Case name: Bell Canada v. Bell Aliant Regional Communications
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Date: 2009-09-18
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Case number: 32607, 32611
Judges: McLachlin, Beverley; Binnie, William Ian Corneil; LeBel, Louis; Deschamps, Marie; Fish, Morris J.; Abella, Rosalie Silberman; Charron, Louise; Rothstein, Marshall; Cromwell, Thomas Albert
On appeal from: Federal Court of Appeal
Subjects: Administrative law
Communications law
Notes: SCC Case Information: 32611, 32607

SUPREME COURT OF CANADA

CITATION: Bell Canada *v.* Bell Aliant Regional Communications, 2009 SCC 40, [2009] 2 S.C.R. 764

DATE: 20090918
DOCKET: 32607, 32611

BETWEEN:

Bell Canada
Appellant
v.
Bell Aliant Regional Communications, Limited Partnership, Consumers' Association of Canada, National Anti-Poverty Organization, Public Interest Advocacy Centre, MTS Allstream Inc., Société en commandite Télébec and TELUS Communications Inc.
Respondents
– and –
Canadian Radio-television and Telecommunications Commission
Intervener

AND BETWEEN:

TELUS Communications Inc.
Appellant
v.
Bell Canada, Arch Disability Law Centre, Bell Aliant Regional Communications, Limited Partnership, Canadian Radio-television and Telecommunications Commission, Consumers' Association of Canada, National Anti-Poverty Organization, Public Interest Advocacy Centre, MTS Allstream Inc., Saskatchewan Telecommunications and Société en commandite Télébec
Respondents

AND BETWEEN:

Consumers' Association of Canada and National Anti-Poverty Organization
Appellants
v.
Canadian Radio-television and Telecommunications Commission, Bell Aliant Regional Communications, Limited Partnership, Bell Canada, Arch Disability Law Centre, MTS Allstream Inc., TELUS Communications Inc. and TELUS Communications (Québec) Inc.
Respondents

82 1000

CORAM: McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Abella, Charron, Rothstein and Cromwell JJ.

REASONS FOR JUDGMENT: (paras. 1 to 78) Abella J. (McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Charron, Rothstein and Cromwell JJ. concurring)

Bell Canada *v.* Bell Aliant Regional Communications, 2009 SCC 40, [2009] 2 S.C.R. 764

Bell Canada *Appellant*

v.

Bell Aliant Regional Communications, Limited Partnership, Consumers' Association of Canada, National Anti-Poverty Organization, Public Interest Advocacy Centre, MTS Allstream Inc., Société en commandite Télébec and TELUS Communications Inc. *Respondents*

and

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– and –

TELUS Communications Inc. *Appellant*

v.

Bell Canada, Arch Disability Law Centre, Bell Aliant Regional Communications, Limited Partnership, Canadian Radio-television and Telecommunications Commission, Consumers' Association of Canada, National Anti-Poverty Organization, Public Interest Advocacy Centre, MTS Allstream Inc., Saskatchewan Telecommunications and Société en commandite Télébec *Respondents*

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Consumers' Association of Canada and National Anti-Poverty Organization *Appellants*

v.

Canadian Radio-television and Telecommunications Commission, Bell Aliant Regional Communications, Limited Partnership, Bell Canada, Arch Disability Law Centre,

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Neutral citation: 2009 SCC 40.

File Nos.: 32607, 32611.

2009: March 26; 2009: September 18.

Present: McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Abella, Charron, Rothstein and Cromwell JJ.

ON APPEAL FROM THE FEDERAL COURT OF APPEAL

Communications law — Telephone — Regulation of rates charged by telecommunications carriers — Canadian Radio-television and Telecommunications Commission ordering carriers to create deferral accounts — Accounts being collected from urban residential telephone service revenues to enhance competition — CRTC directing that accounts be disposed of to increase accessibility of telecommunications services for persons with disabilities and to expand broadband coverage — Remaining amounts, if any, being distributed to subscribers — Whether Telecommunications Act authorizes CRTC to direct disposition of deferral account funds as it did — Telecommunications Act, S.C. 1993, c. 38, ss. 7, 47.

Administrative law — Appeals — Standard of review — Canadian Radio-television and Telecommunications Commission — Standard of review applicable to CRTC's decision to direct disposition of deferral accounts — Telecommunications Act, S.C. 1993, c. 38, ss. 7, 47, 52(1).

In May 2002, the Canadian Radio-television and Telecommunications Commission ("CRTC"), in the exercise of its rate-setting authority, established a formula to regulate the maximum prices to be charged for certain services offered by incumbent local exchange carriers, including for residential telephone services in mainly urban non-high cost serving areas (the "Price Caps Decision"). Under the formula established by the Price Caps Decision, any increase in the price charged for these services in a given year was limited to an inflationary cap, less a productivity offset to reflect the low degree of competition in that particular market. The CRTC ordered the carriers to establish deferral accounts as separate accounting entries in their ledgers to record funds representing the difference between the rates actually charged and those as otherwise determined by the formula. At the time, the CRTC did not direct how the deferral account funds were to be used.

In December 2003, Bell Canada sought approval from the CRTC to use the balance in its deferral account to expand high-speed broadband internet services in remote and rural communities. The

CRTC invited submissions and conducted a public process to determine the appropriate disposition of the deferral accounts. In February 2006, it decided that each deferral account should be used to improve accessibility for individuals with disabilities and for broadband expansion. Any unexpended funds were to be distributed to certain current residential subscribers through a one-time credit or via prospective rate reductions. This was known as the "Deferral Accounts Decision".

Bell Canada appealed the order of one-time credits, while the Consumers' Association of Canada and the National Anti-Poverty Organization appealed the direction that the funds be used for broadband expansion. The Federal Court of Appeal dismissed the appeals, finding that the Price Caps Decision regime always contemplated that the disposition of the deferral accounts would be subject to the CRTC's directions and that the CRTC was at all times acting within its mandate. TELUS Communications Inc. joined Bell Canada as an appellant in this Court.

Held: The appeals should be dismissed.

The CRTC's creation and use of the deferral accounts for broadband expansion and consumer credits was authorized by the provisions of the *Telecommunications Act* which lays out the basic legislative framework of the Canadian telecommunications industry. In particular, s. 7 of the Act sets out certain broad telecommunications policy objectives and s. 47(*a*) directs the CRTC to implement them when exercising its statutory authority, balancing the interests of consumers, carriers and competitors. A central responsibility of the CRTC is to determine and approve just and reasonable rates to be charged for telecommunications services. Pursuing policy objectives through the exercise of its rate-setting power is precisely what s. 47 requires the CRTC to do in setting just and reasonable rates. [1] [28] [36]

The issues raised in these appeals go to the very heart of the CRTC's specialized expertise. The core of the quarrel in effect is with the methodology for setting rates and the allocation of certain proceeds derived from those rates, a polycentric exercise with which the CRTC is statutorily charged and which it is uniquely qualified to undertake. The standard of review is therefore reasonableness. [38]

In ordering subscriber credits and approving the use of funds for broadband expansion, the CRTC acted reasonably and in accordance with the policy objectives of the *Telecommunications Act*. In the Price Caps Decision, the CRTC indicated that the amounts in the deferral accounts would help achieve the CRTC's objectives. When the CRTC approved the rates derived from the Price Caps Decision, the portion of the revenues that went into the deferral accounts remained subject to the CRTC's further directions. The deferral accounts, and the fact that they were encumbered by the possibility of the CRTC's future directions, were therefore an integral part of the rate-setting exercise. The allocation of deferral account funds to consumers was neither a variation of a final rate nor, strictly speaking, a rebate. From the Price Caps Decision onwards, it was understood that the disposition of the deferral account funds might

include an eventual credit to subscribers once the CRTC determined the appropriate allocation. [64-65] [77]

There was no inappropriate cross-subsidization between residential telephone services and broadband expansion. The *Telecommunications Act* contemplates a comprehensive national telecommunications framework. The policy objectives that the CRTC is always obliged to consider demonstrate that it need not limit itself to considering solely the service at issue in determining whether rates are just and reasonable. It properly treated the statutory objectives as guiding principles in the exercise of its rate-setting authority, and came to a reasonable conclusion. [73] [75] [77]

Cases Cited

Referred to: Telecom Decision CRTC 2002-34, May 30, 2002; Telecom Decision CRTC 2005-69, December 16, 2005; Telecom Decision CRTC 2003-15, March 18, 2003; Telecom Decision CRTC 2003-18, March 18, 2003; Telecom Decision CRTC 2006-9, February 16, 2006; Telecom Decision CRTC 2008-1, January 17, 2008; *Council of Canadians with Disabilities v. VIA Rail Canada Inc.*, 2007 SCC 15, [2007] 1 S.C.R. 650; *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190; *Canada (Citizenship and Immigration) v. Khosa*, 2009 SCC 12, [2009] 1 S.C.R. 339; *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186; *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140; *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12; *Canadian National Railways Co. v. Bell Telephone Co. of Canada*, [1939] 1 S.C.R. 308; Telecom Decision CRTC 97-9, May 1, 1997; Telecom Decision CRTC 94-19, September 16, 1994; *Edmonton (City) v. 360Networks Canada Ltd.*, 2007 FCA 106, [2007] 4 F.C.R. 747, leave to appeal refused, [2007] 3 S.C.R. vii; *Barrie Public Utilities v. Canadian Cable Television Assn.*, 2003 SCC 28, [2003] 1 S.C.R. 476; Telecom Decision CRTC 93-9, July 23, 1993; *Bell Canada v. Canada (Canadian Radio-television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722; *EPCOR Generation Inc. v. Energy and Utilities Board*, 2003 ABCA 374, 346 A.R. 281; *Reference Re Section 101 of the Public Utilities Act* (1998), 164 Nfld. & P.E.I.R. 60.

Statutes and Regulations Cited

Railway Act, R.S.C. 1985, c. R-3, s. 340(1).

Telecommunications Act, S.C. 1993, c. 38, ss. 7, 24, 25(1), 27, 32(g), 35(1), 37(1), 42(1), 46.5(1), 47, 52(1).

Authors Cited

Ryan, Michael H. *Canadian Telecommunications Law and Regulation.* Scarborough: Carswell, 1993 (loose-leaf updated 2008, release 2).

APPEALS from a judgment of the Federal Court of Appeal (Richard C.J. and Noël and Sharlow JJ.A.), 2008 FCA 91, 375 N.R. 124, 80 Admin. L.R. (4th) 159, [2008] F.C.J. No. 397 (QL), 2008 CarswellNat 544, affirming a decision of the Canadian Radio-television and Telecommunications Commission, 2006 LNCRTCE 9 (QL), 2006 CarswellNat 6317. Appeals dismissed.

Neil Finkelstein, Catherine Beagan Flood and *Rahat Godil*, for the appellant/respondent Bell Canada.

Michael H. Ryan, John E. Lowe, Stephen R. Schmidt and *Sonya A. Morgan*, for the appellant/respondent TELUS Communications Inc. and the respondent TELUS Communications (Québec) Inc.

Richard P. Stephenson, Danny Kastner and *Michael Janigan*, for the appellants/respondents the Consumers' Association of Canada and the National Anti-Poverty Organization and the respondent the Public Interest Advocacy Centre.

Michael Koch and *Dina F. Graser*, for the respondent MTS Allstream Inc.

John B. Laskin and *Afshan Ali*, for the respondent/intervener the Canadian Radio-television and Telecommunications Commission.

No one appeared for the respondents Société en commandite Télébec, Arch Disability Law Centre, Bell Aliant Regional Communications, Limited Partnership, and Saskatchewan Telecommunications.

The judgment of the Court was delivered by

[1] ABELLA J. — The *Telecommunications Act*, S.C. 1993, c. 38, sets out certain broad telecommunications policy objectives. It directs the Canadian Radio-television and Telecommunications Commission ("CRTC") to implement them in the exercise of its statutory authority, balancing the interests of consumers, carriers and competitors in the context of the Canadian telecommunications industry. The issue in these appeals is whether this authority was properly exercised.

[2] While distinct questions arise in each of the appeals before us, the common problem is whether the CRTC, in the exercise of its rate-setting authority, appropriately directed the allocation of funds to various purposes. In the Bell Canada and TELUS Communications Inc. appeal, the challenged purpose is the distribution of funds to customers, while in the Consumers' Association of Canada and National Anti-Poverty Organization appeal, the impugned allocation was directed at the expansion of broadband infrastructure. For the reasons that follow, in my

view the CRTC's allocations were reasonable based on the Canadian telecommunications policy objectives that it is obliged to consider in the exercise of all of its powers, including its authority to approve just and reasonable rates.

Background

[3] The CRTC issued its landmark "Price Caps Decision"[1] in May 2002. Exercising its rate-setting authority, the CRTC established a formula to regulate the maximum prices charged for certain services offered by incumbent local exchange carriers ("ILECs"), who are primarily well-established telecommunications carriers.

[4] As part of its decision, the CRTC ordered the affected carriers to create separate accounting entries in their ledgers. These were called "deferral accounts". The funds contained in these deferral accounts were derived from residential telephone service revenues in non-high cost serving areas ("non-HCSAs"), which are mainly urban. Under the formula established by the Price Caps Decision, any increase in the price charged for these services in a given year was limited to an inflationary cap, less a productivity offset to reflect the low degree of competition in that particular market.

[5] More specifically, the effect of the inflationary cap was to bar carriers from increasing their prices at a rate greater than inflation. The productivity offset, on the other hand, put downward pressure on the rates to be charged. While market forces would normally serve to encourage carriers to reduce both their costs and their prices, the low level of competition in the non-HCSA market led the CRTC to conclude that an offsetting factor was necessary as a proxy for the effect of competition.

