

does not encompass the right to repeat arguments every time the panel convenes to discuss the case."

Similarly, in *Carlin v. Registered Psychiatric Nurses' Association* Binder J. stated the following:[30]

"In my opinion, in general, it is proper for counsel to:

1. Attend at the hearing of a tribunal, to provide advice to the tribunals, when *requested* by the tribunal to do so, provided, except in very special circumstances, that such advice is given *openly and in the presence of all interested parties*.
2. Assist the hearing tribunal in preparing and even drafting the reasons for decision of the tribunal." (emphasis in the original)

The above passages suggest that, in the non-prosecutorial context, a fair trial requires ensuring that parties have the opportunity to know the case they have to meet. That right consists of being able to respond to law and policy arguments put forward by staff.

This approach is also demonstrated in cases where the courts have been critical of tribunals for not giving parties the opportunity to respond to staff positions. For example, in *B.P. Canada Energy Co. v. Alta (Energy & Utilities Bd.*), the Alberta Court of Appeal found that a party's right to know the case it had to meet was arguably violated because the Alberta Energy Utilities Board staff and the panel conducted examinations of "core logs and other data not in evidence at the hearing… The fact that the parties were not present for these examinations contributes to this issue's seriousness."[31] The same Court, although dismissing a leave to appeal motion as premature, acknowledged that there may have been arguable issues for appeal with respect to staff's presentation to the Board of "evidence or interpretation of evidence [that] is not disclosed to hearing participants."[32]

[30] (1996), 39 Admin L.R. (2d) 177 (Alta. Q.B.), at 199 (emphasis in the original).
[31] (2003), 6 Admin. L.R. (4th) 163 at 173.
[32] *Devon Canada Corp. v. Alberta (Energy & Utilities Bd)*, (2003), 3 Admin. L.R. (4th) 154 at 158

This is also aligned with academic opinion. In *Regulations of Professions in Canada*, J.T. Casey proposes the following approach:[33]

> "…the solution lies in the adoption of a procedure which permits counsel to a discipline tribunal to be present during deliberations but which also ensures that the dictates of procedural fairness are met. A commitment that the 'prosecutor' and counsel to the member facing charges will be given the opportunity to address any new legal issues or arguments which arise during deliberations and which were not previously canvassed by the parties in open hearings, would alleviate most of the concerns."

This approach is supported in Jones and deVillars, *Principles of Administrative Law* (3d), where the authors state that providing parties with the opportunity to respond to any new issues raised in deliberations "is entirely consistent with the principles set out in *Consolidated Bathurst* and *Tremblay* and provides the better view of what are the appropriate constraints on counsel to an administrative tribunal."[34]

Finally, in the American context, William F. Pedersen has argued that openness in administrative tribunal decision making reflects an improved method of policing fairness than imposing restrictions on staff's ability to communicate with panels:[35]

> "All these measures abandon splitting up the agency internally as a means of reducing bias. Instead, they treat the agency as a unit in which all staff members are available to advise in a final decision. They then open up the deliberations of that unit to the scrutiny of outside forces to a much greater extent than has been customary. The checks and balances on the agency remain, but they depend much less than they did on analogizing the agency to a court."

A review of the case law and the literature suggests little support for the position that, as a legal matter, staff cannot both make submissions in a proceeding and continue to assist panels in preparing decisions in non-prosecutorial hearings. The key requirement is that parties be made aware of staff positions and have the opportunity to respond.

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[33] (Toronto: Carswell, 1994) at 8-38 to 8-39)
[34] (Toronto: Carswell, 1999) at 325.
[35] "The Decline of Separation of Functions in Regulatory Agencies" (1978), 64 Virginia Law Review, 991 at 1031.

It is therefore recommended that:

- Board staff should participate in hearings with the objectives of identifying and evaluating options for the Board's consideration in a proceeding by reference to the public interest. Staff should be required to present its view of the public interest on the record so that parties may respond to it. Only in very rare cases, staff's participation in a proceeding in this role may be incompatible with its ability to assist the panel in its deliberative process. An example of this is where staff is in a prosecutorial role in a compliance proceeding in Part VII.1 of the Act.

Part III – Role of Parties

The role of the parties in OEB proceedings is linked to the role of staff. The minimal role of staff over the last several years has been accompanied by an increased reliance on parties to the proceeding. This has led to both benefits and costs. The benefit is that the OEB benefits from having a fully engaged stakeholder community. It is not unusual for a Board proceeding to have several representatives of groups representing residential customers, institutional customers, commercial customers, industrial customers, retailers, generators and environmental groups. These intervenors bring their perspective to bear on the complex problems addressed by the Board. The Board encourages intervenor participation through cost awards for hearings, Code/Rule development, and policy initiatives. It is one of the most extensive cost awards regimes in the country.

The cost of this approach is that the parties have been relied upon to represent, not just the particular interests they are retained to advance, but the totality of the public interest. As indicated, staff have not been used to add to the options presented to the Board. In addition to the issues respecting the Board's mandate discussed earlier, there are additional concerns to leaving the development of issues entirely to the parties.

One concern is that the interests claimed to be represented before the Board are extremely broad and cannot reasonably be presumed to align within the organizations that intervene

before the Board. For example, most parties before the Board claim to represent vastly broad and divergent groups, such as "residential customers". Residential customers of energy consist of virtually every person resident in Ontario. It is inconceivable that every resident in Ontario is capable of constituting a single interest on complex matters of energy policy before the Board. For example, what is the interest of residential customers on the creation of retail commodity purchase options? Some customers, who have no interest in retail competition receive no benefit from this option. Other customers, who are interested in retail options, or who are served by retailers, may benefit from having more options available. In these circumstances, residential customers will have quite varied, and even conflicting, interests. A related example is whether residential customers benefit from policies that reduce price volatility of system supply. Some customers may and some may not. When faced with these types of issues, residential customer representatives who wish to advocate on behalf of residential customers must make a determination of which approach to support. In making this choice, they are effectively making policy trade-offs between different categories of customers.

Allowing these representatives to make the trade-offs themselves is not a problem for the Board if the intervenors' representation is accepted as a meaningful but not exclusive input into the Board's determination of what is in the interests of residential customers. In this case, intervenors representing residential customers present a perspective that the Board should consider. This only becomes a problem if the Board treats the customer representatives as representing the "sole" voice of residential customers and is unwilling to consider the matter further. In such a situation, the Board is expecting the intervenor to make the trade-offs that are involved in deciding on a position. In this case, the Board's mandate to represent the interests of consumers (as well as other interests) is exercised by merely registering the opinion of the intervenor.

Another consequence of not using a proactive staff model is that the role of the parties may arguably have become somewhat open ended. Applicants and intervenors provided the entire landscape of options before the Board. With the participation of a proactive

staff that is representing the public interest, the role of parties to proceedings may take on a sharper focus. Intervenors, in particular, will have a clearer and more precise mandate to represent the interests of their constituency. This clarity should make their participation more valuable to the Board and perhaps even allow them to more clearly represent their client's interest.

The expectation of a clear and precise representational interest in an intervenor's participation may be demonstrated in a number of ways: standing, costs and conduct in a proceeding. Each will be addressed in turn.

With respect to standing, the Board's Rules of Practice provide that a "person applying for intervenor status must satisfy the Board that he or she has a substantial interest and intends to participate actively and responsibly in the proceeding…" The Rules also provide that every intervention application must identify "the interest of the intervenor in the proceeding and the grounds for the intervention." [36] While the Board has rarely refused a party standing to participate in a hearing, intervenor status has been denied in cases where the issues are beyond the Board's jurisdiction. Furthermore, it is very rare that an application for intervention status has gone beyond a *pro forma* statement that the outcome of a decision may have an impact on a constituency. To be fair, requiring greater specificity to support an intervention application is more difficult where proceedings are open ended and the issues are not developed with any level of specificity until well into the pre-hearing and even hearing stage. Unless issues are clearly identified at the outset of the proceeding, it is not realistic to expect that intervenors can clearly identify the issues that they are interested in pursuing as early as the standing stage of the proceeding. To the extent that the Board does move clear issue development to an early stage of the proceeding, it may be possible to consider more rigorous standing requirements at that early stage.

With respect to costs, the Board's practice is identified in its *Practice Directions on Cost Awards*. These directions set out eligibility requirements as well as granting the panel the

[36] *Ontario Energy Board Rules of Practice and Procedure*, Rules 23.02, 23.03

discretion to award partial or full costs of participating depending on a number of factors, especially the party's contribution to the proceeding. The Board's practice has been to occasionally discount an intervenor's cost awards based on its contribution. There is no known case of the Board refusing to allow an applicant the ability to recover its costs from utility customers. The Board's Business Plan indicates that it will carry out a review of its current funding model in this fiscal year. Given the complexity and contentiousness of the issues at stake in funding, it is probably better to not consider changes to the cost award regime at this stage, and leave that issue to be addressed in a more thorough review as planned. However, where a party (whether applicant or intervenor) needlessly extends proceedings, the Board's authority over cost awards and cost recovery provide it with the ability to impose financial consequences.

Finally, there is conduct in the proceedings – that is, the hearing itself (the pre-hearing process will be addressed below). Panels have the ability to control their process. They are thus clearly in the position to require parties to demonstrate how their participation relates to the interest that they represent. It may be that, as cases are more thoroughly developed through a more proactive staff, panels will be better placed to direct parties to clearly identify this role. This includes asking parties at the commencement of a hearing to indicate which issues they have an interest in and how the issue affects their constituency, and querying an intervenor representative if that representative's participation in cross-examination or argument does not appear to relate to the intervenor's constituency. This requirement can be expressed through greater engagement by the panel in supervising the questions and submissions of parties. As indicated, the Board's authority over cost awards and recovery of regulatory costs could also be used in this regard.

In summary, recommendations in this area are as follows:

- Parties to a proceeding should be required to demonstrate how their participation relates to the specific and particular interest of their constituency. This can be achieved through various methods, including asking parties at the commencement of a hearing to indicate which issues they have an interest in and how the issue

affects their constituency, and querying an intervenor representative if that representative's participation in cross-examination or argument does not appear to relate to the intervenor's constituency. This requirement can be expressed through greater engagement by the panel in supervising the questions and submissions of parties.

Part IV - Pre-Hearing Processes

The Board has broad authority to develop pre-hearing processes, specifically disclosure requirements and pre-hearing conferences. Each will be considered in turn.

(i) Disclosure

The Board has very broad powers to order disclosure of documents and other types of information.[37] The Board's standard practice has been to use the written interrogatory process. This process has some limitations. First, parties write interrogatories independently and at the same time; the result is considerable duplication of questions. Second, there is little cost to asking a large number of questions, so a large number are asked. Third, applicants face little consequence for providing non-responsive answers to questions. They may therefore avoid answering questions and, in anticipation of this, intervenors state their questions very broadly. The number of irrelevant interrogatories is also increased by the lack of clear issue definition in proceedings.

The Board has recently been experimenting with alternatives to written interrogatories, namely, technical conferences and written records. Technical conferences involve discovery of witnesses in the presence of other parties. Transcripts of conferences are admissible as part of the record in the proceedings. Where a witness cannot immediately provide an answer, an undertaking may be provided. An alternative to technical conferences is written records where affidavit evidence is filed and parties may schedule

[37] See S.P.P.A. , s. 5.4.

their own cross-examinations where required. The key difference between the two is that the first is an event sponsored and organized by the Board, while cross-examination in the latter is scheduled and conducted by individual parties as required. Both of these discovery mechanisms have an advantage over written interrogatories in that answers are provided in real time and made available to others. They may also be more effective at clarifying technical issues. They are therefore timelier and less duplicative than the written interrogatory process.

A theoretical issue, which has not yet arisen in practice, is that disputes over appropriateness of questions may not be resolved at the technical conference. The Board's Rules of Practice do not explicitly address this issue, but it would be consistent with the Rules for a party to bring a motion to the Board to determine whether answers should be provided. Another alternative would be for a Board Member to attend at technical conferences to provide rulings as required. This would require an amendment to the Board's Rules of Practice.

It has been the practice that transcripts from technical conferences are used as a supplement to a witness's oral testimony, while transcripts from cross-examination on affidavits are used in lieu of oral testimony. However, that is not a necessary distinction, and transcripts may be used in either way. Where transcripts are used in lieu of oral testimony, the parties have been required to file written arguments addressing both factual and legal submissions. Using transcripts as an alternative to oral testimony has greater potential than is currently exercised at the Board. It is widely available in the courts, and can be used wherever there are no material facts in dispute, or where the real issue relates to the inference to be drawn from facts.[38] Given that it is the case in many Board proceedings, the Board could make much greater use of this process than is currently the case. Making greater use of this would be facilitated by explicitly outlining the process in the Board's Rules of Practice.

[38] Rules of Civil Procedure, Rule 38 and, for example, *Somerleigh v. Lakehead Region Conservation Authority*, [2005] O.J. 4798 and *Collins v. Canada (Attorney General)*, [2005] O.J. 2317.

(ii) Settlement

The *S.P.P.A* grants the Board broad authority to address the settlement or simplification of issues in a proceeding.[39] The Rules of Practice provide for settlement negotiations at the direction of the Board. Settlement discussions are often facilitated by external consultants or Board staff and are carried on without prejudice. Staff attend settlement discussions, but do not sign settlement agreements and information obtained in settlement negotiations is kept in confidence and, in particular, is not shared with the panel assigned to the proceeding.

Settlement negotiations sometime result in comprehensive proposals that resolve most or even all issues between the parties. Settlement proposals are filed with the Board. Where a settlement proposal is unanimous, the Board may approve the proposal and dispose of the issues that are subject to the proposal. A party who does not agree with the settlement of an issue is entitled to offer evidence in opposition to the settlement proposal and cross-examine on that issue at the hearing.[40]

The Board has not explicitly adopted a policy towards settlements and, for example, has not expressly endorsed settlement as generally in the public interest. Given the public interest mandate of the Board, it is unlikely that such a general proposition would be possible.[41] Although the Board has, on occasion, identified some specific issues that should not be settled, it has done so only rarely.[42] Further, the Board has never indicated which issues it believes should be settled or the consequences for parties if there is no settlement. Rather, the settlement process has been largely left to the parties to work out among themselves.

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[39] See *S.P.P.A.*, s. 5.3.
[40] See Ontario Rules of Civil Procedure, Rule 14.05(3)(c), Rule 38.01.
[41] In the analogous example of negotiated rulemaking, the American courts have rejected the proposition that a regulator could bind itself to a negotiated agreement. The United States Court of Appeal stated that "It sounds like an abdication of regulatory authority to the regulated, the full burgeoning of the interest-group state, and the final confirmation of the 'capture' theory of administrative regulation." See: *USA Group Loan Services Inc. v. Riley* 82 F. 3d 708 (7th Cir. 1996) at 714. Quoted in, Alfred Aman, "Administrative Law for a New Century", in Michael Taggart (ed), *The Province of Administrative Law* (Oxford: Hart Publishing, 1997) 90 at 107.
[42] The two examples where this has occurred are the IESO proceeding and the current NGEIR proceeding.

Given the lack of guidance from the Board as to the value of negotiated settlement, it is difficult to conclude whether the current process is successful or not. However, there are structural reasons inherent in the Board's process that may work against settlement.

First, the parties do not have clear incentives to settle in order to avoid a hearing. Specifically, the costs of both funded intervenors and utility applicants are passed through to ratepayers. The parties therefore do not bear the expense of proceeding with a hearing.

Second, the reasonableness of parties' positions or conduct within settlement negotiations is kept secret from the panel. Parties therefore do not face consequences for taking unreasonable positions. This may be contrasted with the judicial Rules of Civil Procedure where parties face cost consequences for turning down settlement offers that are more favourable than that obtained by a judgment.[43]

The Board should provide guidance in the course of a proceeding with respect to its expectations for settlement and then provide incentives and other measures to encourage settlement. Specifically:

- The Board's expectations for settlement should be identified in a proceeding. Specifically, the Board should, prior to settlement discussions, advise parties which issues the Board believes should be settled and which issues the Board believes should go to a hearing.

- Board Members (other than the panel) should be made available to participate in the settlement of selected issues, such as through an in-chambers settlement conference or to review proposed settlement options and provide insight and perspective on the reasonableness of parties' positions;

[43] See Rules of Civil Procedure, Rule 49.

- Parties may be required to file their final offer on issues that the Board identifies should be settled. The panel may review these offers after releasing its substantive decision and may consider it in making cost awards and determining whether all of a utility's regulatory costs may be recovered from customers.

Ontario Energy Board

Application of Cost Allocation for Electricity Distributors

Report of the Board

EB-2007-0667

November 28, 2007

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1 Introduction

1.1 Scope

This Report sets out the Board's policies in relation to specific cost allocation matters for electricity distributors, and represents the culmination of a consultation process that began several years ago. It addresses a number of issues, most significantly the relationship between the class revenue and the class total allocated costs (the "revenue-to-cost ratio"). This Report also discusses the treatment of the Monthly Service Charge, metering credits for the unmetered scattered load class, transformer credits for customer-owned transformers, and charges for the provision of standby power for customers with load displacement generation.

1.2 Background

While electricity rates have been unbundled for some time, the basic historical cost relationship among rate classes has remained largely unchanged for the past twenty years.

Consultations on cost allocation have been on-going since 2002, and have benefited from the significant involvement of, and collaboration by, stakeholders and Board staff. An important milestone in this process was the issuance, on September 29, 2006, of a report of the Board entitled *Cost Allocation: Board Directions on Cost Allocation Methodology for Electricity Distributors*,[1] which articulated a number of principles and established the cost allocation methodology to be used by distributors for the purpose of electricity rate design (the "Methodology"). To enable the Board to evaluate the Methodology, distributors were directed to use it in association with their respective approved 2006 revenue requirement for the purpose of making informational filings at the end of 2006 and through the spring of 2007.

The results of Board staff's analysis of the informational filings were set out in a staff Discussion Paper issued on June 28, 2007 and entitled *On the Implications Arising from a Review of the Electricity Distributors' Cost Allocation Filings*[2] (the "Discussion Paper"). Among other things, the Discussion Paper proposed an incremental approach for adjusting rates based on the Methodology. Interested parties were invited to comment on the Discussion Paper, and those that did so are listed in Appendix A.

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[1] Available on the Board's website at http://www.oeb.gov.on.ca/documents/cases/EB-2005-0317/report_directions_290906.pdf.

[2] Available on the Board's website at http://www.oeb.gov.on.ca/documents/cases/EB-2007-0667/staff-discussion-paper_20070628.pdf.

1.3 Approach to Cost Allocation

The establishment of specific revenue requirements through cost causality determinations is a fundamental rate-making principle. Cost allocation is key to implementing that principle. Cost allocation policies reasonably allocate the costs of providing service to various classes of consumers and, as such, provide an important reference for establishing rates that are just and reasonable.

The Board is cognizant of factors that currently limit or otherwise affect the ability or desirability of moving immediately to a cost allocation framework that might, from a theoretical perspective, be considered the ideal. These influencing factors include data quality issues and limited modelling experience, and are discussed in greater detail in section 2.3 of this Report. The Board also recognizes however, that cost allocation is, by its very nature, a matter that calls for the exercise of some judgment, both in terms of the cost allocation methodology itself and in terms of how and where cost allocation principles fit within the broader spectrum of rate setting principles that apply to – and the objectives sought to be achieved in – the setting of utility rates. The existence of the influencing factors does not outweigh the merit in moving forward on cost allocation. Rather, the Board considers that it is both important and appropriate to implement cost allocation policies at this time, and believes that the policies set out in this Report are directionally sound. With better quality data, greater experience with cost allocation modeling and further developments in relation to other rate design issues, the policies will be refined as required.

The policies set out in this Report have been informed by the Discussion Paper and the comments of interested parties on it. The Board is grateful to all that have participated in the consultations that have enabled the Board to complete this phase of its cost allocation work.

1.4 Organization of the Report

This Report is organized as follows:

- Section 2: **Revenue-to-cost Ratios – A Range Approach**, summarizes the Board's approach to revenue-to-cost ratios.
- Section 3: **Revenue-to-cost Ratios – Ranges by Rate Class**, sets out the class-specific revenue-to-cost ratio ranges that have been established for each customer class.
- Section 4: **Other Rate Matters**, discusses the treatment of the upper and lower bounds for the level of the Monthly Service Charges, metering credits for the unmetered scattered load class, transformer credits for customer-owned transformers, and charges for the provision of standby power for customers with load displacement generation.
- Section 5: **Implementation**, identifies how the policies set out in this Report are expected to be applied by distributors.

This Report includes, as applicable, descriptions of, the Board's rationale supporting its policies, relevant influencing factors and issues that require further examination.

2 Revenue-to-cost Ratios – A Range Approach

2.1 Policy Summary

This section sets out an overview of the Board's policy as it relates to revenue-to-cost ratios.

The Board has concluded that an incremental approach is appropriate in light of the influencing factors identified below, and that a range approach is preferable to implementation of a specific revenue-to-cost ratio. Influencing factors aside, a revenue-to-cost ratio of one may not be achievable or desirable for other reasons (for example, to accommodate different rate design objectives). In addition, as a practical matter there may be little difference between a revenue-to-cost ratio of near one and the theoretical ideal of one.

The Board has therefore adopted, with some modification, the proposal set out in the Discussion Paper of creating bands or ranges of tolerance around revenue-to-cost ratios of one. As the influencing factors are addressed over time, the Board expects that these bands will narrow and move closer to one.

The ranges established by the Board are set out in section 3, and are intended to be minimum requirements. To the extent that distributors can address influencing factors that are within their control (such as data quality), they should attempt to do so and to move revenue-to-cost ratios nearer to one. As indicated in the Report other issues such as addressing the fact that the Uniform System of Accounts is less detailed than required to accommodate the methodology and certain rate design matters are beyond the control of individual distributors. These exogenous issues also need to be addressed before moving to an appropriate specific revenue-to-cost ratio.

2.2 The Underlying Analysis

Board staff conducted an analysis of the informational cost allocation filings to evaluate the reasonableness of the results filed by each distributor. The analysis and the results are more fully described in the Discussion Paper. By way of summary, Board staff employed two different approaches to test for reasonableness, both of which used the ratio of the class revenue compared to the allocated costs to the class as a measure of reasonableness.

The first approach was a statistical cross-sectional analysis to determine if the results by rate class across distributors tended to cluster. The second examined whether the clustering or lack of clustering could be explained by the input assumptions or judgments in the Methodology. This second analysis tested the sensitivity of the results to the judgements used to categorize the most significant component of the revenue

requirement; namely, the total cost related to the shared distribution facilities (poles, lines and transformers).

2.3 Influencing Factors

In developing its policy on revenue-to-cost ratios, the Board has considered the impact of the following factors.

2.3.1 Quality of the data:

It is apparent that accounting and load data can be improved. Although the cost allocation review was conducted on the approved 2006 distribution rates and revenue requirements, many distributors did not have the details that would be needed to develop more robust cost allocations. More extensive internal accounting would improve accuracy of costs by reducing the frequency of prorating operating and depreciation expenses. Comments received from some of the distributors also suggested that the Uniform System of Accounts should be modified to capture the level of detail required for cost allocation.

In addition, load data and load analysis contribute to important cost allocators; namely, the coincident peak and the non-coincident peak. The Board recognizes the significant work done by distributors, and Hydro One Networks Inc. in particular, in obtaining a set of load data as part of the cost allocation informational filings. However, the Board acknowledges that some of the information is based on estimates from a statistical model and may not be completely representative of current loads due to sampling errors and current market characteristics.

Data improvements in the future: It is important that accounting and load data be available at the appropriate level of detail to address the need for and use of estimated or default allocations and to ensure the reasonableness of the cost allocation results. There is also a need to examine the current Uniform System of Accounts to see if there are modifications that could be made in order to provide for the level of detail required for cost allocation purposes. A general review of the Uniform System of Accounts is currently being undertaken by the Board's audit group. This work is expected to consider the need for both greater accounting detail and additional accounting guidance. In the interim, distributors should nonetheless endeavour to record accounting information at a level of detail that accommodates cost allocation data input requirements.

With respect to load data and load analysis, the Board anticipates that the installation of smart meters, with their more exact load data, will provide opportunities for better analysis in the future and, as a result, will provide better cost allocators for the cost allocation model.

2.3.2 Limited modelling experience:

The cost allocation model is complex, and the data required for the model was not always readily available for modelling. This created interpretation issues for the analysts using the model, including the appropriate aligning of costs for the different voltage levels in the model and the number of connections for street lighting. The informational filings were the first time most distributors performed a cost allocation. As distributors apply this model in subsequent filings they will develop greater expertise in the application of data to the model, which in turn will allow for a greater reliance on the outcomes.

Modelling improvements in the future: The Board anticipates that, as distributors become more familiar with cost allocation concepts, they will better understand the blending of operating statistics and practice with accounting data, and they will more effectively and consistently use the models in the preparation of their rate applications. The Board also expects distributors to review their allocation factors as better load data become available from smart meters.

2.3.3 Status of current rate classes:

The general customer classifications have been in existence for many decades and the rate structures have been in place since the early 2000s. The current cost allocation methodology and model are based on these classes and structures. The introduction of smart metering will provide additional data and new ways to examine class structures. Any changes in customer classification or load data could have a significant impact on future cost allocation studies.

Rate classes in the future: An initiative is currently under way to examine the rate design for electricity distributors (consultation process EB-2007-003) (the "Rate Review"). The Rate Review covers both customer classification and rate structure issues, and its results could affect the way in which rates are set in the future.