[6] Given the countervailing factors at work in the Price Caps Decision formula, there was the potential for a decrease in the price of residential services in these areas if inflation fell below a certain level. Rather than mandating such a decrease, however, the CRTC concluded that lower prices, and therefore the prospect of lower revenues, would constitute a barrier to the entry of new carriers into this particular telecommunications market. It therefore ordered that amounts representing the difference between the rates *actually* charged, not including the decrease mandated by the Price Caps Decision formula, and the rates as *otherwise determined* through the formula, were to be collected from subscribers and recorded in deferral accounts held by each carrier. These accounts were to be reviewed annually by the CRTC. The intent of the Price Caps Decision was, therefore, that prices for these services would remain at a level sufficient to encourage market entry, while at the same time maintaining the pressure on the incumbent carriers to reduce their costs.

[7] The principal objectives the CRTC intended the Price Caps Decision to achieve were the following:

a) to render reliable and affordable services of high quality, accessible to both urban and rural area customers;

b) to balance the interests of the three main stakeholders in telecommunications markets, i.e., customers, competitors and incumbent telephone companies;

c) to foster facilities-based competition in Canadian telecommunications markets;

d) to provide incumbents with incentives to increase efficiencies and to be more innovative; and

e) to adopt regulatory approaches that impose the minimum regulatory burden compatible with the achievement of the previous four objectives. [para. 99]

[8] The CRTC discussed the future use of the deferral account funds as follows:

> The Commission anticipates that an adjustment to the deferral account would be made whenever the Commission approves rate reductions for residential local services that are proposed by the ILECs as a result of competitive pressures. The Commission also anticipates that the deferral account would be drawn down to mitigate rate increases for residential service that could result from the approval of exogenous factors or when inflation exceeds productivity. Other draw downs could occur, for example, through subscriber rebates or the funding of initiatives that would benefit residential customers in other ways. [Emphasis added; para. 412.]

At the time, it did not specifically direct how the deferral account funds were to be used, leaving the issue subject to further submissions. While some participants objected to the creation of the deferral accounts, no one appealed the Price Caps Decision (*Bell Canada v. Canadian Radio-television and Telecommunications Commission*, 2008 FCA 91, 80 Admin. L.R. (4th) 159, at para. 14).

[9] The Price Caps Decision was to apply to services offered by Bell Canada, TELUS, and other affected carriers for the four-year period from June 1, 2002 to May 31, 2006. In a decision in 2005, the CRTC extended this price regulation regime for another year to May 31, 2007.[2] The CRTC allowed some draw-downs of the deferral accounts following the Price Caps Decision that are not at issue in these appeals.

[10] In March 2003, in two separate decisions, the CRTC approved the rates for Bell Canada and TELUS.[3] In the Bell Canada decision, the CRTC appeared to contemplate the continued operation of the deferral accounts established in the Price Caps Decision. It ordered, for example, that certain tax savings be allocated to the deferral accounts:

> The Commission, in Decision 2002-34, established a deferral account in conjunction with the application of a basket constraint equal to the rate of inflation less a productivity offset to all revenues from residential services in non-HCSAs. The Commission considers that AT&T Canada's proposal to allocate the Ontario GRT and the Quebec TGE tax savings associated with all capped services to the price cap deferral account is inconsistent with that determination. The

> Commission finds that Bell Canada's proposal to include the Ontario GRT and Quebec TGE tax savings associated with the residential local services in non-HCSAs basket in the price cap deferral account is consistent with that determination. [Emphasis added; para. 32.]

[11] On December 2, 2003, Bell Canada sought the approval of the CRTC to use the balance in its deferral account to expand high-speed broadband internet service to remote and rural communities. In response, on March 24, 2004, the CRTC issued a public notice requesting submissions on the appropriate disposition of the deferral accounts.[4] Pursuant to this notice, the CRTC conducted a public process whereby proposals were invited for the disposition of the affected carriers' deferral accounts. The review was extensive and proposals were received from numerous parties.

[12] This led to the release of the "Deferral Accounts Decision" on February 16, 2006.[5] In this decision, the CRTC directed how the funds in the deferral accounts were to be used. These directions form the foundation of these appeals.

[13] After considering the various policy objectives outlined in the applicable statute, the *Telecommunications Act*, and the purposes set out in the Price Caps Decision, the CRTC concluded that all funds in the deferral accounts should be targeted for disposal by a designated date in 2006:

> The attachment to this Decision provides preliminary estimates of the deferral account balances as of the end of the fourth year of the current price cap period in 2006. The Commission notes that the deferral account balances are expected to be very large for some ILECs. It also notes the concern that allowing funds to continue to accumulate in the accounts would create inefficiencies and uncertainties.
>
> . . .
>
> Accordingly, the Commission considers it appropriate not only to provide directions on the disposition of all the funds that will have accumulated in the ILECs' deferral accounts by the end of the fourth year of the price cap period in 2006, but also to provide directions to address amounts recurring beyond this period in order to prevent further accumulation of funds in the deferral accounts. The Commission will provide directions and guidelines for disposing of these amounts later in this Decision. [Emphasis added; paras. 58 and 60.]

[14] The CRTC further decided that the deferral accounts should be disbursed primarily for two purposes. As a priority, at least 5 percent of the accounts was to be used for improving accessibility to telecommunications services for individuals with disabilities. The other 95 percent was to be used for broadband expansion in rural and remote communities. Proposals were invited on how the deferral account funds should be applied. If the proposal as approved was for less than the balance of its deferral account, an affected carrier was to distribute the remaining amount to consumers.

[15] In summary, therefore, the CRTC decided that the affected carriers should focus on broadband expansion and accessibility improvement. It also decided that if these two objectives could be fulfilled for an amount

less than the full deferral account balances, credits to subscribers would be ordered out of the remainder. It should be noted that customers were not to be compensated in proportion to what they had paid through these credits because of the potential administrative complexity of identifying these individuals and quantifying their respective shares. Instead, the credits were to be provided to certain current subscribers. Prospective rate reductions could also be used to eliminate recurring amounts in the accounts.

[16] At the time, the balance in the deferral accounts established under the Price Caps Decision was considerable. Bell Canada's account was estimated to contain approximately $480.5 million, while the TELUS account was estimated at about $170 million.

[17] It is helpful to set out how the CRTC explained its decision on the allocation of the deferral account funds. Referencing the importance of telecommunications in connecting Canada's "vast geography and relatively dispersed population", it stressed that Canada had fallen behind in the adoption of broadband services (paras. 73-74). It contrasted the wide availability of broadband service in urban areas with the less developed network in rural and remote communities. Further, it noted that the objectives outlined in the Price Caps Decision and in the *Telecommunications Act* at s. 7(*b*) provided for improving the quality of telecommunications services in those communities, and that their social and economic development would be favoured by an expansion of the national broadband network. In its view, this initiative would also provide a helpful complement to the efforts of both levels of government to expand broadband coverage. It therefore concluded that broadband expansion was an appropriate use of a part of the deferral account funds (paras. 73-80).

[18] The CRTC also explained that while customer credits would be consistent with the objectives set out in s. 7 of the *Telecommunications Act* and with the Price Caps Decision, these disbursements should not be given priority because broadband expansion and accessibility services provided greater long-term benefits. Nevertheless, credits effectively balanced the interests of the "three main stakeholders in the telecommunications markets" (para. 115), namely customers, competitors and carriers. It concluded that credits did not contradict the purpose of the deferral accounts, and contrasted one-time credits with a reduction of rates. In its view, credits, unlike rate reductions, did not have a sustained negative impact on competition in these markets, which was the concern the deferral accounts were set up to address (paras. 112-16).

[19] A dissenting Commissioner expressed concerns over the disposition of the deferral account funds. In her view, the CRTC had no mandate to direct the expansion of broadband networks across the country. The CRTC's policy had generally been to ensure the provision of a basic level of service, not services like broadband, and she therefore considered the CRTC's reliance on the objectives of the *Telecommunications Act* to be inappropriate.

[20] On January 17, 2008, the CRTC issued another decision dealing with the carriers' proposals to use their deferral account balances for the purposes set out in the Deferral Accounts Decision.[6] Some carriers' plans were approved in part, with the result that only a portion of their deferral account balances was allocated to those projects. Consequently, the CRTC required them to submit, by March 25, 2008, a plan for crediting the balance in their deferral accounts to residential subscribers in non-HCSAs.

[21] Bell Canada, as well as the Consumers' Association of Canada and the National Anti-Poverty Organization, appealed the CRTC's Deferral Accounts Decision to the Federal Court of Appeal. The Deferral Accounts Decision was stayed by Richard C.J. in the Federal Court of Appeal on January 25, 2008. The decision requiring further submissions on plans to distribute the deferral account balances was also stayed by Sharlow J.A. pending the filing of an application for leave to appeal to this Court on April 23, 2008. Both stay orders were extended by this Court on September 25, 2008. The stay orders do not apply to the funds allocated for the improvement of accessibility for individuals with disabilities.

[22] In a careful judgment by Sharlow J.A., the court unanimously dismissed the appeals (2008 FCA 91, 80 Admin. L.R. (4th) 159), concluding that the Price Caps Decision regime always contemplated the future disposition of the deferral account funds as the CRTC would direct, and that the CRTC acted within its broad mandate to pursue its regulatory objectives. For the reasons that follow, I agree with the conclusions reached by Sharlow J.A.

Analysis

[23] The parties have staked out diametrically opposite positions on how the balance of the deferral account funds should be allocated.

[24] Bell Canada argued that the CRTC had no statutory authority to order what it claimed amounted to retrospective "rebates" to consumers. In its view, the distributions ordered by the CRTC were in substance a variation of rates that had been declared final. TELUS joined Bell Canada in this Court, and argued that the CRTC's order for "rebates" constituted an unjust confiscation of property.

[25] In response, the CRTC contended that its broad mandate to set rates under the *Telecommunications Act* includes establishing and ordering the disposal of funds from deferral accounts. Because the deferral account funds had always been subject to the possibility of disbursement to customers, there was therefore no variation of a final rate or any impermissible confiscation.

[26] The Consumers' Association of Canada was the only party to oppose the allocation of 5 percent of the deferral account balances to improving accessibility, but abandoned this argument during the hearing before the Federal Court of Appeal. Together with the National Anti-Poverty Organization, it argued before this Court that the rest of the deferral account balances should be distributed to customers in full, and that the CRTC had no authority to allow the use of the funds for broadband expansion.

[27] These arguments bring us directly to the statutory scheme at issue.

[28] The *Telecommunications Act* lays out the basic legislative framework of the Canadian telecommunications industry. In addition to setting out numerous specific powers, the statute's guiding objectives are set out in s. 7. Pursuant to s. 47(a), the CRTC must consider these objectives in the exercise of *all* of its powers. These provisions state:

> **7.** It is hereby affirmed that telecommunications performs an essential role in the maintenance of Canada's identity and sovereignty and that the Canadian telecommunications policy has as its objectives
>
> (*a*) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions;
>
> (*b*) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada;
>
> (*c*) to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications;
>
> (*d*) to promote the ownership and control of Canadian carriers by Canadians;
>
> (*e*) to promote the use of Canadian transmission facilities for telecommunications within Canada and between Canada and points outside Canada;
>
> (*f*) to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective;
>
> (*g*) to stimulate research and development in Canada in the field of telecommunications and to encourage innovation in the provision of telecommunications services;
>
> (*h*) to respond to the economic and social requirements of users of telecommunications services; and
>
> (*i*) to contribute to the protection of the privacy of persons.
>
> . . .
>
> **47.** The Commission shall exercise its powers and perform its duties under this Act and any special Act
>
> (*a*) with a view to implementing the Canadian telecommunications policy objectives and ensuring that Canadian carriers provide telecommunications services and charge rates in accordance with section 27;

The CRTC relied on these two provisions in arguing that it was required to take into account a broad spectrum of considerations in the exercise of its rate-setting powers, and that the Deferral Accounts Decision was simply an extension of this approach.

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[29] The *Telecommunications Act* grants the CRTC the general power to set and regulate rates for telecommunications services in Canada. All tariffs imposed by carriers, including rates for services, must be submitted to it for approval, and it may decide any matter with respect to rates in the telecommunications services industry, as the following provisions show:

24. The offering and provision of any telecommunications service by a Canadian carrier are subject to any conditions imposed by the Commission or included in a tariff approved by the Commission.

25. (1) No Canadian carrier shall provide a telecommunications service except in accordance with a tariff filed with and approved by the Commission that specifies the rate or the maximum or minimum rate, or both, to be charged for the service.

. . .

32. The Commission may, for the purposes of this Part,

. . .

(*g*) in the absence of any applicable provision in this Part, determine any matter and make any order relating to the rates, tariffs or telecommunications services of Canadian carriers.

[30] The guiding rule of rate-setting under the *Telecommunications Act* is that the rates be "just and reasonable", a longstanding regulatory principle. To determine whether rates meet this standard, the CRTC has a wide discretion which is protected by a privative clause:

27. (1) Every rate charged by a Canadian carrier for a telecommunications service shall be just and reasonable.

. . .

(3) The Commission may determine in any case, as a question of fact, whether a Canadian carrier has complied with section 25, this section or section 29, or with any decision made under section 24, 25, 29, 34 or 40.

. . .

(5) In determining whether a rate is just and reasonable, the Commission may adopt any method or technique that it considers appropriate, whether based on a carrier's return on its rate base or otherwise.

. . .

52. (1) The Commission may, in exercising its powers and performing its duties under this Act or any special Act, determine any question of law or of fact, and its determination on a question of fact is binding and conclusive.

[31] In addition to the power under s. 27(5) to adopt "any method or technique that it considers appropriate" for determining whether a rate is just and reasonable, the CRTC also has the authority under s. 37(1) to order a carrier to adopt "any accounting method or system of accounts" in view of the proper administration of the *Telecommunications Act*. Section 37(1) states:

37. (1) The Commission may require a Canadian carrier

(*a*) to adopt any method of identifying the costs of providing telecommunications services and to adopt any accounting method or system of accounts for the purposes of the administration of this Act;

[32] The CRTC has other broad powers which, while not at issue in this case, nevertheless further demonstrate the comprehensive regulatory powers Parliament intended to grant. These include the ability to order a Canadian carrier to provide any service in certain circumstances (s. 35(1)); to require communications facilities to be provided or constructed (s. 42(1)); and to establish any sort of fund for the purpose of supporting access to basic telecommunications services (s. 46.5(1)).

[33] This statutory overview assists in dealing with the preliminary issue of the applicable standard of review. Although the Federal Court of Appeal accepted the parties' position that the applicable standard of review was correctness, Sharlow J.A. acknowledged that the standard of review could be more deferential in light of this Court's decision in *Council of Canadians with Disabilities v. VIA Rail Canada Inc.*, 2007 SCC 15, [2007] 1 S.C.R. 650, at paras. 98-100. This was an invitation, it seems to me, to clarify what the appropriate standard is.

[34] Bell Canada and TELUS concede that the CRTC had the authority to approve disbursements from the deferral accounts for initiatives to improve broadband expansion and accessibility to telecommunications services for persons with disabilities, and that they actually sought such approval. In their view, however, this authority did not extend to what they characterized as retrospective "rebates". Similarly, in the Consumers' appeal the crux of the complaint is with whether the CRTC could direct that the funds be disbursed in certain ways, not with whether it had the authority to direct how the funds ought to be spent generally.

[35] This means that for the Bell Canada and TELUS appeal, the dispute is over the CRTC's authority and discretion under the *Telecommunications Act* in connection with ordering credits to customers from the deferral accounts. In the Consumers' appeal, it is over its authority and discretion in ordering that funds from the deferral accounts be used for the expansion of broadband services.

[36] A central responsibility of the CRTC is to determine and approve just and reasonable rates to be charged for telecommunications services. Together with its rate-setting power, the CRTC has the ability to impose *any* condition on the provision of a service, adopt *any* method to determine whether a rate is just and reasonable and require a carrier to adopt *any* accounting method. It is obliged to exercise all of its powers and duties with a view to implementing the Canadian telecommunications policy objectives set out in s. 7.

[37] The CRTC's authority to establish the deferral accounts is found through a combined reading of ss. 27 and 37(1). The authority to establish these accounts necessarily includes the disposition of the funds they contain, a disposition which represents the final step in a process set in motion by the Price Caps Decision. It is self-evident that the CRTC has considerable expertise with respect to this type of question. This observation is reflected in its extensive statutory powers in this regard and in the strong privative clause in s. 52(1) protecting its determinations on questions of fact from appeal, including whether a carrier has adopted a just and reasonable rate.

[38] In my view, therefore, the issues raised in these appeals go to the very heart of the CRTC's specialized expertise. In the appeals before us, the core of the quarrel in effect is with the methodology for setting rates and the allocation of certain proceeds derived from those rates, a polycentric exercise with which the CRTC is statutorily charged and which it is uniquely qualified to undertake. This argues for a more deferential standard of review, which leads us to consider whether the CRTC was reasonable in directing how the funds from the deferral accounts were to be used. (See *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190, at para. 54; *Canada (Citizenship and Immigration) v. Khosa*, 2009 SCC 12, [2009] 1 S.C.R. 339, at para. 25; and *VIA Rail Canada*, at paras. 88-100.)

[39] This brings us to the nature of the CRTC's rate-setting power in the context of this case. The predecessor statute for telecommunications rate-setting, the *Railway Act*, R.S.C. 1985, c. R-3, also stipulated that rates be "just and reasonable" (s. 340(1)). Traditionally, those rates were based on a balancing between a fair rate for the consumer and a fair return on the carrier's investment. (See, e.g., *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186, at pp. 192-93, and *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140, at para. 65.)

[40] Even before the expansive language now found in the *Telecommunications Act*, regulatory agencies had enjoyed considerable discretion in determining the factors to be considered and the methodology that could be adopted for assessing whether rates were just and reasonable. For instance, in dismissing a leave application in *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12 (S.C.C.), Taschereau J. wrote:

> [I]f the Board is bound to grant a relief which is just to the public and secures to the railways a fair return, it is not bound to accept for the determination of the rates to be charged, the sole method proposed by the applicant. The obligation to act is a question of law, but the choice of the method to be adopted is a question of discretion with which, under the statute, no Court of law may interfere. [Emphasis added; p. 13.]

In making this determination, he relied on Duff C.J.'s judgment in *Canadian National Railways Co. v. Bell Telephone Co. of Canada*, [1939] S.C.R. 308, for the following proposition in the particular statutory context of that case:

> The law dictates neither the order to be made in a given case nor the considerations by which the Board is to be guided in arriving at the conclusion that an order, or what order, is necessary or proper in a given case. True, it is the duty of all public bodies and others invested with statutory powers to act reasonably in the execution of them, but the policy of the statue [*sic*] is that, subject to the appeal to the Governor in Council under section 52, in exercising an administrative discretion entrusted to it, the Board itself is to be the final arbiter as to the order to be made. [p. 315]

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(See also Michael H. Ryan, *Canadian Telecommunications Law and Regulation* (loose-leaf), at §612.)

[41] The CRTC's already broad discretion in determining whether rates are just and reasonable has been further enhanced by the inclusion of s. 27(5) in the *Telecommunications Act* permitting the CRTC to adopt "any method", language which was absent from the *Railway Act*.

[42] Even more significantly, the *Railway Act* contained nothing analogous to the statutory direction under s. 47 that the CRTC must exercise its rate-setting powers with a view to implementing the Canadian telecommunications objectives set out in s. 7. These statutory additions are significant. Coupled with its rate-setting power, and its ability to use any method for arriving at a just and reasonable rate, these provisions contradict the restrictive interpretation of the CRTC's authority proposed by various parties in these appeals.

[43] This was highlighted by Sharlow J.A. when she stated:

> Because of the combined operation of section 47 and section 7 of the *Telecommunications Act* . . ., the CRTC's rating jurisdiction is not limited to considerations that have traditionally been considered relevant to ensuring a fair price for consumers and a fair rate of return to the provider of telecommunication services. Section 47 of the *Telecommunications Act* expressly requires the CRTC to consider, as well, the policy objectives listed in section 7 of the *Telecommunications Act*. What that means, in my view, is that in rating decisions under the *Telecommunications Act*, the CRTC is entitled to consider any or all of the policy objectives listed in section 7. [para. 35]

[44] It is true that the CRTC had previously used a "rate base rate of return" method, based on a combination of a rate of return for investors in telecommunications carriers and a rate base calculated using the carriers' assets. This resulted in rates charged for the carrier's services that would, on the one hand, provide a fair return for the capital invested in the carrier, and, on the other, be fair to the customers of the carrier.

[45] However, these expansive provisions mean that the rate base rate of return approach is not necessarily the only basis for setting a just and reasonable rate. Furthermore, based on ss. 7, 27(5) and 47, the CRTC is not required to confine itself to balancing only the interests of subscribers and carriers with respect to a particular service. In the Price Caps Decision, for example, the CRTC chose to focus on maximum prices for services, rather than on the rate base rate of return approach. It did so, in part, to foster competition in certain markets, a goal untethered to the direct relationship between the carrier and subscriber in the traditional rate base rate of return approach. A similar pricing approach was adopted by the CRTC in a decision preceding the Price Caps Decision.[7]

[46] The CRTC has interpreted these provisions broadly and identified them as responsive to the evolved industry context in which it operates. In its "Review of Regulatory Framework" decision,[8] it wrote:

> The Act . . . provides the tools necessary to allow the Commission to alter the traditional manner in which it regulates (i.e., to depart from rate base rate of return regulation).
>
> . . .
>
> In brief, telecommunications today transcends traditional boundaries and simple definition. It is an industry, a market and a means of doing business that encompasses a constantly evolving range of voice, data and video products and services. . . .
>
> In this context, the Commission notes that the Act contemplates the evolution of basic service by setting out as an objective the provision of reliable and affordable telecommunications, rather than merely affordable telephone service. [Emphasis added; pp. 6 and 10.]

[47] In *Edmonton (City) v. 360Networks Canada Ltd.*, 2007 FCA 106, [2007] 4 F.C.R. 747, leave to appeal refused, [2007] 3 S.C.R. vii, the Federal Court of Appeal drew similar conclusions, observing that the *Telecommunications Act* should be interpreted by reference to the policy objectives, and that s. 7 justified in part the view that the "Act should be interpreted as creating a comprehensive regulatory scheme" (para. 46). A duty to take a more comprehensive approach was also noted by Ryan, who observed:

> Because of the importance of the telecommunications industry to the country as a whole, rate-making issues may sometimes assume a dimension that gives them a significance that extends beyond the immediate interests of the carrier, its shareholders and its customers, and engages the interests of the public at large. It is also part of the duty of the regulator to take these more far-reaching interests into account. [§604]

[48] This leads inevitably, it seems to me, to the conclusion that the CRTC may set rates that are just and reasonable for the purposes of the *Telecommunications Act* through a diverse range of methods, taking into account a variety of different constituencies and interests referred to in s. 7, not simply those it had previously considered when it was operating under the more restrictive provisions of the *Railway Act*. This observation will also be apposite later in these reasons when the question of "final rates" is discussed in connection with the Bell Canada appeal.

[49] I see nothing in this conclusion which contradicts the ratio in *Barrie Public Utilities v. Canadian Cable Television Assn.*, 2003 SCC 28, [2003] 1 S.C.R. 476. In that case, the issue was whether the CRTC could make an order granting cable companies access to certain utilities' power poles. In that decision, the CRTC had relied on the Canadian telecommunications policy objectives to inform its interpretation of the relevant provisions. In deciding that the language of the *Telecommunications Act* did not give the CRTC the power to grant access to the power poles, Gonthier J. for the majority concluded that the CRTC had inappropriately interpreted the Canadian telecommunications policy objectives in s. 7 as power-conferring (para. 42).

[50] The circumstances of *Barrie Public Utilities* are entirely distinct from those at issue before us. Here, we are dealing with the CRTC setting rates that were required to be just and reasonable, an authority fully supported by unambiguous statutory language. In so doing, the CRTC was exercising a broad authority, which, according to s. 47, it was required to do "with a view to implementing the Canadian telecommunications policy objectives". The policy considerations in s. 7 were factors that the CRTC was required to, and did, take into account.

[51] Nor does this Court's decision in *ATCO* preclude the pursuit of public interest objectives through rate-setting. In that case, Bastarache J. for the majority, took a strict approach to the Alberta Energy and Utilities Board's powers under the applicable statute. The issue was whether the Board had the authority to order the distribution of proceeds by a regulated company to its subscribers from an asset sale it had approved. It was argued that because the Board had the authority to make "further orders" and impose conditions "in the public interest" on any order, it therefore had the ability to order the disposition of the sale proceeds.

[52] In holding that the Board had no such authority, Bastarache J. relied in part on the conclusion that the Board's statutory power to make orders or impose conditions in the public interest was insufficiently precise to grant the ability to distribute sale proceeds to ratepayers (para. 46). The ability of the Board to approve an asset sale, and its authority to make any order it wished in the public interest, were necessarily limited by the context of the relevant provisions (paras. 46-48 and 50). It was obliged too to adopt a rate base rate of return method to determine rates, pursuant to its governing statute (paras. 65-66).

[53] Unlike *ATCO*, in the case before us, the CRTC's rate-setting authority and its ability to establish deferral accounts for this purpose are at the very core of its competence. The CRTC is statutorily authorized to adopt *any* method of determining just and reasonable rates. Furthermore, it is required to consider the statutory objectives in the exercise of its authority, in contrast to the permissive, free-floating direction to consider the public interest that existed in *ATCO*. The *Telecommunications Act* displaces many of the traditional restrictions on rate-setting described in *ATCO*, thereby granting the CRTC the ability to balance the interests of carriers, consumers and competitors in the broader context of the Canadian telecommunications industry (Review of Regulatory Framework decision, at pp. 6 and 10).

[54] The fact that deferral accounts are at issue does nothing to change this framework. No party objected to the CRTC's authority to establish the deferral accounts themselves. These accounts are accepted regulatory tools, available as a part of the Commission's rate-setting powers. As the CRTC has noted, deferral accounts "enabl[e] a regulator to defer consideration of a particular item of expense or revenue that is incapable of being forecast with certainty for the test year".[9] They have traditionally protected against future eventualities, particularly the difference between forecasted and actual costs and revenues, allowing a regulator to shift costs and expenses from one regulatory period to another. While the CRTC's creation and use of the deferral accounts for broadband expansion and consumer credits may have been innovative, it was fully supported by the provisions of the *Telecommunications Act*.

[55] In my view, it follows from the CRTC's broad discretion to determine just and reasonable rates under s. 27, its power to order a carrier to adopt any accounting method under s. 37, and its statutory mandate under s. 47 to implement the wide-ranging Canadian telecommunications policy objectives set out in s. 7, that the *Telecommunications Act* provides the CRTC with considerable scope in establishing and approving the use to be made of deferral accounts. They were created in accordance both with the CRTC's rate-setting authority and with the goal that all rates charged by carriers were and would remain just and reasonable.

[56] A deferral account would not serve its purpose if the CRTC did not also have the power to order the disposition of the funds contained in it. In my view, the CRTC had the authority to order the disposition of the accounts in the exercise of its rate-setting power, provided that this exercise was reasonable.

[57] I therefore agree with the following observation by Sharlow J.A.:

> The Price Caps Decision required Bell Canada to credit a portion of its final rates to a deferral account, which the CRTC had clearly indicated would be disposed of in due course as the CRTC would direct. There is no dispute that the CRTC is entitled to use the device of a mandatory deferral account to impose a contingent obligation on a telecommunication service provider to make expenditures that the CRTC may direct in the future. It necessarily follows that the CRTC is entitled to make an order crystallizing that obligation and directing a particular expenditure, provided the expenditure can reasonably be justified by one or more of the policy objectives listed in section 7 of the *Telecommunications Act*. [Emphasis added; para. 52.]