2.3.4 Managing the movement of rates closer to allocated costs:

A principle of rate making is that rate stability in most instances is desirable. Rates should not be constructed in a manner that leads to subsequent counter directional changes. The Board considers it appropriate to avoid premature movement of rates in circumstances where subsequent applications of the model or changes in circumstances could lead to a directionally different movement. Rate instability of this nature is confusing to consumers, frustrates their energy cost planning and undermines their confidence in the rate making process.

Another principle of rate making is the avoidance of rate shock. Proposed rate changes should consider the ability of consumers to react to their new costs. In aligning rate levels closer to costs, reducing a high revenue-to-cost ratio for any one class requires an offsetting increase to one or more other classes. Such

realignments could result in large rate increases, particularly when combined with other plans that affect the distributor's revenue requirement.

The Board expects to address these concerns as and when they arise in the context of individual rate applications. Distributors should endeavour to move their revenue-to-cost ratios closer to one if this is supported by improved cost allocations. However, if a large increase is required to move closer to one, rate mitigation plans should be proposed by the distributor. Distributors should not move their revenue-to-cost ratios further away from one.

3 Revenue-to-cost Ratios – Ranges by Rate Class

This section sets out the revenue-to-cost ratios established by the Board for different rate classes.

3.1 Residential Class

The Board has concluded that, for the Residential Class, the appropriate range within which the revenue-to-cost ratio should fall is +/- 15% of 1.00 (i.e., 0.85 to 1.15).

The Residential Class comprises customers that use electricity exclusively in a separate metered living accommodation, which is typically a detached home, town home or premises within a building such as a triplex. When viewed cross-sectionally, the revenue-to-cost ratios reflected in the informational filings clustered closely around a common value. The sensitivity analysis supported a narrow range for variances in allocated costs.

The Discussion Paper proposed a range of +/- 20% centred on revenue-to-cost ratios of 1.00. Some participants commented that the Residential Class range should be narrower. The Board notes that the analysis tends to support a greater statistical confidence in the outcomes of the Residential Class cost allocations. There is also greater homogeneity in this class, and less likelihood that changes to rate classifications would affect the overall costs assigned to this type of customer. The range established by the Board is therefore narrower than that proposed in the Discussion Paper.

3.2 General Service Less Than 50 kW Class

The Board has concluded that, for the General Service less than 50 kW Class (the "GS<50 Class"), the appropriate range within which the revenue-to-cost ratio should fall is +/- 20% of 1.00 (i.e., 0.80 to 1.20).

The GS<50 Class comprises non-residential customers whose monthly average peak demand is less than 50 kW. Typically, these accounts are for commercial, institutional, industrial and bulk-metered apartment buildings or condominiums. When viewed cross-sectionally, the revenue-to-cost ratios reflected in the informational filings clustered closely around a common value. The sensitivity analysis tended to support a relatively narrow range for variances in allocated costs.

The Discussion Paper proposed a range of +/- 20% centred on a revenue-to-cost ratio of 1.00. Most participants agreed with this range. However, some participants also commented that the GS<50 Class should have a narrower range. The Board notes that this Class is less homogenous than the Residential Class. In addition, the 50 kW boundary that separates this Class from the General Service 50 to 4,999 kW Class is

somewhat arbitrary. The widespread introduction of smart or interval metering for customers in both this class and the next larger class will provide a better basis on which to re-examine both class structures as part of the Rate Review. For these reasons, the Board believes that the +/- 20% band proposed in the Discussion Paper is appropriate.

3.3 General Service 50 to 4,999 kW Class

The Board has concluded that, for the General Service 50 to 4,999 kW Class (the "GS≥50 Class")the appropriate range within which the revenue-to-cost ratio should fall is -20% to +80% of 1.00 (i.e., 0.80 to 1.80).

The GS≥50 Class comprises all subclasses whose monthly average peak demand falls within the range of 50 kW to 4,999 kW. The customers are typically large industrial, commercial, multiple dwelling and institutional buildings. The cross-sectional analysis of the revenue-to-cost ratios reflected in the informational filings did not reveal any clustering. Distributors with such customers generally had revenue-to-cost ratios significantly above 120%. The sensitivity analysis also indicated large changes in the revenue-to-cost ratios as assumptions in the methodology changed.

The Discussion Paper proposed an asymmetrical range around 1.00 of -20% to +80%. A number of participants agreed with this proposal, noting concerns about the effects on other classes if the range were made too narrow too quickly. Given the heterogeneity of this Class it is difficult to assess the directional impact the intended abatement of the aforementioned influencing factors will have on its constituent's rates. Due to the potential for undesirable rate instability, for other classes as well as members of this class, the Board believes that the adoption of a narrower band than that proposed in the Disscussion Paper would be inappropriate at this time.

3.4 General Service Unmetered Scattered Load Class

The Board has concluded that, for the General Service Unmetered Scattered Load Class (the "USL Class"), the appropriate range within which the revenue-to-cost ratio should fall is +/ 20% of 1.00 (i.e., 0.80 to 1.20).

Unmetered scattered loads ("USL") are accounts for unmetered applications such as bus shelters, telecommunications and cable amplifiers, billboards and the like, where the billing determinant can be established by applying the operating hours to the operating loads. The majority of distributors charge USL customers on the basis of the GS<50 rate schedule (possibly with a modification of the Monthly Service Charge). A few distributors have a stand alone rate schedule for the USL Class. With few data points, the analysis for distributors with a stand alone USL Class was inconclusive.

The Discussion Paper proposed that the range for the USL Class not differ from that of the GS<50 Class. Most participants did not specifically comment on this staff proposal. While one participant submitted its own analysis, the resulting comments were primarily

related to rate design issues. The Board believes that, for cost allocation purposes, all USL customers should be treated the same regardless of whether they are in a separate rate class or are classified in the GS<50 Class. Given that the majority of distributors charge USL customers on the basis of the GS<50 Class rate schedule, the range is set to be the same as that for the GS<50 Class; namely, +/- 20% centred on a revenue-to-cost ratio of 1.00.

3.5 Large User Class

The Board has concluded that, for the Large User Class, the appropriate range within which the revenue-to-cost ratio should fall is +/- 15% of 1.00 (i.e., 0.85 to 1.15).

This Class comprises very large customers whose monthly average peak demand is equal to or greater than 5,000 kW. They are typically large industrial customers. The cross-sectional analysis of the revenue-to-cost ratios reflected in the information filings did not reveal any clustering. Distributors with such customers generally had revenue-to-cost ratios significantly above 120%. The sensitivity analysis also indicated large changes in the revenue-to-cost ratios as assumptions in the methodology changed.

The Discussion Paper proposed an asymmetrical range around 1.00 of -20% to +180%. Some participants proposed narrower bands than the one proposed in the Discussion Paper. The Board notes that customers within this Class have been interval metered for many years, which results in better load data. The relative size of customers in this class means that better operating and cost data are available. The Board therefore considers the results of the cost allocation model for the Large User Class more reliable than the results in the case of the GS≥50 Class. The Board has therefore adopted a narrower range for this Class than the one proposed in the Discussion Paper.

3.6 Street Lighting and Sentinel Lighting Classes

The Board has concluded that, for both the Street Lighting Class and the Sentinel Lighting Class, the appropriate range within which the revenue-to-cost ratio should fall is -30% to +20% of 1.00 (i.e., 0.70 to 1.20).

Staff's analysis treated these two Classes together due to their similarities; namely, there is no metering, and the load profiles are similar, responding to the lack of daylight. In the cross-sectional analysis of the revenue-to-cost ratios reflected in the informational filings, there was a strong tendency to cluster at a very low ratio around 30%. However, these Classes are sensitive to changes in the assumptions in the model.

The Discussion Paper proposed an asymmetrical range of -30% to +20% around 1.00. Comments from participants suggested that the model over-represents costs for street lighting. If this is correct, the resulting revenue-to-cost ratio would tend to be understated, probably with a value below 1.00.

The Board agrees with staff's analysis and with the comments of participants to the effect that the Street Lighting and Sentinel Lighting Classes present significant issues that need to be resolved in respect to the allocation of costs and the model's sensitivity to changes in assumptions. The Board has therefore adopted the range proposed in the Discussion Paper.

4 Other Rate Matters

4.1 Other Rate Matters

The review of the informational cost allocation filings considered other rate design matters. This section discusses the treatment of the fixed rate component (Monthly Service Charge ("MSC")) of the distribution rate as well as metering credits for the USL Class, transformer credits for customer-owned transformers, and charges for the provision of standby power for customers with load displacement generation.

4.2 The Monthly Service Charge

4.2.1 Lower Bound for the Monthly Service Charge

The Discussion Paper proposed that the floor for the MSC be the avoided costs. Staff's rationale for this proposal was that these costs are not subject to other cost allocation judgments (such as the minimum plant) and therefore there can be a higher level of confidence in the associated outcomes. These are costs defined as meter-related, billing, and collection costs. Many participants agreed with this proposal. One participant commented that the costs associated with a service drop should also be included in the avoided cost calculation. The Methodology was specific about the definition of avoided costs and the Board is not persuaded to depart from that definition at this time. The Board remains of the view that the use of avoided costs, as defined in the Methodology, is an appropriate basis for establishing the minimum or floor amount for the MSC at this time.

4.2.2 Upper Bound for the Monthly Service Charge

The Methodology set a ceiling for the MSC based on the avoided costs plus the allocated customer costs. The Discussion Paper proposed that the ceiling for the MSC be 120% of this level. Some participants believed that the results of the sensitivity analysis were not an appropriate basis for setting an upper bound.

The Board considers it to be inappropriate to make significant changes to the ceiling for the MSC at this time, given the number of issues that remain to be examined. The appropriateness of the methodologies cited above, used to set the MSC is an issue that will be examined within the scope of the Rate Review. The Rate Review will also examine the role of rate design in achieving various objectives, including conservation of energy. Both of these undertakings will have determinative impacts on the fixed/variable ratio policy.

In the interim, the Board does not expect distributors to make changes to the MSC that result in a charge that is greater than the ceiling as defined in the Methodology for the MSC. Distributors that are currently above this value are not

required to make changes to their current MSC to bring it to or below this level at this time.

4.3 Certain Specific Credits and Charges

The following were identified in the Methodology as questions to be addressed through the review of the informational filings:

1. Should one provincial rate be set for a metering credit for USL?
2. Should one province-wide rate be set for a transformer credit for customers that own their own transformers?
3. Should one province-wide rate be set for a load displacement generation standby charge?

The cost allocation model was designed to specifically determine these rate components on a distributor-specific basis, with the intent of being able to reflect each distributor's costs as opposed to having one standard credit or charge for all distributors.

The Discussion Paper indicated that the setting of an average province-wide value would not be appropriate, principally due to the variability in the results using the cost allocations. Most participants commented that these credits and charges should be determined on a distributor-by-distributor basis.

These credits and charges are expected to be the subject of review as part of the Rate Review. In addition, the standby charge for customers with load displacement generation facilities is also being considered as part of the current initiative regarding distributed generation rates, rate classification and the recovery of connection costs for distributed generation (consultation process EB-2007-0630).

Given the variability of the results and the fact that these credits and charges are the subject of either or both of the above-noted ongoing initiatives, the Board does not consider it appropriate to set a province-wide rate for any of these three items at this time. In the interim, these credits and charges will continue to be set on a case-by-case basis.

5 Implementation

The cost allocation policies reflected in this Report should be followed by distributors whenever they apply for rates on a cost of service basis. To the extent that the application of these cost allocation policies results in a significant shift in the rate burden amongst classes relative to the status quo, distributors should be prepared to address potential mitigation measures. Except as noted below, these cost allocation policies will not apply in relation to applications for rate adjustments based on the Board's incentive regulation mechanism ("IRM").

The Board recognizes that some distributors whose rates will be rebased for 2008 will have filed their rate applications prior to the issuance of this Report while others should be filing soon. However, the Board does not expect that there are significant practical impediments to applying the cost allocation policies to these cost of service applications. The policies do not affect a distributor's overall revenue requirement calculation. In addition, the Board's *Filing Requirements for Transmission and Distribution Applications*[3] already provide for the filing of a completed cost allocation study based on updated forecast year data, and distributors have for some time had a model that they can use for that purpose.

Updating and applying cost allocations in a manner that reflects the cost allocation policies set out in this Report should therefore not, in most cases, require a significant incremental effort by distributors. To the extent that it is determined by the Board that accommodation of these policies is impractical in any given case and can reasonably be deferred, the cost allocation issue may be addressed in the context of the distributor's 2009 IRM rate application.

[3] Available on the Board's website at http://www.oeb.gov.on.ca/html/en/industryrelations/rulesguidesandforms_regulatory.htm#filreq

Appendix A

The following distributors and other interested parties filed comments on the Board staff Discussion Paper, issued on June 28, 2007. Their comments are available on the Board's website at www.oeb.gov.on.ca.[4]

Association of Major Power Consumers in Ontario
Coalition of Large Distributors
Electricity Distributors Association
Energy Cost Management Inc.
Energy Probe Research Foundation
EnWin Utilities Ltd.
Federation of Ontario Cottagers' Associations
Hydro One Networks Inc.
London Hydro
London Property Management Association
Power Workers' Union
Rogers Cable Communications Inc.
School Energy Coalition
Mr. William Harper

[4] http://www.oeb.gov.on.ca/html/en/industryrelations/ongoingprojects_costallocation_review.htm

Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2006-0034

IN THE MATTER OF the *Ontario Energy Board Act, 1998,* S.O. 1998, c.15

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2007.