[58] This general analytical framework brings us to the more specific questions in these appeals. In the first appeal, Bell Canada relied on Gonthier J.'s decision *Bell Canada v. Canada (Canadian Radio-television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722 ("*Bell Canada (1989)*"), to argue that "final" rates cannot be changed and that the funds in the deferral accounts could not, therefore, be distributed as "rebates" to customers.

[59] In *Bell Canada (1989)*, the CRTC approved a series of interim rates. It subsequently reviewed them in light of Bell Canada's changed financial situation, and ordered the carrier to credit what it considered to be excess revenues to its current subscribers. Arguing against the CRTC's authority to do so, Bell Canada contended that the CRTC could not order a one-time credit with respect to revenues earned from rates approved by the CRTC, whether the rate order was an interim one or not. Gonthier J. observed that while the *Railway Act* contemplated a positive approval scheme that only allowed for prospective, not retroactive or retrospective rate-setting, the one-time credit at issue was nevertheless permissible because the original rates were interim and therefore inherently subject to change.

[60] In the current case, Bell Canada argued that the rates had been made final, and that the disposition of the deferral accounts for one-time credits was therefore impermissible. More specifically, it argued that the CRTC's

order of one-time credits from the deferral accounts amounted to retrospective rate-setting as the term was used in *Bell Canada (1989)*, at p. 1749, namely, that their "purpose is to remedy the imposition of rates approved in the past and found in the final analysis to be excessive".

[61] In my view, because this case concerns encumbered revenues in deferral accounts (referred to by Sharlow J.A. as contingent obligations or liabilities), we are not dealing with the variation of final rates. As Sharlow J.A. pointed out, *Bell Canada (1989)* is inapplicable because it was known from the outset in the case before us that Bell Canada would be obliged to use the balance of its deferral account in accordance with the CRTC's subsequent direction (para. 53).

[62] It would, with respect, be an oversimplification to consider that *Bell Canada (1989)* applies to bar the provision of credits to consumers in this case. *Bell Canada (1989)* was decided under the *Railway Act*, a statutory scheme that, significantly, did not include any of the considerations or mandates set out in ss. 7, 27(5) and 47 of the *Telecommunications Act*. Nor did it involve the disposition of funds contained in deferral accounts.

[63] In my view, the credits ordered out of the deferral accounts in the case before us are neither retroactive nor retrospective. They do not vary the original rate as approved, which included the deferral accounts, nor do they seek to remedy a deficiency in the rate order through later measures, since these credits or reductions were contemplated as a possible disposition of the deferral account balances from the beginning. These funds can properly be characterized as encumbered revenues, because the rates *always* remained subject to the deferral accounts mechanism established in the Price Caps Decision. The use of deferral accounts therefore precludes a finding of retroactivity or retrospectivity. Furthermore, using deferral accounts to account for the difference between forecast and actual costs and revenues has traditionally been held not to constitute retroactive rate-setting (*EPCOR Generation Inc. v. Energy and Utilities Board*, 2003 ABCA 374, 346 A.R. 281, at para. 12, and *Reference Re Section 101 of the Public Utilities Act* (1998), 164 Nfld. & P.E.I.R. 60 (Nfld. C.A.), at paras. 97-98 and 175).

[64] The Deferral Accounts Decision was the culmination of a process undertaken in the Price Caps Decision. In the Price Caps Decision, the CRTC indicated that the amounts in the deferral accounts were to be used in a manner contributing to achieving the CRTC's objectives (paras. 409 and 412). In the Deferral Accounts Decision, the CRTC summarized its earlier findings that draw-downs could occur for various purposes, including through subscriber credits (para. 6). When the CRTC approved the rates derived from the Price Caps Decision, the portion of the revenues that went into the deferral accounts remained encumbered. The deferral accounts, and the encumbrance to which the funds recorded in them were subject, were therefore an integral part of the rate-setting exercise ensuring that the rates approved were just and reasonable. It follows that nothing in the Deferral Accounts Decision changed either the Price Caps Decision or any other prior CRTC decision on this point. The CRTC's later allocation of deferral account balances for various purposes, therefore, including customer credits, was not a variation of a final rate order.

[65] The allocation of deferral account funds to consumers was not, strictly speaking, a "rebate" in any event. Instead, as in *Bell Canada (1989)*, these allocations were one-time disbursements or rate reductions the

carriers were required to make out of the deferral accounts to their *current* subscribers. The possibility of one-time credits was present from the inception of the rate-setting exercise. From the Price Caps Decision onwards, it was understood that the disposition of the deferral account funds might include an eventual credit to subscribers once the CRTC determined the appropriate allocation. It was precisely because the rate-setting mechanism approved by the CRTC included accumulation in and disposition from the deferral accounts pursuant to further CRTC orders, that the rates were and continued to be just and reasonable.

[66] Therefore, rather than viewing *Bell Canada (1989)* as setting a strict rule that subscriber credits can never be ordered out of revenues derived from final rates, it is important to remember Gonthier J.'s concern that the financial stability of regulated utilities could be undermined if rates were open to indiscriminate variation (p. 1760). Nothing in the Deferral Accounts Decision undermined the financial stability of the affected carriers. The amounts at issue were always treated differently for accounting purposes, and the regulated carriers were aware of the fact that the portion of their revenues going into the deferral accounts remained encumbered. In fact, the Price Caps Decision formula would have allowed for *lower* rates than the ones ultimately set, were it not for the creation of the deferral accounts. Those lower rates could conceivably have been considered sufficient to maintain the financial stability of the carriers and were increased only in an effort to encourage market entry by new competitors.

[67] TELUS argued additionally that the Deferral Accounts Decision constituted a confiscation of its property. This is an argument I have difficulty accepting. The funds in the accounts never belonged unequivocally to the carriers, and always consisted of encumbered revenues. Had the CRTC intended that these revenues be used for any purposes the affected carriers wanted, it could simply have approved the rates as just and reasonable and ordered the balance of the deferral accounts turned over to them. It chose not to do so.

[68] It is also worth noting that in approving Bell Canada's rates, the CRTC ordered it to allocate certain tax savings to the deferral accounts.[10] Neither the CRTC, nor Bell Canada, could possibly have expected that the company would be able to keep that portion of its rate revenue representing a past liability for taxes that it was in fact not currently liable to pay or defer.

[69] For the above reasons, I would dismiss the Bell Canada and TELUS appeal.

[70] The premise underlying the Consumers' Association of Canada appeal is that the disposition of some deferral account funds for broadband expansion highlighted the fact that the rates charged by carriers were, in a certain sense, not just and reasonable. Consumers can only succeed if it can demonstrate that the CRTC's decision was unreasonable.

[71] At its core, Consumers' primary argument was that the Deferral Accounts Decision effectively forced users of a certain service (residential subscribers in certain areas) to subsidize users of another service (the future users of broadband services) once the expansion of broadband infrastructure was completed. In its view, this was an

indication that the rates charged to residential users were not in fact just and reasonable, and that therefore the balance in the deferral accounts, excluding the disbursements for accessibility services, should be distributed to customers.

[72] As previously noted, the deferral accounts were created and disbursed pursuant to the CRTC's power to approve just and reasonable rates, and were an integral part of such rates. Far from rendering these rates inappropriate, the deferral accounts *ensured* that the rates were just and reasonable. And the policy objectives in s. 7, which the CRTC is always obliged to consider, demonstrate that the CRTC need not limit itself to considering solely the service at issue in determining whether rates are just and reasonable. The statute contemplates a comprehensive national telecommunications framework. It does not require the CRTC to atomize individual services. It is for the CRTC to determine a tolerable level of cross-subsidization.

[73] Nor does the traditional approach to telecommunications regulation support Consumers' argument. Long-distance telephone users have long subsidized local telephone users (Price Caps Decision, at para. 2). Therefore, while rates for individual services covered by the *Telecommunications Act* may be evaluated on a just and reasonable basis, rates are not necessarily rendered unreasonable or unjust simply because there is some cross-subsidization between services. (See Ryan, at §604, for the proposition that the CRTC can determine the appropriate extent of cross-subsidization for a given telecommunications carrier.)

[74] In my view, the CRTC properly considered the objectives set out in s. 7 when it ordered expenditures for the expansion of broadband infrastructure and consumer credits. In doing so, it treated the statutory objectives as guiding principles in the exercise of its rate-setting authority. Pursuing policy objectives through the exercise of its rate-setting power is precisely what s. 47 requires the CRTC to do in setting just and reasonable rates.

[75] In deciding to allocate the deferral account funds to improving accessibility services and broadband expansion in rural and remote areas, the CRTC had in mind its statutorily mandated objectives of facilitating "the orderly development throughout Canada of a telecommunications system that serves to . . . strengthen the social and economic fabric of Canada" under s. 7(*a*); rendering "reliable and affordable telecommunications services . . . to Canadians in both urban and rural areas" under s. 7(*b*); and responding "to the economic and social requirements of users of telecommunications services" pursuant to s. 7(*h*).

[76] The CRTC heard from several parties, considered its statutorily mandated objectives in exercising its powers, and decided on an appropriate course of action. Under the circumstances, I have no hesitation in holding that the CRTC made a reasonable decision in ordering broadband expansion.

[77] I would therefore conclude that the CRTC did exactly what it was mandated to do under the *Telecommunications Act*. It had the statutory authority to set just and reasonable rates, to establish the deferral

accounts, and to direct the disposition of the funds in those accounts. It was obliged to do so in accordance with the telecommunications policy objectives set out in the legislation and, as a result, to balance and consider a wide variety of objectives and interests. It did so in these appeals in a reasonable way, both in ordering subscriber credits and in approving the use of the funds for broadband expansion.

[78] I would dismiss the appeals. At the request of all parties, there will be no order for costs.

Appeals dismissed.

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[1] Telecom Decision CRTC 2002-34, May 30, 2002 (online: www.crtc.gc.ca/eng/archive/2002/dt2002-34.htm).

[2] Telecom Decision CRTC 2005-69, December 16, 2005 (online: www.crtc.gc.ca/eng/archive/2005/dt2005-69.htm).

[3] Telecom Decision CRTC 2003-15, March 18, 2003 (online: www.crtc.gc.ca/eng/archive/2003/dt2003-15.htm) and Telecom Decision CRTC 2003-18, March 18, 2003 (online: www.crtc.gc.ca/eng/archive/2003/dt2003-18.htm).

[4] Telecom Public Notice CRTC 2004-1.

[5] Telecom Decision CRTC 2006-9 (online: www.crtc.gc.ca/eng/archive/2006/dt2006-9.htm).

[6] Telecom Decision CRTC 2008-1 (online: www.crtc.gc.ca/eng/archive/2008/dt2008-1.htm).

[7] Telecom Decision CRTC 97-9, May 1, 1997 (online: www.crtc.gc.ca/eng/archive/1997/DT97-9.htm).

[8] Telecom Decision CRTC 94-19, September 16, 1994 (online: www.crtc.gc.ca/eng/archive/1994/DT94-19.htm).

[9] Telecom Decision CRTC 93-9, July 23, 1993 (online: www.crtc.gc.ca/eng/archive/1993/DT93-9.htm).

[10] Telecom Decision CRTC 2003-15, at para. 32.

Arkansas Louisiana Gas Co. v. Hall
453 U.S. 571 (1981)

Syllabus | Case

U.S. Supreme Court

Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981)

Arkansas Louisiana Gas Co. v. Hall

No. 78-1789

Argued April 20, 1981

Decided July 2, 1981

453 U.S. 571

CERTIORARI TO THE SUPREME COURT OF LOUISIANA

Syllabus

In 1952, respondent natural gas producers and petitioner entered into a contract under which respondents agreed to sell petitioner natural gas from a certain gas field in Louisiana. The contract contained a fixed price schedule and a "favored nations clause," which provided that, if petitioner purchased gas from the gas field from another party at a higher rate than it was paying respondents, then respondents would be entitled to a higher price for their sales to petitioner. In 1954, respondents filed the contract and their rates with the Federal Power Commission (now the Federal Energy Regulatory

Commission and obtained from it a certificate authorizing the sale of gas at the specified contract rates. In 1961, petitioner purchased certain leases in the same gas field from the United States and began producing gas on its leasehold. In 1974, respondents filed an action in a Louisiana state court, contending that petitioner's lease payments to the United States had triggered the favored nations clause. Because petitioner had not increased its payments to respondents as required by that clause, respondents sought as damages an amount equal to the difference between the price they actually were paid in the intervening years and the price they would have been paid had that clause gone into effect. Although finding that the clause had been triggered, the trial court held that the "filed rate doctrine," which prohibits a federally regulated seller of natural gas from charging rates higher than those filed with the Commission pursuant to the Natural Gas Act, precluded an award of damages for the period prior to 1972 (the time during which respondents were subject to the Commission's jurisdiction). The intermediate appellate court affirmed, but the Louisiana Supreme Court reversed, holding that respondents were entitled to damages for the period between 1961 and 1972 notwithstanding the filed rate doctrine. The court reasoned that petitioner's failure to inform respondents of the lease payments to the United States had prevented respondents from filing rate increases with the Commission, and that, if they had done so, the increases would have been approved.

Held: The filed rate doctrine prohibits the award of damages for petitioner's breach during the period that respondents were subject to the Commission's jurisdiction. Pp. 453 U. S. 576-585.

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(a) The Natural Gas Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission, and prevents the Commission itself from imposing a rate increase for gas already sold. Here, the Louisiana Supreme Court's ruling amounts to nothing less than the award of a retroactive rate increase based on speculation about what the Commission might have done had it been faced with the facts of this case. This is precisely what the filed rate doctrine forbids. It would undermine the congressional scheme of uniform rate regulation to allow a state court to award as damages a rate never filed with the Commission, and thus never found to be reasonable within the meaning of the Act. Pp. 453 U. S. 576-579.