BEFORE: Gordon Kaiser
Presiding Member and Vice Chair

Paul Vlahos
Member

Ken Quesnelle
Member

DECISION - RATE AFFORDABILITY PROGRAMS

This is the decision of Board Member Vlahos and Board Member Quesnelle. The dissenting opinion with reasons of Vice Chair Kaiser follows the majority decision.

Enbridge Gas Distribution Inc. ("EGD") filed an application dated August 25, 2006 with the Ontario Energy Board under section 36 of the *Ontario Energy Board Act, 1998 ("*the *Act")*, requesting a rate increase effective January 1, 2007. On October 4, 2006, the Board issued Procedural Order No. 1 establishing an oral hearing on October 12, 2006 to hear submissions regarding the issues the Board should consider in this proceeding. This decision relates to one specific issue: rate affordability programs.

The Low-income Energy Network ("LIEN") proposes that the Board accept as an issue in this proceeding the following matter:

> Should the residential rate schedules for EGD include a rate affordability assistance program for low-income consumers? If so, how should a program be funded? How should eligibility criteria be determined? How should levels of assistance be determined?

The inclusion of this issue in this proceeding was opposed by several parties, and no party, other than LIEN, supported its inclusion.

A number of parties questioned whether the Board had jurisdiction to hear this matter. The Board in its Decision of October 20, 2006 found that jurisdiction was a threshold issue and that before proceeding further the Board must satisfy itself that it had jurisdiction. The Board accordingly invited parties to file written submissions addressing the jurisdictional arguments made by LIEN.

A number of parties filed written arguments indicating that the Board does not have jurisdiction to hear LIEN's issue in this proceeding. On November 7, 2006, LIEN served a Notice of Constitutional Question providing the Attorney General of Ontario with an opportunity to respond to LIEN's arguments about the application of section 15 of the Charter of Rights and Freedoms to the interpretation of the Board's jurisdiction. The Board indicated that it would defer its Decision until the Attorney General had an opportunity to respond.

On November 27, 2006, counsel for the Attorney General of Ontario advised the Board that it did not intend to intervene at this jurisdictional stage of the proceeding. The Board then advised the parties that irrespective of the outcome of the jurisdiction hearing it would not consider the issue in this proceeding as it would delay the rate case unreasonably.

Positions of the Parties

The Industrial Gas Users Association ("IGUA"), the Consumers Council of Canada ("CCC"), Enbridge Gas Distribution Inc. ("EGD") and Union Gas Limited ("Union") all argued that the Board does not have jurisdiction to establish special rates for low-income consumers. Their arguments contain the common contention that the setting of

rates based on a criterion of income level is not captured within the meaning or the intent of the *Ontario Energy Board Act, 1998* (the "Act"). To various degrees, these Parties also provided argument on the implementation difficulties that would arise if such a program were put in place and in general, the appropriateness of the Board establishing rates in such a manner.

Board staff submitted that the Board's authority to fix or approve just and reasonable rates under section 36 of the Act can encompass authority to implement at least some forms of rate affordability assistance programs for low income consumers but absent a specific proposal, Board staff did not believe it was prudent to speculate just how far that authority might extend.

In its reply argument, LIEN reiterated its arguments that the Board does have the jurisdiction to order special rates for low income consumers.

Board Findings

Before the Board addresses the issue of its jurisdiction, the Board will comment on Board Staff's submission regarding the absence of a specific proposal.

In its submission, Board staff referred to the record noting that LIEN appeared to confirm that the program that it might propose were this issue added to the issues list was that filed in an earlier proceeding involving the rates of Union Gas Ltd., Ontario's other large gas distributor. Board staff also noted LIEN's position that the issue of the Board's authority is related to low income programs generally, and should not be tied to any specific proposal.

The Board notes that certain parties opposing jurisdiction, particularly CCC, referred extensively to the specifics of the program advanced by LIEN before this Board in the separate proceeding referenced above as well as before the Nova Scotia Public Utilities Board and LIEN did not argue in its reply submissions that such references were unjustified or non-relevant. In any event, the Board does not consider the absence of a specific proposal in this proceeding to be determinative of the Board's jurisdiction. In this case, the issue is whether the Board does or does not have jurisdiction to establish rates based on rate affordability for low income consumers.

The Board considers this matter to be one of clear importance and is of the view that clarity of its position on jurisdiction is required to instruct those who are advocating on behalf of a low-income constituency. This Decision therefore is predicated on the following understanding: That the proposal is to establish a rate group for low income consumers. The defining characteristic of the rate group would be income-level and the program would be funded by general rates. It is in this context that the Board has considered the question of jurisdiction.

The Board agrees with the Parties that argued that the Act does not provide the Board with the authority, either explicitly or implicitly, to approve rates using income level as a criterion. The implementation difficulties referred to by parties are not, in the Board's view, pivotal to the issue at hand. Concerns that may arise related to implementation of new processes or the need to expand Board expertise are not threshold considerations related to the determination of jurisdiction. Where jurisdiction is found to exist, the Board structures itself accordingly.

The Board exercises its jurisdiction within the legislative framework established by Government. The *Ontario Energy Board Act, 1998* provides the objectives that govern the Board in its activities. The objectives and the statute as a whole are the sole reference for the determination of jurisdiction. The Board also derives certain powers from other statutes, but none of these powers are relevant to this particular issue.

Economic regulation is rooted in the achievement of economic efficiencies, the establishment of fair returns for natural monopolies and the development of appropriate cost allocation methodologies. Also, when appropriately authorized, economic regulation can be utilized in the pursuit of broad social goals such as conserving natural resources or in the provision of incentives for certain behaviours that are seen by the legislature to be in the public interest. An example of this can be seen in the Government's direction to the Board, authorized by the statute to enable certain approaches to conservation and demand management.

Through statute, governments authorize bodies such as the Ontario Energy Board to administer the economic regulation of specific sectors of society. At its core, the Board is an economic regulator, and that is where its expertise lies. The Board is engaged in many of the typical economic regulation activities mentioned above and makes determinations as to the appropriateness of the financial consequences of the regulated activities it authorizes.

The manner in which the Board makes its determinations is firmly grounded in the economic regulatory principles associated with rate setting. As submitted by Board Staff, while the term “economic regulator” is not precise, there is a widely accepted and practiced convention related to the setting of rates. Examples of these principles are more fully articulated later in this decision in the analysis of various submissions. The Government has a clear understanding of how the Board operates and the economic regulation principles that it utilizes as an economic regulator and has witnessed the Board’s practices in that regard.

The Board was created and made operational through legislation. The Board has a responsibility to operate to the full depth and breadth of the authority granted in its governing statute. The limits or boundaries of its authority need not, nor should, be a bright line. This would require near unachievable foresight by the legislators to consider all of the possible eventualities. The objectives provided in the Act are intended to be broad enough to allow the Board to operate with discretion in an ever changing environment and focused enough to ensure that the Board operates within the government’s policy framework. Determinations on jurisdiction should be guided solely by the question of what can reasonably be considered to have been intended by the legislators in the scoping and crafting of the Board’s mandate. There should be no pre-destining bias based on a desire by the regulator to include or exclude any particular issue.

As described by section 36(3) of the Act, the Board has broad authority to utilize whatever methods or techniques it deems appropriate to set just and reasonable rates. LIEN has argued that this be interpreted as the Board having authority to establish a low-income rate class, using income level as a determinant. The Board does not agree. Significant departure from its current practices and principles would be required to institute a rate making process based on income level. The Board considers LIEN’s proposal both in the intent and on the basis on which the transfer of benefits would take place to be a significant departure from the traditional rate setting principles applied currently by the Board. The Board’s rate setting activities that currently have the effect of transferring benefits do so to accommodate either regulatory efficiency, the removal of financial barriers in support of government policy initiatives or to support a mitigation policy to overcome cost differential such as in rural rate subsidies. None of these activities are based on an income level determinant. The Board also notes that to the extent that any of the current benefit transfers are material, such as in the rural rate

subsidy and conservation initiatives, they are supported by the objectives of the Act, specific sections of the Act or by Ministerial Directives under section 27 of the Act.

The use of income level as a determinate in establishing utility rates has broad public policy implications. The interplay that this type of income redistribution program would have with other income redistribution programs that would reside outside of the Board's purview could be significant. The consideration of income redistribution should not be done in isolation of the broader government policy environment. The management of the interplay would necessitate a prescriptive statute or directive.

Income redistribution policies are at the core of the work done by democratically elected governments. The Board is of the opinion that had the Government wanted the Board to engage in such a fundamentally important function it would have specifically stated as such.

The Board is of the view that there is no compelling evidence to suggest that the objectives contained in the Act encompass, explicitly or implicitly, any accommodation for such a fundamental departure from the manner in which the Board currently regulates. For these reasons and for the reasons stated below the Board finds that it does not have jurisdiction to develop a rate class with an income level determinant as depicted earlier in this decision.

Analysis of Submissions

The Board is a statutory tribunal. In the *ATCO Gas and Pipelines Ltd. v. Alberta* (*Energy and Utilities Board*), [2006] SCC 4 decision, the Supreme Court described the sources from which statutory tribunals obtain their powers:

> In the area of administrative law, tribunals and Boards obtain their jurisdiction under various statutes (express jurisdiction); and (2) the common law, by application of the doctrine of jurisdiction by necessary implication (implied powers).

A statutory Board has no powers other than those given to it by statute, either expressly or impliedly. If the Board's jurisdiction to order a low income affordability program cannot be found either expressly or impliedly in a statute, then it does not exist.

The question boils down to one of statutory interpretation. The courts have adopted what E.A. Driedger described as the modern approach to statutory interpretation:

> Today there is only one principle or approach; namely, the words of an Act are to be read in their entire context and in their grammatical and ordinate sense harmoniously with the scheme of the Act and the object of the Act, and the intention of Parliament.

The Ontario Energy Board Act

In support of its submission that the Board does have the requisite jurisdiction, LIEN pointed to section 36(2) and 36(3) of the *Ontario Energy Board Act, 1998* (the "Act").

> 36 (2) The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas.
>
> 36 (3) In approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate.

The panel is also guided by the Board's objectives as set out in section 2 of the Act, in particular objective 2:

> 2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service.

In the panel's view, neither section 36 nor section 2 explicitly grants to the Board the jurisdiction to order the implementation of a low income affordability program. The panel also finds that the Board does not gain the requisite jurisdiction through the doctrine of necessary implication.

Explicit Powers

Section 36(2) contains the Board's just and reasonable rates powers with regard to natural gas utilities. It is not disputed that the Board's powers to determine just and reasonable rates are very broad. Several parties cited the *Union Gas v. Ontario (Energy Board)* (1983), 43 O.R. (2nd) 489 (Ont. Sup. Ct.) case, where the court noted:

> That in balancing these conflicting interests and determining rates that are just and reasonable, the OEB has wide discretion is not in doubt.

The Board is aware that its discretion is broad; however, in its consideration of the intent of its governing statutes, the Board must be reasonable in considering the larger public policy arena and the degree to which the legislators considered the Board's conventional ambit.

The Board is guided in the contemplation of its jurisdiction by the following. In *Re Multi Malls Inc. et al. v. Minister of Transportation and Communications et al,* 14O.R. (2d) 49, the Ontario Court of Appeal noted that the powers of regulatory tribunals "must be exercised reasonably and according to the law, and cannot be exercised for a collateral object or an extraneous and irrelevant purpose, however commendable."

In determining what is just and reasonable, the Board must be guided by its objectives and the overall purpose of the Act.

LIEN has focussed on the Board's objective number 2, which requires the Board to protect consumers with regard to prices and system reliability. In the context of the proposed low-income rate program a sub-set of consumers would be afforded protection at the expense of others. The sub-set would be identified on a level of income basis and based on ability to pay. The Board sees this as a fundamental departure from its current rate setting principles.

LIEN also pointed to a number of cases in support of its contention that one of the Board's responsibilities is to keep prices low. For example, LIEN quoted *Union v. Ontario (Energy Board)* as follows:

> Put another way, it is the function of the OEB to balance the interest of the appellants in earning the highest possible return on the operation of its enterprise, a monopoly, with the conflicting interest of its consumers to be served as cheaply as possible.

In LIEN's submission, this case stands for the proposition that "just and reasonable" requires that the consumer be served as cheaply as possible. In the Board's view, LEIN's submission misconstrues the thrust of the court's pronouncement, which in fact requires that the Board balance the utility's interest in earning a return with the consumer's interest in being served cheaply. The court did not give preference to one group of consumers' interest over that of another.

In summary, the panel can find no explicit grant of jurisdiction to order the creation of a rate class based on income, as depicted earlier in this decision, in the *Ontario Energy Board Act.*

Implicit Powers

ATCO described the doctrine of jurisdiction by necessary implication as follows:

> […] the powers conferred by an enabling statute are considered to include not only those expressly granted but also, by implication, all powers which are practically necessary for the accomplishment of the object intended to be secured by the statutory regime created by the legislature.

In the panel's view, the power to order the implementation of low income affordability programs is not a practical necessity for the Board to accomplish its statutory objectives.

In fixing just and reasonable rates, Section 36(3) of the Act does allow the Board "to adopt any method or technique it considers appropriate." However, in the panel's view, "any method or technique" cannot reasonably be stretched to mean a fundamental replacement of the rate making process based on cost causality with one based on income level as a rate grouping determinant. This particular section replaced section 19 of the old *Ontario Energy Board Act*, R.S.O. 1980, which required a traditional cost of service analysis in quite prescriptive terms:

> 19(2) In approving or fixing rates and other charges under subsection (1), the Board shall determine a rate base for the transmitter, distributor, or storage company, and shall determine whether the return on the rate base produced or to be produced by such rates and other charges is reasonable.
> (3) The rate base to be determined by the Board under subsection (2) shall be the total of,
> (a) a reasonable allowance for the cost of the property that is used or useful in serving the public, less an amount considered adequate by the Board for depreciation, amortization and depletion;
> (b) a reasonable allowance for working capital; and
> (c) such other amounts as, in the opinion of the Board, ought to be included.
> […]

The change to section 36(3), which allows the Board to "adopt any method or technique it considers appropriate" was deliberately made by the legislature and should accordingly be given meaning. It gives the Board the flexibility to employ other methods of ratemaking in fixing just and reasonable rates, such as incentive ratemaking, rather than the traditional cost of service regulation specified in section 19 of the old Act. The change in the legislation was coincident with the addition of the regulation of the electricity sector to the Board's mandate. The granting of the authority to use methods other than cost of service to set rates for the gas sector was an alignment with the non-prescriptive authority to set rates for the electricity sector. The Board is of the view that if the intent of the legislature by the new language was to include ratemaking considering income level as a rate class determinant, the new Act would have made this provision explicit given the opportunity at the time of the update of the Act and the resultant departure from the Board's past practice.

The Board approves subsidies to rural and remote consumers through the Rural and Remote Rate assistance program. The Board is given the explicit authority to do so under section 79 of the Act. Some Parties have pointed to the fact that the legislature chose to specifically enumerate these instances where some ratepayers will subsidize others suggests that it did not intend to grant this power generally. LIEN submits that section 79 demonstrates that the Act contemplates the Board acting to protect economically disadvantaged groups when approving or fixing just and reasonable rates.

The Board considers the fact that section 79 of the Act exists as an indication that the Government has been explicit on issues that it considers warranting special treatment. It should be noted that rural rate assistance predates the Act and the inclusion of section 79 ensured the maintenance of the subsidy. Therefore less can be inferred regarding the significance of section 79 being included in the Act. The Board notes that the underpinning rationale for the rural rate assistance is fundamentally different from the rationale supporting the proposed low-income rate class. Rural rate assistance does not consider income level as an eligibility determinate nor is their any indication that its genesis is rooted in a belief that civil and human rights legislation has historically failed to protect agricultural workers as a group as was submitted by LIEN. The eligibility is based on location and the inherent higher costs of service that are related to density levels. The assistance has the effect of mitigating a cost differential related to geography and is conferred on all customers irrespective of their income level.

A common and long standing feature of rate-making is the application of the same charges to all customers in a given customer classification. There is admittedly a degree of subsidization in such rate making as not all customers in a given rate classification impose precisely the same costs to a utility. However, this practice is necessary in order to avoid the complexities and costs of having to determine the individual costs of millions of customers and the existence of millions of rate classifications. Whatever subsidies may exist in such method, it is done for the general benefit and not to favour or target a specific customer group over another on the basis of income level.

The Board is vigilant in ensuring that customer groups are afforded the opportunity to receive the benefits of the costs charged. In the case of Demand Side Management (DSM) programs, for example, the Board has ordered that specific funding be channelled for programs aimed at low income consumers. It cannot be argued that this constitutes discriminatory pricing. Rather, the contrary. It is an attempt to avoid discrimination against low income customers who also pay for DSM programs but may not have equal opportunities to take advantage of these programs.

Both Board Staff and LIEN submitted that the Board's allowance of contributions to an emergency financial relief program known as Winter Warmth is an indication of the Board's recognition of low-income customers as a group that can be recognized for special treatment. It was also submitted that the fact that these contributions are funded by rates is an indication that authority exists in fixing or approving just and reasonable rates for intra and interclass subsidies. The Board does not agree with this reasoning. The program is designed to trigger assistance upon approval of an application for financial assistance by a customer in a financial crisis situation. The relief is very situation and occurrence specific. Therefore the recipients of this assistance do not constitute a rate class or a sub-class. The program is funded by all customers, therefore the Board does not agree with the assertion that it demonstrates authority for intra and interclass subsidies. The Board is of the view that it would be extremely disproportional to draw on the charity objectives of this modest program to support a determination that the legislators envisioned the possibility of a rate setting determinate of income level.

The Board's treatment of similar requests

The Board has in fact considered similar requests in the past for special (lower) rates. In EBRO 493, as one example, the Ontario Native Alliance ("ONA") asked the Board to order a utility to evaluate the establishment of a rate class for the purpose of providing redress for aboriginal peoples. The Board rejected this request and stated:

> The Board is required by its legislation to "fix just and reasonable rates", and in doing so it attempts to ensure that no undue discrimination occurs between rate classes, and that the principles of cost causality are followed in allocating the underlying rates. While the Board recognizes ONA's concerns, the Board finds that the establishment of a special rate class to provide redress for aboriginal consumers of Centra does not meet the above criteria and it is not prepared to order the studies requested by ONA.
>
> (*Decision with Reasons*, EBRO 493, pp. 314 and 317)

Although this decision did not explicitly state that the Board has no jurisdiction to consider special rates for disadvantaged groups, it is a clear expression from the Board on its view of its mandate. It is this Board's view that if the legislature had intended to grant the Board the power to order the implementation of low income assistance programs, it would have stated so expressly.

A very similar jurisdictional issue was recently before the Nova Scotia Court of Appeal. In this case, the Nova Scotia Utility and Review Board's ("NSURB") decision that it did not have jurisdiction to order low income affordability programs was appealed to the Court of Appeal. The Court upheld the NSURB's finding that it did not have jurisdiction. Speaking for the majority, Fichaud J.A. stated: "[t]he statute does not endow the Board with discretion to consider the social justice of reduced rates for low income consumers. […] It is for the Legislature to decide whether to expand the Board's purview…"[1]

The Charter

LIEN has submitted that, in making its determination on jurisdiction, the Board should be guided by the Canadian Charter of Rights and Freedoms (the "Charter"). In LIEN's view, where there is ambiguity in the interpretation of a statute, a tribunal should be

[1] *Dalhousie Legal Aid Service v. Nova Scotia Power Inc*" [2006] N.S.J. No. 243 (C.A.)

guided by Charter principles. In support of this position, LIEN cited the Supreme Court decision in *R. v. Rogers* [2006] 1 SCR 554:

> "It has long been accepted that courts should apply and develop common law rules in accordance with the values and principles enshrined in the Charter: *RWDSU v. Dolphin Delivery Ltd.,* [1986] 2 S.C.R. 573, at p. 603; *Cloutier v. Langlois*, [1990] 1 S.C.R. 158, at p. 184; *R. v. Salituro*, [1991] 3 S.C.R. 654, at p. 675; *R. v. Golden*, [2001] 3 S.C.R. 679, 2001 SCC 83, at para. 86; *R. v. Mann,* [2004] 3 S.C.R. 59, 2004 SCC 52, at paras. 17-19. However, it is equally well settled that, in the interpretation of a statute, Charter values as an interpretative tool can only play a role where there is a genuine ambiguity in the legislation. In other words, where the legislation permits two different, yet equally plausible, interpretations, each of which is equally consistent with the apparent purpose of the statute, it is appropriate to prefer the interpretation that accords with Charter principles."

While the Board does not dispute the sentiments expressed in this passage, this decision does not apply to the case at hand. The Court was clear that Charter values are to be applied as an interpretive tool "where there is a genuine ambiguity in the legislation." In this case, we find no such ambiguity. The Board simply has not been given the powers that LIEN seeks to ascribe to it.

Conclusion

It is therefore the majority's finding that the Board does not have the jurisdiction to order the implementation of a rate class based on an income level determinant as described above.

DATED at Toronto, April 26, 2007

Original signed by

Paul Vlahos
Member

Original signed by

Ken Quesnelle
Member

DISSENTING DECISION

The issue in this Motion is whether the Board has the jurisdiction to order special rates for low-income consumers. For the reasons set out below, I respectfully disagree with the majority and find that the Board has jurisdiction.

This is not the first time this matter has come before the Board. The Applicant in this case, the Low Income Energy Network (LIEN), raised an identical issue in the Union rate case last year. That Panel did not reject the matter on the basis of jurisdiction but deferred it on the grounds that it would be best to consider the matter in a different forum. LIEN argued before us that there had been little progress and accordingly wished to have the matter heard in the Enbridge rate case. This Panel ruled that before deciding the issue it wished to have detailed submissions on whether the Board had jurisdiction. This section addresses that issue.

The Industrial Gas Users Association (IGUA), the Consumers Council of Canada (CCC"), Enbridge Gas Distribution Inc. (EGD) and Union Gas Limited (Union) all argue that the Board does not have the jurisdiction to establish special rates for low-income consumers.

Board staff argued that the Board did have jurisdiction to implement some form of rate affordability assistance programs for low-income consumers but stated, "absent a specific proposal Board staff does not believe it is prudent to speculate just how far that authority might extend."

For the reasons outlined below, I find that the Board has jurisdiction to approve special rates for low-income consumers in appropriate cases. No decision is being made as to whether the Board should exercise that jurisdiction however. There is no specific proposal before us. A decision whether to exercise jurisdiction should be deferred to a proceeding that faces a definitive proposal.

A number of parties also argued that if there were a proceeding to consider low-income rates, it should be a generic proceeding. That, in fact, was the Board's decision the last time this Board considered this issue.[1] I agree with that decision.

[1] *Union Gas Limited*, EB-2005-0520 (O.E.B.), Transcript, Vol. 01, May 23, 2006 at 86-87 [hereinafter referred to as *Union*].

The case that LIEN makes for rate affordability programs is best summarized in paragraphs 1 and 2 of its written submissions:

> "1. Unaffordable gas and electricity rates cause great hardship to poor consumers in Ontario. Sometimes they are forced to choose between heating or eating; sometimes their supply is disconnected. The Ontario Energy Board's ("Board") statutory objective to protect the interests of consumers with respect to prices and the reliability and quality of gas service is not being met by the current rate fixing system. The interests of low-income consumers are not protected and de facto the service to them is unreliable and inadequate.
>
> 2. The Board's self-acknowledged and judicially acknowledged mandate is to regulate the province's electricity and natural gas sectors in the public interest. Low-income consumers form a substantial proportion of Ontario's population: approximately 18% of households spread throughout the province. Gas rates and service that disadvantage such a substantial segment of the public, whether directly through rate structure or indirectly through terms and conditions, are not in the public interest."

Jurisdiction

Any Tribunal only has the powers stated in its governing statute or those, which arise by "necessary implication" from the wording of the statute, its structure and its purpose.[2] This Board's jurisdiction to fix "just and reasonable" rates is found in section 36(2) of the *Ontario Energy Board Act,* 1998:

> "The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas."

One of the Board's statutory objectives as set out in section 2 of the Act is to "protect the interests of consumers with respect to prices and the reliability and quality of gas service." LIEN argues that without a rate affordability program, the interests of low-income consumers are not protected.

It is generally accepted that the Board's jurisdiction is very broad. In *Union Gas Ltd.* v. *Township of Dawn*, the Ontario Divisional Court in 1977 stated:

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[2] *ACTO Gas and Pipelines Ltd.* v. *Alberta (Energy and Utilities Board*, [2006] 1 S.C.R. 140, [2006] 2.C.J. 400 at para. 38. See also *Bell Canada* v. *Canada (Canadian Radio-Television and Telecommunications Commission*, [1989] 1 S.C.R. 1722.