(b) Congress has granted exclusive authority over rate regulation to the Commission, and, in so doing, withheld the authority to grant retroactive rate increases or to permit collection of a rate other than the one on file. It would be inconsistent with this purpose to permit a state court to do through a breach of contract action what the Commission may

not do. Under the filed rate doctrine, the Commission alone is empowered to approve the higher rate respondents might have filed with it, and until it has done so, no rate other than the one on file may be charged. The court below thus has usurped a function that Congress has assigned to a federal regulatory body. *Cf. Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co.,* 450 U. S. 311. This the Supremacy Clause will not permit. Pp. 453 U. S. 579-582.

(c) Under the filed rate doctrine, when there is a conflict between the filed rate and the contract rate, the filed rate prevails. P. 453 U. S. 582.

(d) Permitting the state court to award what amounts to a retroactive right to collect a rate in excess of the filed rate "only accentuates the danger of conflict," and no appeal to equitable principles can justify such usurpation of federal authority. Pp. 453 U. S. 583-584.

368 So.2d 984, affirmed in part, vacated in part, and remanded.

MARSHALL, J., delivered the opinion of the Court, in which BURGER, C.J., and BRENNAN, WHITE, and BLACKMUN, JJ., joined. POWELL, J., filed a dissenting opinion, *post,* p. 453 U. S. 585. STEVENS, J., filed a dissenting opinion, in which REHNQUIST, J., joined, *post,* p. 453 U. S. 586. STEWART, J., took no part in the consideration or decision of the case.

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JUSTICE MARSHALL delivered the opinion of the Court.

The "filed rate doctrine" prohibits a federally regulated seller of natural gas from charging rates higher than those filed with the Federal Energy Regulatory Commission pursuant to the Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. § 717 *et seq.* (1976 ed. and Supp. III). The question before us is whether that doctrine forbids a state court to calculate damages in a breach of contract action based on an assumption that, had a higher rate been filed, the Commission would have approved it.

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I

Respondents are producers of natural gas, and petitioner Arkansas Louisiana Gas Co. (Arkla) is a customer who buys their gas. In 1952, respondents [Footnote 1] and Arkla entered into a contract under which respondents agreed to sell Arkla natural gas from the Sligo Gas Field in Louisiana. The contract contained a fixed price schedule and a

"favored nations clause." The favored nations clause provided that, if Arkla purchased Sligo Field natural gas from another party at a rate higher than the one it was paying respondents, then respondents would be entitled to a higher price for their sales to Arkla. [Footnote 2]

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In 1954, respondents filed with the Federal Power Commission (now the Federal Energy Regulatory Commission) [Footnote 3] the contract and their rates and obtained from the Commission a certificate authorizing the sale of gas at the rates specified in the contract.

In September, 1961, Arkla purchased certain leases in the Sligo Field from the United States and began producing gas on its leasehold. In 1974, respondents filed this state court action contending that Arkla's lease payments to the United States had triggered the favored nations clause. Because Arkla had not increased its payments to respondents as required by the clause, respondents sought as damages an amount equal to the difference between the price they actually were paid in the intervening years and the price they would have been paid had the favored nations clause gone into effect.

In its answer, Arkla denied that its lease payments were purchases of gas within the meaning of the favored nations clause. Arkla subsequently amended its answer to allege in addition that the Commission had primary jurisdiction over the issues in contention. Arkla also sought a Commission ruling that its lease payments had not triggered the favored nations clause. The Commission did not act immediately, and the case proceeded to trial. The state trial court found that Arkla's payments had triggered the favored nations clause, but nonetheless held that the filed rate doctrine precluded

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an award of damages for the period prior to 1972. The intermediate appellate court affirmed, 359 So.2d 255 (1978), and both parties sought leave to appeal. The Supreme Court of Louisiana denied Arkla's petition for appeal, 362 So.2d 1120 (1978), and Arkla sought certiorari in this Court on the question whether the interpretation of the favored nations clause should have been referred to the Commission. We denied the petition. 444 U.S. 878 (1979).

While Arkla's petition for certiorari was pending, the Supreme Court of Louisiana granted respondents' petition for review and reversed the intermediate court on the measure of damages. 368 So.2d 984 (1979). The court held that respondents were entitled to damages for the period between 1961 and 1972 notwithstanding the filed rate doctrine.

The court reasoned that Arkla's failure to inform respondents of the lease payments to the United States had prevented respondents from filing rate increases with the Commission, and that, had respondents filed rate increases with the Commission, the rate increases would have been approved. *Id.* at 991. After the decision by the Supreme Court of Louisiana, the Commission, in May, 1979, finally declined to exercise primary jurisdiction over the case, holding that the interpretation of the favored nations clause raised no matters on which the Commission had particular expertise. *Arkansas Louisiana Gas Co. v. Hall,* 7 FERC 61, 175, p. 61,321. [Footnote 4] The Commission

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did, however, state: "It is our opinion that the Louisiana Supreme Court's award of damages for the 1961-1972 period violates the filed rate doctrine." *Id.* at 61,325. n. 18. [Footnote 5] Under that doctrine, no regulated seller is legally entitled to collect a rate in excess of the one filed with the Commission for a particular period. *See infra* at 453 U. S. 576-579. We granted Arkla's subsequent petition for certiorari challenging the judgment of the Louisiana Supreme Court. 449 U.S. 1109 (1981). [Footnote 6]

II

Sections 4 (c) and 4 (d) of the Natural Gas Act, 52 Stat. 822 823, 15 U.S.C. §§ 717c(c) and 717c(d), require sellers of

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natural gas in interstate commerce to file their rates with the Commission. Under § 4(a) of the Act, 2 Stat. 822, 15 U.S.C. § 717c(a), the rates that a regulated gas company files with the Commission for sale and transportation of natural gas are lawful only if they are "just and reasonable." No court may substitute its own judgment on reasonableness for the judgment of the Commission. The authority to decide whether the rates are reasonable is vested by § 4 of the Act solely in the Commission, *see FPC v. Hope Natural Gas Co.,* 320 U. S. 591, 320 U. S. 611 (1944), and "the right to a reasonable rate is the right to the rate which the Commission files or fixes," *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.,* 341 U. S. 246, 341 U. S. 251 (1951). [Footnote 7] Except when the Commission permits a waiver, no regulated seller of natural gas may collect a rate other than the one filed with the Commission. § 4(d), 52 Stat. 823, 15 U.S.C. § 717c(d). These straightforward principles underlie the "filed rate doctrine," which forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority. *See, e.g., T.I.M.E. Inc. v. United States,*

359 U. S. 464, 359 U. S. 473 (1959). The filed rate doctrine has its origins in this Court's cases interpreting the Interstate Commerce Act, *see, e.g., Lowden v. Simonds-Shields-Lonsdale Grain Co.,* 306 U. S. 516, 306 U. S. 520-521 (1939); *Pennsylvania R. Co. v. International Coal Co.,* 230 U. S. 184, 230 U. S. 196-197 (1913), and has been extended across the spectrum of regulated utilities.

"The considerations underlying the doctrine . . . are preservation of the agency's primary jurisdiction

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over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant."

City of Cleveland v. FPC, 174 U.S.App.D.C. 1, 10, 525 F.2d 845, 854 (1976). *See City of Piqua v. FERC,* 198 U.S.App.D.C. 8, 13, 610 F.2d 950, 955 (1979).

Not only do the courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively. [Footnote 8] When the Commission finds a rate unreasonable, it "shall determine the just and reasonable rate . . . to be *thereafter* observed and in force." § 5(a), 52 Stat. 823, 15 U.S.C. § 717d(a) (emphasis added). *See, e.g., FPC v. Tennessee Gas Co.,* 371 U. S. 145, 371 U. S. 152-153 (1962); *FPC v. Sierra Pacific Power Co.,* 350 U. S. 348, 350 U. S. 353 (1956). This rule bars "the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate." *City of Piqua v. FERC, supra,* at 12, 610 F.2d at 954.

In sum, the Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission, and prevents the Commission itself from imposing a rate increase for gas already sold. Petitioner Arkla and the Commission as *amicus curiae* both argue that these rules, taken in tandem, are sufficient to dispose of this case. No matter how the ruling of the Louisiana Supreme Court may be characterized, they argue, it amounts to nothing less than the award of a retroactive rate increase based on speculation

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about what the Commission might have done had it been faced with the facts of this case. This, they contend, is precisely what the filed rate doctrine forbids. We agree. It would undermine the congressional scheme of uniform rate regulation to allow a state

court to award as damages a rate never filed with the Commission, and thus never found to be reasonable within the meaning of the Act. Following that course would permit state courts to grant regulated sellers greater relief than they could obtain from the Commission itself.

In asserting that the filed rate doctrine has no application here, respondents contend first that the state court has done no more than determine the damages they have suffered as a result of Arkla's breach of the contract. [Footnote 9] No federal interests, they maintain, are affected by the state court's action. But the Commission itself has found that permitting this damages award could have an "unsettling effect . . . on other gas purchase transactions," and would have a "potential for disruption of natural gas markets. . . ." *Arkansas Louisiana Gas Co. v. Hall,* 13 FERC

831 F.2d 1135 (1987)

COLUMBIA GAS TRANSMISSION CORPORATION, Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, Respondent,

Public Service Electric and Gas Company, Philadelphia Gas Works, Philadelphia Electric Company, Bay State Gas Company, et al., Intervenors.

Nos. 85-1846, 85-1847, 86-1021, 86-1074, 86-1082, 86-1164 and 86-1187.

United States Court of Appeals, District of Columbia Circuit.

Argued December 15, 1986.
Decided October 27, 1987.

1136 *1136 Richard L. Gottlieb, Charleston, W.Va., for petitioner Columbia Gas Transmission Corp. in Nos. 85-1846, 85-1847, 86-1074, 86-1082 and 86-1164. Steve H. Finch, G.D.H. Snyder, and S.J. Small, Charleston, W.Va., entered appearances for Columbia Gas Transmission Corp.

Philip B. Malter, with whom Charles F. Wheatley, Jr., Annapolis, Md., and Paul M. Flynn, Washington, D.C., were on the brief, for petitioner Mun. Defense Group in No. 86-1187.

Michael J. Fremuth, with whom Thomas F. Ryan, Jr., and Robert G. Hardy, Washington, D.C., were on the brief, for Transcontinental Gas Pipe Line Corp., petitioner in No. 86-1021 and intervenor in No. 85-1847; and on the joint brief for intervenor pipelines, with Bolivar C. Andrews, Carl W. Ulrich, Judy M. Johnson, and J. Stephen Martin, Houston, Tex., for intervenor Texas Eastern Transmission Corp.; William Douglas Field, Jr., Owensboro, Ky., and Michael R. Waller, Houston, Tex., for intervenor Texas Gas Transmission Corp.; Raymond N. Shibley, Lawrence G. Acker, and Patrick J. Whittle, Washington, D.C., for intervenors Trunkline Gas Co. and Panhandle Eastern Pipe Line Co. Thomas R. Sheets, Houston, Tex., also entered an appearance for intervenor Texas Eastern Transmission Corp.

John H. Conway, Atty., F.E.R.C., for respondent. Barbara J. Weller, Sol., and A. Karen Hill, F.E.R.C., Washington, D.C., were on the brief, for respondent.

Glenn W. Letham and Joshua L. Menter, Washington, D.C., were on the brief, for intervenor Memphis Light, Gas & Water Div. in No. 86-1074.

John Sandor, Washington, D.C., was on the brief, for amicus curiae The Nat. Ass'n of Consumer Owned Gas Systems, urging reversal.

Frank P. Saponaro, Jr. and Jennifer K. Walter, Washington, D.C., entered appearances for intervenor Philadelphia Gas Works.

James R. Lacey, Newark, N.J., entered an appearance for intervenor Public Service Elec. and Gas Co.

Robert A. MacDonnell, Philadelphia, Pa., entered an appearance for intervenor Philadelphia Elec. Co.

John S. Schmid, Washington, D.C., entered an appearance for intervenors Bay State Gas Co., et al.

John E. Holtzinger, Jr., John T. Stough, Jr., and Jacolyn A. Simmons, Washington, D.C., entered appearances for intervenor Atlanta Gas Light Co.

1137 Stanley M. Morley, Joel F. Zipp, and Paul W. Diehl, Washington, D.C., entered appearances *1137 for intervenor South Carolina Pipeline Corp.

Nusha Wyner, Newark, N.J., Stanley W. Balis, and Susan N. Kelly, Washington, D.C., entered appearances for intervenor Public Advocate of New Jersey.

Frank H. Strickler and Gordon M. Grant, Washington, D.C., entered appearances for intervenor Washington Gas Light Co.

David E. Blabey, Albany, N.Y., Richard A. Solomon, and David D'Alessandro, Washington, D.C., entered appearances for intervenor Public Service Com'n of the State of N.Y.

Jerry W. Amos, Greensboro, N.C., entered an appearance for intervenor Piedmont Natural Gas Co., Inc.

William W. Ross and Daniel L. Koffsky, Washington, D.C., entered appearances for intervenor Consumers Power Co.

James H. Holt and Jeffrey M. Petrash, Detroit, Mich., entered appearances for intervenor Michigan Consol. Gas Co.

John R. Schaefgan, Jr. and Richard M. Merriman, Washington, D.C., entered appearances for intervenors General Customer Service Group, et al.

Before BUCKLEY and WILLIAMS, Circuit Judges, and GERHARD A. GESELL,[*] U.S. District Judge for the District of Columbia.

Opinion for the Court filed by Circuit Judge BUCKLEY.

BUCKLEY, Circuit Judge:

Petitioners challenge Federal Energy Regulatory Commission orders permitting five pipelines to recover a surcharge from their customers on gas already sold to them. The amount of the surcharge would, in effect, reimburse the pipelines for the amounts that the pipelines had subsequently been required to pay to producers for certain deferred production-associated costs. The principal issue in these cases is the propriety, under the governing statutes, of such a surcharge.