> "this statute makes it crystal clear that all matters relating to or incidental to the production, distribution, transmission or storage of natural gas, including the setting of rates, location of lines and appurtenances, expropriation of necessary lands and easements, are under the exclusive jurisdiction of the Ontario Energy Board and are not subject to legislative authority by municipal courts under the *Planning Act*.
>
> These are all matters that are to be considered in light of the general public interest and not local or parochial interests. The words "in the public interest" which appear, for example, in s. 40(8), s. 41(3) and s. 43(3), which I have quoted, would seem to leave no room for doubt that it is broad public interest that must be served.[3]

The same Court in 2005 issued two important decisions. The Court stated in the *NRG* case:

> "The Board's mandate to fix just and reasonable rates under section 36(3) of the *Ontario Energy Board Act, 1998* is unconditioned by directed criteria and is broad; the Board is expressly allowed to adopt any method it considers appropriate."[4]

The ruling in the Enbridge case decided that the Board in fixing just and reasonable rates can consider matters of "broad public policy:"

> "the expertise of the tribunal in regulatory matters is unquestioned. This is a highly specialized and technical area of expertise. It is also recognized that the legislation involves economic regulation of energy resources, including setting prices for energy which are fair to the distributors and the suppliers, while at the same time are a reasonable cost for the consumer to pay. This will frequently engage the balancing of competing interests, as well as consideration of broad public policy."[5]

This legal principle must be considered in the context of the fact situation before us. The supply of natural gas can be considered a necessity that is available from a single source with prices set by an agent of the Crown. The Divisional Court has said that the Board is entitled in setting rates to consider "broad public policy". This suggests that in appropriate circumstances the Board can consider ability to pay in setting rates if it is necessary to meet broad public policy concerns. Access to an essential service may be such a concern.

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[3] (1977), 15 O.R. (2d) 722, [1977] O.J. No. 2223 at paras. 28 and 29.

[4] *Natural Resource Gas Ltd.* v. *Ontario Energy Board*, [2005] O.J. No. 1520 (Div. Ct.) at para 13.

[5] *Enbridge Gas Distribution Inc.* v. *Ontario Energy Board* (2005), 75 O.R. (3d) 72, [2005] O.J. No. 756 at para. 24.

Those arguing a lack of jurisdiction on the part of the Ontario Board point to section 79 of the Act, which specifically authorizes the Board to provide rate protection for rural or remote customers of an electricity distributor. They argue that if the legislature had intended special rates for low-income consumers, the legislature would specifically have inserted a provision similar to section 79.

With respect, the correct reading of the legislative history of that section does not bear this interpretation. The section was introduced when the Board first obtained the jurisdiction to regulate electricity distributors. Prior to that, electricity distributors in the Province were regulated by Ontario Hydro, a Crown corporation. The Government through its Crown corporation had established the policy of setting special rates in remote and rural areas of the province. This section was introduced in 1999 when the authority to set rates was transferred to the Ontario Energy Board to indicate to the Board that this policy should continue.[6] I do not accept that this section represents an attempt by the Government to circumscribe the jurisdiction of the Board. That is contrary to the clear wording of section 36(3) which specifically applies to gas distributors.[7]

The Ability to Pay

Those arguing that the Board does not have jurisdiction to enact special rates for low-income customers often do so on the basis that rate-setting would depart from standard regulatory principles and morph into social engineering. They argue that the Board should not consider ability to pay in setting rates, relying to some degree on the decision of the Alberta Board, which rejected lifeline rates on the basis, that "life-line rates are rates based not on economic principles of regulation such as cost of service but on a social principle of the customer's ability to pay."[8]

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[6] Ontario Regulation 442/01 – *Rural or Remote Electricity Rate Protection* (made under the *Ontario Energy Board Act, 1998*) requires the OEB to determine the annual amount to be collected and distributed for rural or remote electricity rate protection. Prior to the Board being granted authority over electricity rate regulation in 1999, rural rate protection was provided through section 108 of the *Power Corporation Act*, R.S.O. 1990, c. P. 18. That section required that the weighted average bill for the first 1000 kws of consumption by rural residential customer be 115% of the weighted average bill for the first 1000 kws of consumption by a municipal residential customer. Funding of this subsidy was provided by municipal commissions and any other person supplied power by Ontario Hydro.

[7] Section 36(3) of the *Ontario Energy Board Act, 1998* states that "In approving or fixing and just and reasonable rates, the Board may adopt any method or technique that it considers appropriate."

[8] *EPCOR Distribution Inc.* (August 13, 2004), Decision 2004-067 (A.E.U.B.) at 184 [hereinafter referred to as *EPCOR*].

LIEN argues to the contrary, stating that the Board is required to set just and reasonable rates, and in this regard, should have regard to its objects, one of which is "to protect the interest of consumers with respect to price". They argue, "how can the Board protect consumers with respect to price if it cannot consider the ability to pay."

Most energy regulators in Canada, including the Ontario Energy Board, agree that the cost of serving customers is a major determinate of rates. But, this is not the only determinate. Another variant of this argument is that the Board is an "economic regulator" and as such, jurisdiction is circumscribed. This principle is relied upon by the majority in this case.

With respect, there is no basis for this position in the statute. This very argument in, substantially similar circumstances, was recently rejected by the Federal Court of Appeal in *Allstream Corp.* v. *Bell Canada*.[9] There, Bell Canada had filed tariffs for optical fiber services in different areas. In some areas, Bell priced the service below the floor price previously established by the CRTC. The Commission approved these rates despite the objection of Allstream, a competitor, that the rates would reduce competition and were beyond the Commissions jurisdiction as an "economic regulator".

All of the Members of the Commission agreed that the proposed rates did not comply with existing criteria because they fell below the applicable floor price. A majority of the Commission, however, ruled that there were "exceptional" circumstances in five cases as the services were necessary to serve schools in the area. Two dissenting Members of the Commission were highly critical of the majority. One Commissioner stated that "with the advent of competition, the Commission has undertaken twelve years in a continuing painstaking process of wringing out the cross subsidization between the various classes of ratepayers and that, to step back from cost based rates and reintroduce hidden cross subsidization was a retrograde and chilling step."[10]

The Federal Court of Appeal in reviewing the Commission's decision considered the sections of the *Telecommunications Act* that governed the Commission's jurisdiction. Section 27(1) of the Act provided that "every rate charged by a Canadian carrier for telecommunications service shall be just and reasonable." Section 27(5) of the Act provided that "in determining whether a rate is just and reasonable, the Commission

[9] [2005] F.C.J. No. 1237.

[10] *Ibid*. at para. 9.

may adopt any method or technique that it considers appropriate, whether based on a carrier's return on its rate base or otherwise." Those sections are identical to Ontario legislation at play in this proceeding. In upholding the Commission's decision, the Federal Court of Appeal, stated:

> The appellant highlights the fact that the courts have historically deferred to utilities commissions in deciding which factors are relevant in determining a just and reasonable rate. However, such factors have typically been economic considerations of the rates themselves. Examples from the jurisprudence sanction reliance on a utility's costs, investments, reserves, and allowances for necessary working capital; a rate of return on the utility's investment; the recovery of fair and reasonable expenses; costs of debt and equity; and general economic conditions. The factors relied on in this case are not economic considerations relative to the rates themselves and therefore, the appellant argues, the Court should not defer to the Commission….
>
> The Commission as a whole has experience in rate setting. The variety of opinions and concerns expressed in the decision under appeal is an indication that different members held different views on the industry, the market, the services to be provided, the policy objectives and their application in these circumstances. It is apparent that the Commission was greatly concerned and the dislocation of complex equipment and facility configurations at a significant cost to the detriment of school boards and municipalities in the relevant areas and that such concerns outweighed, in its view, Bell's failure to seek prior approval of these rates. These are considerations that a specialized board can entertain and weigh relative to other considerations. It is true that these considerations are not purely economic in the sense referred to by the appellant such as costs, investment, allowance for necessary working capital, rate of return, etc. These considerations, however, are part of the Commission's wide mandate under section 7, a mandate it alone possesses and are quite distinct from the grant of a rebate under paragraph 27(6)(b) of the Act, a power the Commission did not invoke.
>
> The Commission's choice of "exceptional circumstances" was not patently unreasonable. I therefore cannot find that they were irrelevant considerations which would amount to an error of law or jurisdiction. I would dismiss this appeal with costs.[11]

There is no specific proposal before the Ontario Energy Board at this point. This is strictly a question whether the Board has jurisdiction to set special rates for low-income consumers. It may be that there must be "exceptional circumstances" for the Board to exercise that jurisdiction and depart from standard rate making principles, but in my view, the Board has that jurisdiction in the appropriate circumstances.

[11] *Ibid* at paras. 22 and 34-36.

A finding that the Board has jurisdiction to consider ability to pay in setting rates, does not mean, as the majority suggests, that there will be a "fundamental change" in rate-making principles across the board. I accept that cost causality is the basic principle. I also accept the Federal Court's view that there should be exceptional circumstances. But, I also believe that in the appropriate circumstances the Board has the authority to enact those programs.

It is important in this context to recognize that section 36(3) of the Act provides that the Board in fixing just and reasonable rates can adopt "any method or technique that it considers appropriate". The majority finds that this language does not allow the Board to consider ability to pay in setting rates. They conclude that if this was the legislative intent, this authority would have been specifically included. With respect, I disagree. This is an extremely broad power. Given the language it is difficult to understand why the legislature would reference one specific rate-making technique or factor. The majority also finds that this provision was intended to allow the Board to move from standard rate-based rate-of-return regulation to incentive regulation. I see nothing in the language of this statute that leads to that restriction.

The majority relies on the decision of the Nova Scotia Court of Appeal upholding the decision of the Nova Scotia regulator, where the Board found that it did not have jurisdiction to order low-income affordability programs. With respect, that decision has no application to the situation before us. That decision was clearly founded on section 67(1) of the *Public Utilities Act* of Nova Scotia[12] which required that rates shall "always be charged equally to all persons under the same rate in substantially similar circumstances and conditions irrespective of service of the same description."

This section is not in the Ontario Act. Rather, what is in the Ontario Act (and not in the Nova Scotia Act) is section 36(3) which authorizes the Board in setting just and reasonable rates to adopt "any method or technique it considers appropriate". The statutory scheme and the regulatory authority granted to the Ontario and Nova Scotia Boards is materially different.

This Board has jurisdiction to set just and reasonable rates, to act in public interest, and to use any rate-making technique considered appropriate. Moreover, Ontario

[12] Section 67(1) of the *Public Utilities Act*, R.S.N.S. 1989, c. 380, provides that "All tolls, rates and charges shall always, under substantially similar circumstances and conditions in respect of service of the same description, be charged equally to all persons and at the same rate, and the Board may by regulation declare what shall constitute substantially similar circumstances and conditions."

courts in numerous decisions have confirmed the Board's broad rate-making authority and that the Board can consider matters of public policy. The fact that the Board may be considered an "economic regulator" does not limit that jurisdiction.

Put simply, just and reasonable rates do not result from the application of a purely mechanical process of rate review and design. A Board can, and should, take into account a variety of considerations beyond costs in determining rates. It is not unusual for energy regulators, including the Ontario Board, to reduce a rate increase because of "rate shock" and spread the increase over a number of years. Such a determination, as LIEN argues, is driven by considerations of the "ability to pay".

I also agree with Board Counsel that the Board has crossed this bridge. This Board in the past has considered ability to pay in different cases. Both Enbridge and Union Gas make annual contributions to the Winter Warmth program, which provides funds to certain low-income consumers to ensure they can heat their homes during winter months.[13]

The majority finds that this program constitutes a "charity" or emergency program and does not reflect principles of rate making. With respect, these long-standing programs provide a subsidy to low-income consumers to allow them to purchase gas. If this Board has jurisdiction to order utilities to pay subsidies to low income customers, it has jurisdiction to order utilities to provide special rates.

Interestingly, we find another example in this very case. In this proceeding, Enbridge is asking the Board to approve fuel-switching programs to enable consumers to shift from electric-water heaters to gas-water heaters, to increase utility sales and promote conservation given the greater efficiency of the gas-water heater.

What's interesting is that the utility is proposing two programs, one for low-income consumers and one for other consumers. The programs are identical and there are roughly the same number of participants in each program. The difference is that the subsidy for the low-income group is $800 per participant while the subsidy for other consumers is only $600. None of the parties of this proceeding objected. No one has argued that the Board does not have jurisdiction to approve different subsidies based on income levels.[14]

[13] See *Union*, EB-2005-0520 (O.E.B.).

[14] *Enbridge Gas Distribution Inc.*, EB-2006-0034 (O.E.B.), Exhibit 1, Tab 1, Schedule 25, at 3.

Unjust Discrimination

Enbridge argues that enacting special rates for low-income consumers would violate the common law principle against unjust discrimination by public utilities as set out in *St. Lawrence Rendering Company Ltd.* v. *the City of Cornwall*.[15]

> "That a public utility was at common law compelled to treat all consumers alike, to charge one no more than the other and to supply the utility as a matter of duty and not as a result of a contract, seems clear."

There is no question that this common law principle has been enshrined in public utility statutes for decades. Section 321 of the *Railway Act* for over 100 years prohibited unjust discrimination or undue preference by telecommunication companies as well as railroads.[16] Most public utilities statutes in Canada contain similar provisions prohibiting unjust discrimination.[17] The *Ontario Act* is unique in that respect, because it does not contain this provision. That does not mean the principle does not apply. It is well founded in the Common Law. However, the common law principle does not stand for no discrimination. The prohibition is against unjust discrimination or undue preference.