We conclude that the Commission exceeded its authority when, without proper notice, it approved what in effect were retroactive increases in the price of natural gas previously sold by the pipelines to their customers.

I. BACKGROUND

Under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w (1982), natural gas companies are required to keep on file with the Federal Energy Regulatory Commission ("FERC" or "Commission") "schedules showing all rates and charges for any transportation or sale [of natural gas] subject to the jurisdiction of the Commission." 15 U.S.C. § 717c(c) (1982). Under the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301-3432 (1982), Congress established ceiling prices for "first sales" (typically sales by producers to pipeline companies ("first purchasers")) of various categories of natural gas. 15 U.S.C. §§ 3312-3319 (1982). In section 110 of the NGPA, Congress permitted natural gas producers to charge for certain production-related costs in excess of the ceiling prices established under the NGPA:

> [A] price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this part if such first sale price exceeds the maximum lawful price to the extent necessary to recover. —
>
> * * * * * *
>
> (2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

15 U.S.C. § 3320(a) (1982).

Upon enactment of the NGPA, the Commission immediately issued, and at the same time sought public comment on, interim regulations to implement section 110. Interim Regulations Implementing the Natural Gas Policy Act of 1978 §§
1138 271.101-271.1106, 43 Fed.Reg. 56,448, 56,552-77 *1138 (1978). The Interim Regulations did not implement every provision of the NGPA, but merely proposed guidelines to deal with those areas demanding the most immediate attention. *Id.* at 56,452. Part 271 of the Interim Regulations specified the maximum lawful prices applicable to first sales of natural gas. *Id.* at 56,552. Subpart K prescribed "regulations under which a price for a first sale of natural gas shall not be considered to exceed the applicable maximum lawful prices set forth in Part 271 if such first sale price exceeds the maximum lawful price to the extent necessary to recover ... production related costs approved by order of the Commission under § 271.1105." *Id.* at 56,574.

In 1980, FERC amended Subpart K to, *inter alia,* (1) allow sellers of committed or dedicated natural gas under the NGPA to apply for production-related costs in excess of NGA allowances, (2) permit certain sellers of natural gas to collect NGA allowances without applications, and (3) provide for a new category of production-related costs ("other costs"). Order No. 94: Order Amending Interim Regulations Under the Natural Gas Policy Act of 1978 and Establishing Policy Under the Natural Gas Act, 45 Fed.Reg. 53,099 (1980).

In the same order, the Commission announced that it would not accept applications for "compression costs" until the Commission completed proceedings to determine an appropriate generic allowance:

> Compression is perhaps the single most complex cost category which we must consider for a production-related add-on. First, of the activities specifically listed under section 110, compression, more than any other, can be undertaken as a production or nonallocable activity. Second, no standard or prevailing industry practice now exists for determining the costs of compression. This means that a seller seeking to add-on compression costs must make a showing as to the costs incurred and the type of compression undertaken. If this must be done case-by-case for each seller there is a potential for long delay and inconclusive results. Rather than this approach (which was the approach of the interim regulations issued in December 1978), we believe that an appropriate allowance for compression can be determined which would apply for specific kinds of compression. To this end we will inaugurate a generic proceeding to determine the appropriate allowance.... During the pendency of the proceeding, in our exercise of discretion, we will accept no applications for compression costs.

Id. at 53,107 (footnote omitted). The Commission initiated the same kind of proceeding to establish an appropriate generic allowance for "gathering costs." *Id.* at 53,108. The Commission assured first sellers that "a retroactive collection procedure will be provided under which the allowance for compression [and gathering] costs determined under the generic rulemaking will be applied to costs incurred with respect to gas delivered on or after the effective date of this Rule if collection of such costs is contractually authorized." *Id.* at 53,107 (footnote omitted).

In the meantime, first purchasers of the gas had recourse to an existing method for recovering these additional estimated costs from their customers; namely, a system of *prospective* charges called "purchased gas adjustment clauses" ("PGA clauses"). 18 C.F.R. § 154.38(d)(4) (1987). PGA clauses, like rates, must be filed with and approved by the Commission before being put into effect. Proposed PGA clauses must also be accompanied by cost studies "based upon actual costs for the 12 months of most recently available actual experience." 18 C.F.R. § 154.38(d)(4)(i). This mechanism thus permits pipelines to recover through prospective sales, on the basis of reasonably current calculations, the fluctuating production-related costs they are required to reimburse producers.

In 1983, the Commission issued Order Nos. 94-A, 48 Fed.Reg. 5,152 (1983), and 94-B, 48 Fed.Reg. 5,190 (1983), containing its long-promised regulations addressing generic compression and gathering cost allowances. These orders authorized natural gas producers to recover retroactively from first purchasers the costs incurred by the producers in
1139 the delivery and compression *1139 of natural gas ("deferred costs") delivered to the pipelines prior to March 7, 1983 (the effective date of Order Nos. 94-A and 94-B), but after July 25, 1980 (the effective date of Order No. 94) or the date on which the producer filed an application with the Commission for reimbursement of the deferred costs, whichever was earlier. 18 C.F.R. § 271.1104(e) (1987).

A number of first purchaser pipeline companies sought to pass these costs on to their customers ("downstream purchasers"). To this end, they petitioned FERC for permission to bill their customers directly for the customers' pro-rata shares of these deferred expenses, such billing to take the form of a surcharge for gas purchased by each customer during the three-year period between the issuance of the interim order (Order No. 94) and the final orders (Order Nos. 94-A and 94-B). In five cases, the Commission issued orders[4] granting pipeline companies permission to do so. The "direct billing" method for reimbursement is described in the proposal submitted by Transcontinental Gas Pipeline Corp. ("Transco") and approved by the Commission. Under its terms, Transco undertook

> to calculate each customer's share of the retroactive allowances based on each customer's actual purchases during each month to which the retroactive allowances apply. Each customer's total amount due, plus interest, will then be billed and paid in equal installments over a twelve-month period, or paid in a single lump-sum payment at the customer's option.

32 F.E.R.C. ¶ 61,230 at 61,543. Thus, in contrast with the prospective PGA clause mechanism, the direct billing procedure was designed to provide pipelines with a method for recovering retroactively, through a system of surcharges, the amounts the Commission determined they were required to reimburse producers for production-associated costs that had accrued during the three-year period.

Petitioners have appealed each of the five orders. Columbia Gas Transmission Corp. and the Municipal Defense Group (representing a number of distribution companies that purchase natural gas from pipeline companies) challenge the legality of direct billing on the ground that it constitutes retroactive ratemaking prohibited by the Natural Gas Act. Columbia Gas also asserts that the direct billing procedure is inconsistent with FERC's own precedent, and that the PGA clause mechanism is the only method (aside from filing for rate increases) that is authorized for recovering such additional expenses.

The Commission, supported by various intervening pipeline companies, defends its approval of the direct billing procedure on the basis of its equitable results, as it would require customers to pay the actual cost of the gas they have purchased. The Commission also argues that its orders do not constitute retroactive rulemaking because the Commission's 1980 and 1983 orders provided adequate notice that the deferred costs would be passed along to the pipelines and their customers.

Although Transco supports the concept of direct billing, it challenges FERC's decision to apply a different rate of interest on amounts previously collected under PGA clauses that Transco must now refund to customers and the rate it may apply in calculating the total amount to be recovered from them through direct billing. The Commission has admitted that its consideration of this issue was based on error and, on November 24, 1986, it moved that we remand this one issue for further consideration.

II. ANALYSIS

A. *The Rule Against Retroactive Ratemaking*

1140 Both Columbia and the Municipal Defense Group challenge direct billing as *1140 constituting retroactive ratemaking and therefore contrary to law. The Commission defends its decisions to allow pipeline companies to directly bill their customers for deferred production-related expenses on the basis of an equitable result:

> The Commission ... determined that allocating these costs to the pipelines' customers on the basis of volumes purchased at the time the costs were incurred "will equitably bill customers for the higher amounts they should have paid based on actual purchases during the past billing periods." This is a sound reason for adopting the direct billing method; thus the Commission's choice of that method is rationally based.

Brief for Commission at 13 (quoting *Transco, reh'g and clarification denied,* 33 F.E.R.C. ¶ 61,213 at 61,443); *see also, e.g., Transco,* 32 F.E.R.C. ¶ 61,230 at 61,543 ("[Transco's proposal] is administratively effective, equitable, and meets our concern that pricing signals not be distorted by the influx of substantial retroactive Order No. 94-A costs. Above all, it will break up the logjam that has existed and permit a relatively speedy passthrough of long overdue cost responsibility."). The Commission further argues that "Order Nos. 94 and 94-A put everyone on notice that these compression and gathering costs would be retroactively collected, once the Commission determined the appropriate method and dollar amount." Brief for Commission at 14 (citing *Transco,* 32 F.E.R.C. ¶ 61,230 at 61,544-45, and 33 F.E.R.C. ¶ 61,213 at 61,443).

Although the parties have mounted an extensive semantic battle over whether the FERC orders amount to retroactive ratemaking (or rate authorization), the effect of the orders is quite clear: downstream purchasers are expected to pay a surcharge, over and above the rates on file at the time of sale, for gas they had already purchased. However described, this constitutes a retroactive rate increase that we find to be prohibited by the NGA. While that prohibition might have been overridden through adequate notice that purchasers would be expected to pay the deferred charges at a later date, Order Nos. 94 and 94-A did not constitute such notice. Because they were addressed exclusively to *first sales* of natural gas, they cannot be deemed to have placed downstream purchasers on notice that they in turn would be expected to absorb those costs through a system of surcharges collected after the fact. Thus there is no support for the Commission's assertion that its orders "put *everyone* on notice."

The rule against retroactive ratemaking is derived from the provisions in the NGA requiring sellers of natural gas to file their rates with the Commission and defining its authority to modify them. The pertinent statutory language reads as follows:

> Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, ... and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sales subject to the jurisdiction of the Commission....

15 U.S.C. § 717c(c).

> [T]he Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company....

15 U.S.C. § 717d(a).

These provisions form the basis for the "filed rate doctrine." In its discussion of the doctrine in *Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 576-78, 101 S.Ct. 2925, 2929-30, 69 L.Ed.2d 856 (1981), the Supreme Court notes that

> the [Natural Gas] Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission and prevents the Commission itself from imposing a rate increase for gas already sold.

Id. at 578, 101 S.Ct. at 2931. Moreover, the Court explicitly states, in a footnote, that "the Commission may not *impose* a retroactive rate alteration and, in particular, may not order reparations...." *Id.* at n. 8 (emphasis in original) (citing *FPC v. Sunray* *1141 *DX Oil Co.,* 391 U.S. 9, 24, 88 S.Ct. 1526, 1534, 20 L.Ed.2d 388 (1968)).

We have recently had occasion to explain, in the case of electrical utilities, the rationale for prohibiting retroactive increases in filed rates:

> The wholesale purchasers of electricity cannot plan their activities unless they know the cost of what they are receiving, particularly if they are retailers, who must calculate their appropriate resale rates, ... but also if they are large-scale purchaser-users. Providing the necessary predictability is the whole

> purpose of the well established "filed rate" doctrine, which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority."

Electrical Dist. No. 1 v. FERC, 774 F.2d 490, 493 (D.C.Cir.1985) (quoting *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577, 101 S.Ct. 2925, 2930, 69 L.Ed.2d 856 (1981)). Although FERC claims that "Order Nos. 94 and 94-A gave notice that the prices paid for gas during the pendency of the Commission's rulemaking were not final prices," Brief for Commission at 16, the orders were explicitly concerned with *first sales.* Furthermore, even in that context, the Commission was careful to limit the application of Order No. 94-A to those cases in which first purchasers were contractually bound to pay the deferred costs.

> As a general matter, the final rules will not operate to authorize the collection of amounts for production-related costs incurred prior to today. A basic principle of administrative procedure is that rules should operate prospectively only. We see no reason to depart from this principle in implementing these amendments. To the contrary, there is good reason to adhere to it.

48 Fed.Reg. at 5,161. In a footnote to the above-quoted section, the Commission stated:

> An exception is made in the case of delivery or compression services. However, this exception is based upon the Commission's notice in Order No. 94 that these costs could be recovered. In addition, this recovery is under particular safeguards to insure that amounts collected for these services may only be collected *if contractual authority existed to collect them at the time they were incurred.*

Id. at n. 89 (emphasis added); *see* 18 C.F.R. § 271.1104(c)(4)(ii). It is thus clear that the notice provided by the two orders was limited to a highly restricted audience.

Furthermore, contrary to what the Commission suggests, Brief for Commission at 16 n. 10, notice may not be imputed as a result of the "passthrough" provision in section 601 of the NGPA, 15 U.S.C. § 3431(c). While section 601 permits a pipeline to recover any amount paid for natural gas that "is deemed to be just and reasonable for purposes of sections 4 and 5 of [the NGA]," *id.* § 3431(c)(2)(A), we read nothing in the language of the section to warrant a resort to retroactive as opposed to prospective rate increases.

We need not address whether the Commission might have accomplished the goal of permitting pipelines to pass these costs on to their customers (in proportion to their takes in the three-year period following Order No. 94) through a system of specific PGA clauses for each account because that issue is not before us. *See* Brief for Commission at 20. Such a device, in any event, would differ significantly from that selected by the Commission, as it would allow all surcharged customers to plan accordingly and would enable those with access to more than one pipeline to respond to the surcharges by reducing purchases from the pipeline(s) imposing the highest additional costs. Nor need we determine whether the Commission, in order to avoid unjust enrichment, might "have ordered pipelines to begin collecting production-related cost surcharges at the time of issuance of Order No. 94, subject to adjustment when Order No. 94-A specified the exact production-related cost allowances." Joint Brief for Intervenor Pipelines at 22 (citing *Kansas Cities v. FERC*, 723 F.2d 82, 93 (D.C.Cir.1983)). As none of the parties has demonstrated that proper notice
1142 was afforded to pipeline customers that they might be subject *1142 to a surcharge on past purchases, we decline to address this hypothetical issue.