Low-income rates do not necessarily offend the general principle of unjust discrimination or undue preference. That judgment will turn upon the exact nature of the program, something that is not before this panel. In short, the common law principle prohibits unjust discrimination, not any discrimination. It is not a bar to the Board exercising its jurisdiction in the appropriate circumstances.

On the contrary, this principle may require special rates. The prohibition against unjust discrimination has often been used to ensure access to a monopoly utility's facilities[18] and arguably relates to the services as well.

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[15] *St. Lawrence Rendering Company Ltd.* v. *the City of Cornwall*, [1951] O.R. 669 at 683. See also *Canada (Attorney General* v. *Toronto (City* (1893, 23 S.C.R. 514.

[16] *Railway Act*, R.S.C. 1970, c. R2, s. 321, as amended. See also the *Telecommunications Act*, S.C., 1993, c. 38, s. 27(2). This section is similar to sections 201 and 202 of the *Communications Act 1934*, 47 USCA (1962) which governs US telecommunications companies. See also *EPCOR*, supra note 12 at 184.

[17] See the *Public Utilities Act*, R.S.N.L. 1990, c. P-47, ss. 82, 84 and 87; the *Electric Power Act*, R.S.P.E.I. 1988, c. E-4, ss. 28-30; the *Public Utilities Board Act*, R.S.A. 2000, c. P-45, ss. 80 and 100; and the *Utilities Commission Act*, R.S.B.C. 1996, c. 473, ss. 58-60.

[18] *Otter Trail Power Co.* v. *United States*, 410 U.S. 366 (1973); *Specialized Common Carrier*, 29 F.C.C. 2d 870 (1971), modified 33 F.C.C. 2d 408 (1972), aff'd sub nom. *Washington Util. & Transp. Comm'n* v. *F.C.C.*, 513 F. 2d 1142 (9th Cir. 19750, cert. denied 423 U.S. 836 (1975); See also *CNCP Telecommunications, Interconnection with Bell Canada,*

Charter of Rights and Freedoms

Section 32.2 of the Act, provides that the Board may make orders approving or fixing "just and reasonable rates" for the sale of gas. LIEN argues that in the absence of clear statutory provisions, the requirement for a "just and reasonable rate" must be interpreted to comply with section 15 of the Canadian Charter of Rights and Freedoms. Section 15 states:

> "15. (1) Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability."

There is no question that the Charter applies to provincial legislation,[19] and the Supreme Court of Canada in *R.* v. *Rogers* held that the Charter, can be used as an interpretative tool:

> "[I]t is equally well settled that, in interpretation of a statute, *Charter* values as an interpretative tool can only play a role where there is a genuine ambiguity in the legislation. In other words, where the legislation permits two different, yet equally plausible, interpretations, each of which is equally consistent with the apparent purpose of the statute, it is appropriate to prefer the interpretation that accords with *Charter* principles."[20]

The majority believes that it is clear that jurisdiction does not exist. As a result, they conclude that the required ambiguity is not present and the Charter cannot be used as an interpretive tool. I have concluded that the Act clearly grants the Board the necessary jurisdiction. Given the lack of ambiguity, the Charter would not be available for purposes of interpretation.

This, with respect, makes little sense. The Charter is the supreme law of the land. No legislation can be contrary to the Charter and no Board can issue an Order contrary to the Charter. To be fair to LIEN, a split decision suggests ambiguity. All parties agree, as the majority states, that there is no explicit authority in the Statute. The

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Telecom. Decision CRTC 79-11, 113 Can. Gazette PT, I, supplement to No. 29, 5 C.R.T. 177 (17 May 1979) aff'd P.C. 1979-2036 at 274.

[19] *Retail, Wholesale and Department Store Union, Local 580 [R.W.D.S.U.]* v. *Dolphin Delivery Ltd.*, [1986] 2 S.C.R. 573.

[20] *R.* v. *Rogers*, [2006] 1 SCR 554, [2006] S.C.J. No. 15 at para. 18; See also *Bell ExpressVu Limited Partnership* v. *Rex*, [2002] 2 S.C.R. 559, [2002] S.C.J. No. 43 at para. 62.

question is whether there is implicit authority. In the circumstances of this case, I find the Charter can be used as an interpretative tool.

It is important to remember that the Charter can also be used by disadvantaged groups to set aside Board decisions refusing to set aside special rates, if that refusal amounted to discrimination within the language of section 15.

The Charter specifically empowers Courts to provide a remedy to anyone whose rights or freedom has been infringed or denied by Government action. Its reach extends not just to laws but the decisions taken pursuant to those laws. The Supreme Court of Canada held in *Slaight*[21] that no public official could be authorized by statute to breach the Charter and therefore all statutory grants of discretion had to be read down only to authorize decision making which is consistent with Charter rights and guarantees. As Professor Hogg has stated:

> "Action taken under statutory authority is valid only if it is within the scope of that authority. Since neither Parliament nor a Legislature can itself pass a law in breach of the Charter, neither body can authorized action which would be in breach of the Charter. Thus, the limitations on statutory authority which are imposed by the Charter will flow down the chain of statutory authority and apply to regulations, by-laws, orders, decisions and all other action (whether legislative, administrative or judicial) which depends for its validity on statutory authority."[22]

In Baker,[23] the Court clearly stated that discretion must be exercised not only in accordance with the boundaries of the statute and the principles of administrative law, but in a manner consistent with the "principles of the Charter" and the "fundamental values of Canadian society".

Applicants under s. 15 must however, show they have been subjected to discrimination or denied a legal benefit or protection. They must also show that the denial of the benefit or protection is on an enumerated or analogous ground.[24] In order to determine whether the Charter applies here, it is necessary to answer two questions. First, is poverty or low income an analogous ground? Second, has there

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[21] *Slaight Communications Inc.* v. *Davidson*, [1989] 1 S.C.R. 1038.

[22] P.W. Hogg, *Constitutional Law of Canada*, looseleaf (Toronto: Carswell, 1997) at para. 34-11.

[23] *Baker* v. *Canada (Minister of Citizenship and Immigration*), [1999] 2 S.C.R. 817 at para. 25.

[24] *Law Society of British Columbia* v. *Andrews*, [1989] 1 S.C.R. 143.

been discrimination or a disadvantage as a result of the failure to enact low income rates?

In the past, courts have been reluctant to define poverty and low income as an analogous ground.[25] More recent cases however, offer broader interpretations. The Ontario Court of Appeal in Falkiner[26] found that there was discrimination contrary to section 15 of the Charter against individuals who were subjected to differential treatment on the analogous ground of "receipt of social assistance". The Nova Scotia Court of Appeal in *Sparks*[27] found that sections of the *Residential Tenancies Act* were unconstitutional because of discrimination contrary to Section 15 of the Charter against "tenants of public housing". The Nova Scotia Court stated in part:

> Low income, in most cases verging on or below poverty, is undeniably a characteristic shared by all residents of public housing; the principle criteria of eligibility for public housing are to have a low income and a need for better housing….
> Section 15(1) of the Charter requires all individuals to have equal benefit of the law without discrimination. Public housing tenants have been excluded from certain benefits private sector tenants have as provided to them in the Act. The effect of ss. 25(2) and s. 10(8)(d) of the Act has been to discriminate against public housing tenants who are a disadvantaged group analogous to the historically recognized groups enumerated in s. 15(1).[28]

The Ontario Court of Appeal in *Falkiner* came to a similar conclusion:

> I consider that the respondents have been subjected to differential treatment on the analogous ground of receipt of social assistance. Recognizing receipt of social assistance as an analogous ground of discrimination is controversial primarily because of concerns about singling out the economically disadvantaged for Charter protection, about immutability and about lack of homogeneity…
>
> [T]he main question in deciding whether a ground of discrimination should be recognized as analogous is whether its recognition would further the purpose of s. 15, the protection of human dignity …The

[25] *Dunmore v. Ontario (Attorney General)* (1997), 37 O.R. (3d) 287. See also *Alcorn v. Canada (Commissioner of Corrections)* (1999), 163 F.T.R. 1 (T.D.).

[26] *Falkiner* v. *Ontario (Ministry of Community and Social Services)* (2002), 59 O.R. (3d) 481, [2002] O.J. No. 1771 {C.A.} [hereinafter referred to as Falkiner].

[27] *Dartmouth/Halifax County Regional Housing Authority* v. *Sparks*, [1993] N.S.J. No. 97 (C.A.)

[28] *Ibid*. at pp. 8 and 9 of 11.

> nature of the group and Canadian society's treatment of that group must be considered. Relevant factors arguing for recognition include the group's historical disadvantage, lack of political power and vulnerability to having its interests disregarded…
>
> [A]lthough the receipt of social assistance reflects economic disadvantage, which alone does not justify protection under s. 15, economic disadvantage often co-exists with other forms of disadvantage. That is the case here.[29]

There is no specific plan before the Board at this point. However, we do know that existing utility programs, that subsidize low income groups rely on existing social welfare legislation to define which individuals are "low income". Accordingly, it is possible that those qualified for the low-income rate programs might be those in "receipt of social assistance".

The more difficult question is whether this group is being disadvantaged by a failure to enact low-income rates. Enbridge says that there is no discrimination because everyone gets the same rate. LIEN argues that the requirement of a single rate regardless of income discriminates those who cannot afford the service.

It is important to recognize the nature of the service at issue. The supply of gas can be considered an essential commodity. And, there is only once source of this commodity, a regulated utility. And, the price is set by the Ontario Engergy Board, an agent of the Crown.

For the reasons expressed above, I believe that the Charter may provide a remedy to disadvantaged groups, in the appropriate circumstances to require Boards to set special rates for supply of an essential commodity from a single regulated source. I also find that the Charter principles of section 15 apply to a determination of jurisdiction and, the Charter supports a conclusion that the Board has jurisdiction. However, even if the Charter does not apply, I believe the Act gives the Ontario Energy Board broad powers and discretion to consider issues of public policy and the necessary jurisdiction to enact low-income rates.

DATED at Toronto, April 26, 2007

Original signed by

Gordon Kaiser
Presiding Member and Vice Chair

[29] *Falkiner, supra* note 27 at paras. 84, 85 and 88.

The Regulation of Public Utilities

Theory and Practice

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1993
PUBLIC UTILITIES REPORTS, INC.
Arlington, Virginia

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First Printing, May 1984
Second Edition, June, 1988
Third Edition, July 1993

Library of Congress Catalog Card No. 93-085285

ISBN 0-910325-45-6

Printed in the United States of America

Nor can the role of the federal government in this reexamination process be overlooked. On the one hand, competition has been promoted by federal agencies, often over objections from the state commissions. On the other hand, the federal government assumed an important input into rate design through enactment of the national energy plan in 1978. Specifically, the Public Utility Regulatory Policies Act (PURPA) (1) required the state commissions to consider, and to implement or adopt if appropriate, any or all of twelve specified standards in the case of electric utilities, (2) initiated a gas utility rate design study, and (3) gave to the U.S. Department of Energy the right to intervene in state electric and gas utility rate proceedings to advocate reforms.

The legal standards guiding the regulatory commissions are broad. Each specific rate must be "just and reasonable." Further, "undue" or "unjust" discrimination among customers is prohibited. The rate structure thus involves determination of specific rates and determination of rate relationships.

The theory of rate design is discussed in the first sections of this chapter: the criteria of a sound rate structure, the bases for price differentiation, the economics of price discrimination and the theory of marginal cost pricing. A special case — lifeline rates — is discussed in the fifth section. The concluding section considers rate design with respect to the electric utility industry.[2]

Criteria of a Sound Rate Structure

Bonbright, in his study on public utility rates, lists eight criteria of a sound or desirable rate structure:

1. The related, "practical" attributes of simplicity, understandability, public acceptability, and feasibility of application.
2. Freedom from controversies as to proper interpretation.
3. Effectiveness in yielding total revenue requirements under the fair-return standard.
4. Revenue stability from year to year.
5. Stability of the rates themselves, with a minimum of unexpected changes seriously adverse to existing customers. (Compare "The best tax is an old tax.")
6. Fairness of the specific rates in the apportionment of total costs of service among the different consumers.
7. Avoidance of "undue discrimination" in rate relationships.
8. Efficiency of the rate classes and rate blocks in discouraging wasteful use of service while promoting all justified types and amounts of use:
   a. in the control of the total amounts of service supplied by the company;
   b. in the control of the relative uses of alternative types of service (on-peak versus off-peak electricity, Pullman travel versus coach

travel, single-party telephone service versus service from a multi-party line, etc.).[3]

Admittedly, these criteria are broad and ambiguous (what, for example, is "undue" discrimination?). They also overlap without offering any rules of priority in case of conflicts. How is the "cost of service" to be measured — marginal cost, average cost or fully distributed cost? Clearly, the measure largely depends on the purpose that a rate is to fulfill. Further, is the dominant objective one of "fairness" or one of "efficiency"?[4] But the criteria are of value "in reminding the rate maker of considerations that might otherwise escape his attention, and also useful in suggesting one important reason why problems of practical rate design do not readily yield to 'scientific' principles of optimum pricing."[5]

Bonbright further suggests that the three primary criteria are numbers 3, 6 and 8; namely,

> (a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost-apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed *fairly* among the beneficiaries of the service; and (c) the optimum-use or consumer-rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.[6]

Cost and Demand: Price Differentiation[7]

There are two bases for price differentiation. The first is differences in costs or the "cost of service." The second is differences in demand or the "value of service." A seller does not discriminate when rates are based upon costs, even though some customers pay more than others. But when rates are based upon demand, discrimination occurs.

Cost of Service

Differences in rates may be due to differences in costs. It is more expensive to serve some customers than others. Those who use the service only occasionally are more expensive to serve than those who use it continuously. The costs of billing each type of customer, for example, may be approximately the same, so that average costs are higher for the first group than for the second. For the telephone industry, terminal costs are as high for short distances as for long distances, so that costs per mile decline with

distance. In the case of electric utilities, little of the distribution plant is applicable to large industrial sales, resulting in a significant cost difference between industrial and residential or small commercial users.

Costs also vary according to the time of use. Customers who use the service during the peak demand period are more expensive to serve than off-peak users. A basic factor in determining the size of a utility plant is the peak demand. Therefore, it costs less to serve those customers who use the service without burdening the business as a whole by adding to the peak demand period. Further, if off-peak usage is increased, the utility may obtain a better utilization of its plant throughout the day, thereby resulting in a larger total output over which fixed costs may be spread.

Value of Service

Differences in rates may be due to differences in demand. A customer's demand is based upon the need or desire for the service, the ability to pay for it and the availability of substitutes. Customers have relatively elastic demands when they have little need for the service, when they have insufficient incomes to pay for the service, or when they can provide it for themselves or purchase it from a competing seller. Customers have relatively inelastic demands when their need and ability to pay for the service are great and when no alternative sources of supply or substitutes are available.

From the seller's point of view, discrimination may offer marked advantages. When a supplier can fully utilize his plant and earn a fair rate of return by charging a single price, he is unlikely to practice price discrimination. But a price low enough to maintain full production may yield insufficient revenues to cover costs, while one set high enough to cover costs may result in unused capacity. In such a situation, the supplier will be able to increase his revenues by charging a higher price where demand is inelastic and a lower price where demand is elastic.

This situation is illustrated in Table 10-1. Assume that an enterprise has a plant with a capacity of 3,800 units. Assume further that total cost includes a fair return on the investment in the plant, so that the final column represents either excess profit or loss. If the firm's output is sold at a single price, the rate will be $8.00 and sales will be 400 units. Profits are maximized. At this price, the plant is not fully utilized. A glance at the table will show that it is impossible for the firm both to cover costs and to maintain full production as long as a single price is charged.

If discrimination is practiced, however, the situation is quite different, as shown in Table 10-2. Now, by dividing customers into separate classes and charging each one a different price, total revenue will increase. Prices will range from a high of $11.00 to a low of $3.00, output will expand to 2,000 units and excess profits will rise to $2,400. Yet, as demonstrated below, such a schedule would be considered as "unduly" discriminatory.

TABLE 10-1
Enterprise Selling at a Single Price

Price	*Sales*	*Total Revenue*	*Total Cost*	*Profit or Loss*
$11.00	100	$1,100	$ 1,600	– $ 500
10.00	200	2,000	2,150	– 150
9.00	300	2,700	2,650	+ 50
8.00	400	3,200	3,100	+ 100
7.00	500	3,500	3,500	0
6.00	700	4,200	4,250	– 50
5.00	1,000	5,000	5,400	– 400
4.00	1,400	5,600	6,700	– 1,100
3.00	2,000	6,000	8,200	– 2,200
2.00	2,800	5,600	10,000	– 4,400
1.00	3,800	3,800	13,000	– 9,200

TABLE 10-2
Enterprise Practicing Price Discrimination

Price	*Sales*	*Sales in Each Class*	*Revenue from Each Class*	*Total Revenue*	*Total Cost*	*Profit or Loss*
$11.00	100	100	$1,100	$ 1,100	$ 1,600	– $ 500
10.00	200	100	1,000	2,100	2,150	– 50
9.00	300	100	900	3,000	2,650	+ 350
8.00	400	100	800	3,800	3,100	+ 700
7.00	500	100	700	4,500	3,500	+ 1,000
6.00	700	200	1,200	5,700	4,250	+ 1,450
5.00	1,000	300	1,500	7,200	5,400	+ 1,800
4.00	1,400	400	1,600	8,800	6,700	+ 2,100
3.00	2,000	600	1,800	10,600	8,200	+ 2,400
2.00	2,800	800	1,600	12,200	10,000	+ 2,200
1.00	3,800	1,000	1,000	13,200	13,000	+ 200

Economics of Price Discrimination

When a firm sells the same service at rates that are not proportional to costs, discrimination results. Stated another way, discrimination occurs when rates are based upon differences in demand rather than differences in costs. Consequently, some buyers will pay more than the cost of the particular service; others will pay less. It must be noted, however, that discrimination is not unlimited. Since sellers cannot force customers to pay more than they believe the service is worth, the upper ceiling is the value of service. A price set above this limit would result in reduced sales. The lower limit is the seller's marginal (sometimes referred to as out-of-pocket) costs. Any sales made at a price below this limit would result in losses, since these costs can be avoided by not producing the output. When fixed costs are high, as in most of the utility industries, these limits are wide, thereby leaving considerable latitude for discrimination.

Unavoidable versus Intentional Discrimination

Discrimination is partially unavoidable. The cost of providing a particular service is difficult, if not impossible, to determine accurately. Some variable costs, such as labor and fuel, are easily identified with a unit of output. Other costs, however, are commonly or jointly incurred in rendering different types of service. Rather than varying directly with output, they decline in importance as output increases. These costs include interest, depreciation, investment in plant and equipment, and administrative overhead. When investment is large, such costs represent a significant percentage of total costs. When the same plant or equipment is used to provide several types of service, there is no one correct way to allocate these costs among the different units of service. Any method of apportionment is subject to dispute.[8] Even if firms tried to base their rates upon costs, therefore, a substantial element of judgment is involved.

Discrimination is also intentional. As previously shown, when one rate is charged for a service, a company may not be able to utilize its capacity fully. Only by discrimination may idle capacity be eliminated. Furthermore, discrimination is often socially desirable. If it allows a company to expand its sales and utilize its facilities more fully, average costs are reduced as fixed costs are spread over more units of output and the firm's profits are increased. Fuller utilization, in turn, may result in lower prices for *all* customers and in wider use of the utility's services. Some services might be offered that would not be available under uniform rates or only available at substantially higher rates; interstate toll calls over low-density routes often are subsidized by revenues from high-density routes. Regional development also may be encouraged; low electric rates encouraged its use and attracted

industry to the Tennessee Valley Authority area. These advantages, however, are unlikely to be realized unless rates are controlled. As Sharfman has pointed out, there is an inherent danger in discrimination:

> The "value of service" principle, as a basis for rate-making, provides at best a vague and indeterminate formula, rather easily construed as justifying any system of rates found expedient by the carrier. Taking the words in their most obvious sense, no rate can exceed the value of service and still continue to be paid by the shipper.[9]

Conditions for Discrimination

Rate discrimination is not possible unless the market can be separated into distinct sectors so that (1) customers who are charged the higher rate cannot buy in the low-rate sector and (2) those buying at the lower rate cannot resell in the high-rate sector. For industries that sell transferable products, this delineation is usually not possible.[10] However, for public utilities that sell services, such a division of the market is possible. Moreover, they are able to control the use of their services, since they generally deliver them to the customer as they are consumed. If a telephone company charges a business customer more than it charges a residential user, the business subscriber cannot obtain the lower rate by connecting his telephone with the residential subscriber's lines. Customers of utilities cannot shift between the established sectors. This condition further implies that the discriminating firm is either free from competition or that competition is controlled. If two firms supplied the same market, their rivalry for business would force rates down. Two other conditions for discrimination also must exist.[11] The elasticities of demand in the established sectors of the market must be considerably different. That is, if the elasticities are equal or similar, so, too, will be the marginal revenue curves, and discrimination would serve no purpose. Finally, the cost of separating the market into sectors must not be too large. Rate discrimination involves some extra expense. Different bills, for example, usually must be printed for each type of customer, and bookkeeping becomes more complex. For discrimination to be profitable, the increase in revenues must be greater than the additional expenses incurred.

Case for Discrimination

Discrimination may be advantageous for two reasons. First, it may result in a fuller utilization of a firm's plant and equipment, and a wider consumption of its service. Second, it may lead to lower prices for all customers. The first was illustrated above, where adoption of price discrimination permitted output to rise from 400 units to 2,000 units. The second can be seen in Table 10-3. Here, the prices, sales and costs are the same as those in the previous

tables, but now it is assumed that a regulatory commission controls the firm's rate structure. It was suggested earlier that the rate structure shown in Table 10-2 involves "undue" discrimination because of the presence of excess profits. If discrimination were not allowed, therefore, the commission would force the seller to produce 500 units, which would sell for $7.00 each, as shown in Table 10-1. At this price, there would be no excess profits.

TABLE 10-3

Enterprise Practicing Price Discrimination under Regulation*

Price	*Sales*	*Sales in Each Class*	*Revenue from Each Class*	*Total Revenue*	*Total Cost*	*Profit/Loss*
$5.00	1,000	1,000	$5,000	$ 5,000	$ 5,400	– $ 400
4.00	1,400	400	1,600	6,600	6,700	– 100
3.00	2,000	600	1,800	8,400	8,200	+ 200
2.00	2,800	800	1,600	10,000	10,000	0
1.00	3,800	1,000	1,000	11,000	13,000	– 2,000

*This rate structure is only one of several possible structures that might be established by a company and accepted by a commission.

By allowing discrimination, the commission could establish the rate schedule shown in Table 10-3. A fair return is earned from a scale of prices that begins at $2.00 and rises to $5.00, while the volume of output is raised to 2,800 units. It should be noted that every price is well below the $7.00 that would have to be charged if discrimination were not allowed. This schedule is made possible since by serving the low-rate customers who cannot afford the service at a higher rate, the firm's fixed costs are spread over more units. As a result of the adoption of such a schedule, no customers are harmed. On the contrary, all of them have been helped: the $5.00 customers have saved $2.00 per unit, while the $4.00, $3.00 and $2.00 rates are required to obtain customers who otherwise could not afford the service.

Such discrimination cannot be justified, however, unless (1) there are high fixed costs and chronic unused capacity, so that costs per unit are reduced as the fixed costs are spread over a larger volume of output; (2) the lower rates are needed to attract new business; (3) all rates cover at least variable costs and make some contribution to fixed (overhead) costs; and (4) regulation is undertaken to keep total earnings reasonable and to keep discrimination within bounds. If these conditions exist, discrimination is desirable, since it leads either to an increased use of the facilities or to a

lower rate for the customers discriminated against.[12] At the same time, it is important to remember that each rate must be set with the thought that all rates together should return to the utility sufficient revenue to cover its total costs of service, including the rate of return allowed by the commission. This statement does not imply that such revenue is guaranteed; rather it simply means that this end should be kept in view.

The Case against Discrimination and Embedded Costs

Under conditions of decreasing costs, and assuming a goal of expanding service to a maximum number of consumers, few would challenge the desirability of discrimination.[13] But such discrimination does not promote economic efficiency, particularly under conditions of increasing costs, since consumers are given improper price signals. Correct price signals — and the achievement of economic efficiency — require marginal cost pricing,[14] and herein lies the controversy concerning rate design.

Utility rate structures, as they were developed over the years, represented a complex and confusing mixture of cost of service and value of service considerations, with the promotion of use as the dominant objective. To the extent that rate structures were cost-justified, they were based upon historical embedded (average or fully distributed) costs. In the words of the Colorado commission:

> For example, a utility will establish an actual test year for determining revenue requirements and utilize the historical costs for purposes of functionalizing and allocating the costs to various classes of customers for purposes of establishing rates. In that fashion, both the revenue requirements and the rates ultimately determined are based upon the average costs for the historical test year.[15]

In many instances, however, discrimination was not justified. Further, rate structures included countless internal subsidies: off-peak users subsidized on-peak users, industrial and commercial customers subsidized residential customers (electric and gas) and long-distance (toll) calls subsidized local exchange service (telephone), to cite only a few examples. Many customers, in short, paid a rate that did not reflect "the marginal social opportunity cost of supply."[16] Those who paid less were encouraged to demand more service; those who paid more were encouraged to demand less service.

By the early 1970s, recognition was growing that such rate structures were incompatible with the new economic environment. Promotion was no longer rational, since new capacity resulted in higher average costs. And competition was forcing some rates toward marginal costs, since internal subsidies require monopoly conditions.[17] Not only were customers being given improper price signals, but utilities found that during inflation, rates