B. *Prior FERC Precedent*

Columbia Gas argues also that the Commission's decision to permit direct billing for deferred expenses is inconsistent with prior Commission opinions, orders, and regulations, and that the Commission failed to provide an adequate explanation of why it departed from its prior rulings. Because we hold the Commission acted beyond its authority in approving the direct billing of deferred costs, we need not decide whether its explanation of its alleged departure from past practice was sufficiently reasonable.

C. *The Interest Decision*

Transco argues that it is being penalized in the amount of almost a million dollars by the FERC order allowing direct billing because it is required to pay customers a higher rate of interest on amounts it is required to refund from past PGA clause collections than it is allowed to charge those same customers on their shares of directly billed deferred costs. Because we find the FERC orders allowing direct billing to be *ultra vires,* the question of the interest differential is moot. Accordingly, we deny the Commission's November 24, 1986 motion to remand that issue for further consideration.

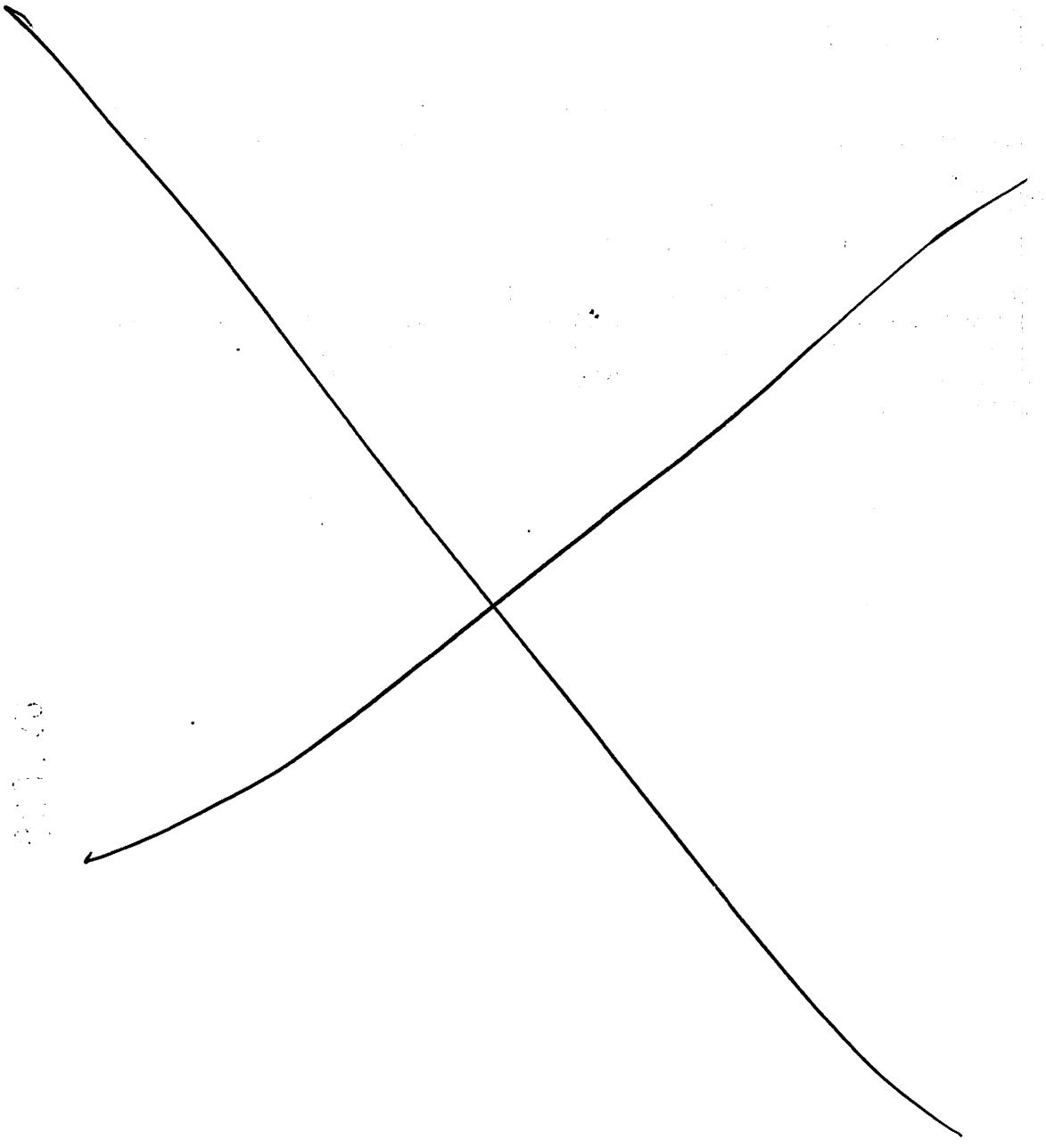
III. CONCLUSION

The five orders on review violate the NGA's prohibition against retroactive ratemaking. We therefore strike the orders authorizing direct billing and remand to the Commission for further proceedings consistent with this opinion.

So ordered.

[*] Sitting by designation pursuant to 28 U.S.C. § 292(a).

[*] *Transcontinental Gas Pipe Line Corp.* [*"Transco"*], 32 F.E.R.C. ¶ 61,230, *reh'g and clarification denied,* 33 F.E.R.C. ¶ 61,213 (1985); *Texas Eastern Transmission Corp.,* 32 F.E.R.C. ¶ 61,493, *reh'g denied,* 33 F.E.R.C. ¶ 61,257 (1985); *Texas Gas Transmission Corp.,* 33 F.E.R.C. ¶ 61,032, *reh'g denied,* 33 F.E.R.C. ¶ 61,359 (1985); *Panhandle Eastern Pipe Line Co.,* 33 F.E.R.C. ¶ 61,218 (1985), *reh'g denied,* 34 F.E.R.C. ¶ 61,231 (1986); and *Trunkline Gas Co.,* 33 F.E.R.C. ¶ 61,217 (1985), *reh'g denied,* 34 F.E.R.C. ¶ 61,021 (1986).



County affirmed the Commission's order. Citizens appealed, and the appellate court invalidated the reduction in the utility's rate base but upheld the reduction in the company's depreciation expense. (153 Ill. App.3d 28.) We allowed the joint petition for leave to appeal filed by the Commission and the Village of Bolingbrook, intervenor. See 107 Ill.2d R. 315(a).

Citizens, a wholly owned subsidiary of the Citizens Utilities Company, provides water service to about 23,000 customers and sewer service to about 22,000 customers in Cook, Du Page, and Will Counties. Citizens is a public utility, as that term is defined in "An Act concerning public utilities" (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 10.3), and therefore the company is subject to the regulatory authority of the Commission. On March 16, 1984, Citizens filed an application with the Commission for an order approving its recorded balance of deferred income taxes as of December 31, 1983, and for other relief. The Village of Bolingbrook and the Water Consumers Association, Inc., were permitted to intervene in the proceeding. Following hearings on the matter before a hearing officer, the Commission entered its order on January 30, 1985. Of relevance here, the Commission reduced the company's rate base by $4,253,953 and reduced the amount of its tax depreciation expense for ratemaking purposes by $403,432. The Commission subsequently denied Citizens' application for rehearing.

Citizens sought review of the Commission's order in the circuit court of Will County. (See Ill. Rev. Stat., 1984 Supp., ch. 111 2/3, par. 72.) There the matter was consolidated with an appeal taken by Citizens from the order of the Commission in a separate case, which involved the company's request for a general rate increase. Following the submission of briefs by the parties, the circuit judge entered a judgment affirming the Commission's orders in both cases.

*200 Citizens appealed the circuit court's judgment. The appellate court reversed that part of the circuit court's judgment affirming the Commission's order making a $4.2 million reduction in Citizens' rate base. The appellate court believed that the rate base reduction constituted retroactive ratemaking and therefore was invalid. The appellate court affirmed that part of the circuit court's judgment affirming the Commission's decision to reduce Citizens' tax depreciation expense for ratemaking purposes by $403,432 for the 1983 test year. Finally, on a question that is not at issue in this appeal, the appellate court reversed that part of the circuit court's judgment affirming the Commission's decision to deny Citizens a working capital allowance for the test year.

In this appeal the Commission and the Village of Bolingbrook, as intervenor, challenge the appellate court's decision invalidating the $4.2 million reduction in Citizens' rate base;

Citizens Utilities Co. v. ILL. COMMERCE COM'N

124 Ill. 2d 195 (1988)

529 N.E.2d 510

CITIZENS UTILITIES COMPANY OF ILLINOIS, Appellee, v. THE ILLINOIS COMMERCE COMMISSION et al., Appellants.

No. 65088.

Supreme Court of Illinois.

Opinion filed September 22, 1988.

*196 *197 *198 Kathleen Nolan and Edward P. O'Brien, Special Assistant Attorneys General, of Chicago, for appellant Illinois Commerce Commission.

George A. Marchetti, of Moss & Bloomberg, Ltd., of Bolingbrook, for appellant Village of Bolingbrook.

Lee N. Abrams, Stephen J. Mattson and John E. Muench, of Mayer, Brown & Platt, of Chicago, for appellee.

Judgment affirmed.

JUSTICE MILLER delivered the opinion of the court:

This appeal concerns an order of the Illinois Commerce Commission (the Commission) regarding certain ratemaking questions involving the Citizens Utilities Company of Illinois (Citizens). In 1985 the Commission entered an order deducting $4,253,953 from Citizens' rate base and reducing the company's tax depreciation expense for ratemaking purposes by $403,432. Citizens sought review of those decisions, and the circuit court of *199 Will

the company actually has paid the Federal government. It now appears that the higher tax figure was used in establishing the utility's rates for the years 1958 through 1982.

The Commission concluded that Citizens had compiled, as of December 31, 1983, a total of $4,657,385 in tax benefits in connection with the depreciation procedures for its contract plant. The Commission ordered that $403,432 in tax depreciation expense for the 1983 test year be deducted from the company's taxable income, reducing its income tax expense for ratemaking purposes. In addition, the Commission ordered that the balance of the benefits, $4,253,953, be deducted from Citizens' rate base. Both reductions are at issue here. As we have said, the Commission and the Village of Bolingbrook, intervenor, bring this appeal contesting the appellate court's reversal of the $4.2 million rate base reduction. At the same time, Citizens has contested, as grounds for cross-relief, the $403,432 reduction in its tax depreciation expense for ratemaking purposes in the 1983 test year.

We point out as a preliminary observation that the present case is governed by "An Act concerning public utilities" (Ill. Rev. Stat. 1983, ch. 111 2/3, pars. 1 through 95) (the Act). Although the Act has been superseded by the Public Utilities Act (Ill. Rev. Stat. 1985, ch. 111 2/3, pars. 1-101 through 14-110), the new statute does not apply to actions or proceedings, such as this one, that were pending on its effective date, January 1, 1986. (Ill. Rev. Stat. 1985, ch. 111 2/3, par. 4-402; see People ex rel. Hartigan v. Illinois Commerce Comm'n (1987), 117 Ill. 2d 120, 130-31.) We do not mean to suggest, however, that our result would necessarily be different if the present case were governed instead by the new Public *203 Utilities Act; many of the statutory provisions relevant here have in fact been reenacted, without substantive change, as part of the new statutory regime.

The Rate Base Reduction

The appellate court held that the $4.2 million rate base reduction ordered by the Commission was invalid as retroactive ratemaking. The Commission and the Village of Bolingbrook maintain, in their joint brief, that Citizens has waived any contention that the rate base reduction is invalid as retroactive ratemaking because the company failed to make the precise objection in its application for rehearing before the Commission. In its application for rehearing Citizens questioned both the rate base reduction and the reduction in depreciation expense; the company did not, however, argue that the rate base reduction was invalid as retroactive ratemaking. Although the Commission and the Village raised the waiver argument in the appellate court, that court failed to address the question in its opinion. In this court, Citizens does not dispute that it first raised the

the Commission and the Village do not contest the appellate court's decision concerning the working capital allowance. Citizens challenges, as grounds for cross-relief, the appellate court's decision upholding the reduction of $403,432 in its tax depreciation expense for ratemaking purposes. See 107 Ill.2d R. 318(a).

In establishing the rates that a public utility is to charge its customers, the Commission bases the determination on the company's operating costs, rate base, and allowed rate of return. A public utility is entitled to recover in its rates certain operating costs. A public utility is also entitled to earn a return on its rate base, or the amount of its invested capital; the return is the product of the allowed rate of return and rate base. The sum of those amounts operating costs and return on rate base is known as the company's revenue requirement. The components of the ratemaking determination may be expressed in "the classic ratemaking formula R (revenue *201 requirement) = C (operating costs) + Ir (invested capital or rate base times rate of return on capital)." (City of Charlottesville, Virginia v. Federal Energy Regulatory Comm'n (D.C. Cir.1985), 774 F.2d 1205, 1217, citing T. Morgan, Economic Regulation of Business 219 (1976).) The same formula is used by the Commission in ratemaking determinations for Illinois. The revenue requirement represents the amount the company is permitted to recover from its customers in the rates it charges. Ratemaking is done in the context of a test year, which in this case was 1983.

Citizens has what is known in the industry as plant acquired by contract, or contract plant. Plant acquired by contract consists of facilities, such as pumping stations and water mains, that were constructed by a real estate developer and that later were deeded by the developer to the utility company upon completion of the subdivision; generally the utility pays the developer a regular fee based on the rates the utility charges its customers. But because the public utility acquires the contract plant at no cost to itself, contract plant is not included in the company's rate base for ratemaking purposes, and therefore the company does not earn a return on the asset.

The questions presented in this case arise from the different treatment accorded contract plant for tax purposes and for ratemaking purposes. Included in the operating costs component of the revenue requirement formula are certain expenses, such as income taxes. In computing its Federal income taxes, Citizens depreciates its contract plant, and in that way the company is allowed to reduce the amount of income taxes it must pay. But in computing its income tax expense for ratemaking purposes, Citizens has not depreciated its contract plant, and therefore its income tax expense for ratemaking purposes has been higher than its income taxes. Thus, *202 Citizens has claimed, for ratemaking purposes, an income tax expense that is greater than the amount of taxes

retroactive-ratemaking objection in the circuit court, but the company contends that it was not until the Commission filed its circuit court brief that the Commission made any attempt to justify the rate base reduction on the ground that it was necessary to prevent Citizens from earning a return on non-investor-supplied funds.

Section 67 of the Act provides that "[n]o appeal shall be allowed from any rule, regulation, order or decision of the Commission unless and until an application for a rehearing thereof shall first have been filed with and finally disposed of by the Commission * * *. No person or corporation in any appeal shall urge or rely upon any grounds not set forth in such application for a rehearing before the Commission." (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 71.) This court has previously enforced the plain *204 terms of that provision, holding that a party may not raise on review an issue or objection that was not expressly raised in the required application for rehearing. See Independent Voters of Illinois v. Illinois Commerce Comm'n (1987), 117 Ill. 2d 90, 100-01; Chicago Junction Ry. Co. v. Illinois Commerce Comm'n (1952), 412 Ill. 579, 588-90; Brotherhood of Railroad Trainmen v. Elgin, Joliet & Eastern Ry. Co. (1943), 382 Ill. 55, 61.

We do not believe that Citizens has waived consideration of its retroactive-ratemaking argument. It bears repeating that the tax benefits at issue arose from the Commission's calculations of the operating costs component of the revenue requirement formula. The tax benefits were never included as part of Citizens' rate base, and therefore the rate base reduction did not remove an item that the Commission had at one time incorrectly installed as part of the company's rate base. The Commission's order failed to articulate a distinct rationale for the $4.2 million reduction in rate base, however. Although the Commission divided the total amount of the tax benefits, $4,657,385, into two separate components $403,432, representing the tax benefits for test year 1983, and $4,253,953, representing the balance the Commission did not make any distinction in its treatment of the two amounts. Rather, the bulk of the Commission's discussion of the question was devoted to what can only be considered an analysis of the depreciation question for the test year, 1983.

The Commission's order provided a summary of its decisions regarding the treatment of the tax benefits resulting from Citizens' contract plant; the Commission adopted the summary nearly verbatim from a proposed order submitted by an intervening party, the Water Consumers Association, Inc. The Commission's order stated:

"The Commission believes that even if Petitioner's [i.e., Citizens'] customers do not pay a return on depreciation *205 expense on Plant Acquired By Contract, the customers have provided the revenues which have led to the income which Petitioner's parent has been

able to shelter from income taxes by taking tax depreciation on Plant Acquired by Contract. Petitioner concedes it has no investment in Plant Acquired by Contract. Developers who sold homes to Petitioner's customers paid for the plant and presumably have already passed that cost onto the customers. The tax benefits ultimately received by the shareholders of Petitioner's parent company are a form of cost-free capital provided by its customers. The customers have provided the revenue which has been sheltered from tax liability, and they have substantially contributed to the plant which Respondent [sic] has been able to use at no cost to itself to shelter customer-provided revenues from taxes. No reasonable explanation has been presented by Petitioner to justify permitting its shareholders to retain all the tax benefits obtained at the expense of its customers and at no cost to Petitioner. Had the customers not provided such revenues, Petitioner would have had to raise capital in the ordinary capital markets at a cost to its shareholders. We know of no reason why Petitioner's customers should be required through rates to bear an imputed level of income tax expense Petitioner does not currently pay and may never have to pay. The Staff recommendation with respect to Plant Acquired by Contract is adopted."

In finding (9) the Commission stated:

"[T]he amount of tax benefits, determined to be $4,657,385 as of December 31, 1983, associated with Petitioner's Plant Acquired By Contract, is not includable in a calculation of Petitioner's deferred income taxes; tax depreciation expense on Plant Acquired By Contract, determined to be $403,432 for the year ending December 31, 1983, should be deducted from Petitioner's taxable income, which will result in a reduction of income tax expense for ratemaking purposes; the balance of $4,253,953 should be reflected as a reduction of Petitioner's rate base for ratemaking purposes[.]"

*206 Although the order contains language suggesting that the tax benefits were non-investor-supplied capital, the order does not state that a reduction would be necessary to prevent the company from earning a return on those sums in the future.

Because the grounds for the Commission's decision making the rate base reduction are not apparent from the order, we do not believe that Citizens' failure to make the retroactive-ratemaking objection in its application for rehearing must preclude the company from raising that argument on review. Under the Act, ratemaking is a legislative function. (People ex rel. Hartigan v. Illinois Commerce Comm'n (1987), 117 Ill. 2d 120, 142; Du Page Utility Co. v. Illinois Commerce Comm'n (1971), 47 Ill. 2d 550, 557-58; Illinois Central R.R. Co. v. Illinois Commerce Comm'n (1944), 387 Ill. 256, 275.) An order of the Commission will be set aside on review if it appears that the Commission acted outside the scope of its authority or infringed on a constitutional right, or that its findings

are against the manifest weight of the evidence. (Independent Voters of Illinois v. Illinois Commerce Comm'n., 117 Ill. 2d at 95; People ex rel. Hartigan, 117 Ill. 2d at 142; Champaign County Telephone Co. v. Illinois Commerce Comm'n (1967), 37 Ill. 2d 312, 320-21; Ill. Rev. Stat. 1983, ch. 111 2/3, par. 72.) Meaningful review of regulatory orders is thwarted, however, if the Commission's failure to express the grounds for its decisions operates to shelter them from review. Therefore, we will consider Citizens' objection that the rate base reduction is invalid as retroactive ratemaking; following that, we shall take up the Commission's defenses for its decision.

We believe that the real effect, whether intended or not, of the $4.2 million reduction in Citizens' rate base is to deny retroactively the tax benefits the Commission *207 permitted the company to enjoy during the period from 1958 to 1982. Such action clearly conflicts with fundamental principles of ratemaking in Illinois. The prohibition of retroactive ratemaking is derived from the overall scheme of the Act and the role of the Commission in the ratemaking process. (Mandel Brothers, Inc. v. Chicago Tunnel Terminal Co. (1954), 2 Ill. 2d 205, 210.) The Act authorizes reparations only for what are deemed "excessive" charges. (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 76.) A rate is effective once it is established by the Commission, unless the rate order is stayed pending review. (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 75.) Moreover, a public utility is required to charge the rates determined by the Commission, in its legislative capacity (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 37), and penalties may be imposed if the company fails to charge the established rates (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 80). The rule prohibiting retroactive ratemaking is consistent with the prospective nature of legislative activity, such as that performed by the Commission in setting rates. Moreover, because the rule prohibits refunds when rates are too high and surcharges when rates are too low, it serves to introduce stability into the ratemaking process. See Poor, Utility Rates Pending Judicial Review: A Riddle Wrapped in a Mystery in Illinois, 17 J. Marshall L. Rev. 743, 753-56 (1984).

The operation of these provisions is well illustrated by the opinion in Mandel Brothers, where the court first enunciated the rule against retroactive ratemaking. That case involved a request by a shipper to recover reparations for allegedly excessive rates charged by a carrier. New, increased rates had taken effect upon the Commerce Commission's approval of them, but the increase was later set aside on judicial review. The shipper then filed with the Commission a complaint for reparations, seeking reimbursement for its payment of the invalid *208 rates. The Commission denied the shipper's request for reparations. The circuit court reached a contrary result, allowing recovery of reparations except for the period for which the court believed the action was

barred by the applicable statute of limitations. This court ruled that no reparations could be awarded and therefore did not consider whether the action was time barred.

The court in Mandel Brothers observed that the common law right to recover reparations for excessive rates had been superseded by section 72 of the Act (Ill. Rev. Stat. 1953, ch. 111 2/3, par. 76), which authorized the Commission to permit reparations for what were termed "excessive" rates. Drawing a distinction between rates set by a utility itself and those established by the Commission, the court noted that under the prevailing view Commission-established rates, though later set aside on judicial review, will not form the basis for an action for reparations. The court went on to reject the shipper's argument that, because the Commission in that case, acting quasi-judicially, had simply approved as reasonable the schedule of rates submitted to it by the carrier, the carrier could be deemed to have set its own rates. The court ruled that the Commission's approval of the new rates was "legislative in character and prospective in its operation. The procedure fixed by the act and followed by the commission unmistakably so indicates." (Mandel Brothers, 2 Ill. 2d at 210.) In support of that conclusion the court noted that under section 36 of the Act any proposed rate changes must be filed with the Commission, which is authorized to conduct hearings on the rate proposal and to establish just and reasonable rates. (Ill. Rev. Stat. 1953, ch. 111 2/3, par. 36.) In addition, section 37 forbids a utility to charge rates different from those established by the Commission, and section 76 prescribes penalties for regulated companies that fail to charge the approved rates. (Ill. Rev. Stat. 1953, ch. 111 2/3, pars. 37, *209 80.) The rate increase at issue in Mandel Brothers had been established following a hearing, in accordance with the statutory procedure.

In Mandel Brothers the court also rejected the shipper's argument that reparations were recoverable because the action of the reviewing court in setting aside the rate increase represented a judicial declaration that the increase was in fact excessive under section 72 of the Act. The court believed that such an interpretation would be inconsistent with the statutory scheme. Significant in that regard was section 71 of the Act, concerning judicial review of Commission orders; section 71 provided that a rate order is not stayed pending review except upon court order. (Ill. Rev. Stat. 1953, ch. 111 2/3, par. 75.) The court noted that in the case before it no order had been entered, or had been requested, staying the challenged rate increase. The court stated in conclusion, "It follows that the rate approved by the Commerce Commission as just and reasonable was the rate which the utility was required to charge so long as the order of the commission remained in effect. It cannot therefore be said that in charging that rate the utility charged an

excessive rate which gave rise to a claim for reparations." Mandel Brothers, 2 Ill. 2d at 211-12.

The continuing vitality of Mandel Brothers was demonstrated recently in Independent Voters of Illinois v. Illinois Commerce Comm'n (1987), 117 Ill. 2d 90, where we reaffirmed the rule against retroactive ratemaking. At issue in Independent Voters was an intervenor's request for a refund of the increased charges paid by telephone service customers under a rate order that had been invalidated by an earlier decision of this court. The refund request encompassed two distinct periods of time: charges incurred before this court issued its opinion invalidating the rate increase, and charges incurred after that date but before new rates took effect. Adhering to *210 Mandel Brothers, the court held in Independent Voters that no refund would be allowed with respect to the charges incurred before this court issued its decision invalidating the rate order; refunds were allowed, however, for excess charges imposed after that date. In denying any refund for the period before the date of this court's earlier decision, we rejected the intervenor's attempt to distinguish Mandel Brothers on the ground that the request was for restitution rather than reparations. We noted that the predicate for a restitutionary award unjust enrichment cannot be held to be present when the challenged rates, though later invalidated, are precisely the rates the company was required to charge for its service. (Independent Voters, 117 Ill. 2d at 97-99.) We also rejected the intervenor's argument that Mandel Brothers should be overruled because the legislature could not have intended that stay orders, authorized under section 71 of the Act, would constitute the only means of avoiding the costs of rate increases that ultimately are set aside. In declining to overrule Mandel Brothers, we noted that in the period since that decision the General Assembly had amended different provisions of the Act but had reenacted, without amendment, the provision in section 71 of the Act that Commission orders are not automatically stayed on review. Independent Voters, 117 Ill. 2d at 99-100.

With those principles in mind, we conclude that the $4.2 million reduction in Citizens' rate base ordered by the Commission constituted retroactive ratemaking, and that the Commission therefore acted outside the scope of its authority when it ordered the rate base reduction. It will be remembered that a public utility's revenue requirement, or the amount the company is entitled to collect from customers in the rates it charges for its service, is the sum of operating costs and allowed return on rate base. The tax benefits at issue here originated as *211 expenses that the company was allowed to recover. Just as there is no recovery of reparations for rates charged under a Commission order later held to be invalid, there can be no retroactive adjustment in this case simply because the Commission has now decided to treat the tax benefits differently. Allowing the rate base

reduction to stand would sanction retroactive ratemaking, a practice that this court has long condemned as inconsistent with the statutory scheme and the Commission's role in the ratemaking process.

The Commission offers a number of defenses for the rate base reduction, and we shall consider them now. First, the Commission contends that the $4.2 million reduction in Citizens' rate base may be justified on the ground that the reduction is necessary to prevent the company from earning a return on non-investor-supplied capital. As we noted earlier in determining that Citizens had not waived consideration of the retroactive-ratemaking argument, the Commission failed to articulate a distinct rationale for its decision to make the $4.2 million reduction in the company's rate base. There is substantial Federal precedent supporting the view that an administrative decision will not be upheld on grounds different from those expressed by the agency itself in its decision. (See American Textile Manufacturers Institute, Inc. v. Donovan (1981), 452 U.S. 490, 539-40, 69 L. Ed. 2d 185, 220, 101 S. Ct. 2478, 2505-06; Federal Power Comm'n v. Texaco, Inc. (1974), 417 U.S. 380, 395-97, 41 L. Ed. 2d 141, 155-56, 94 S. Ct. 2315, 2325-26; Federal Power Comm'n v. United Gas Pipe Line Co. (1968), 393 U.S. 71, 72-73, 21 L. Ed. 2d 55, 56-57, 89 S. Ct. 55, 55-56 (per curiam); Burlington Truck Lines, Inc. v. United States (1962), 371 U.S. 156, 167-68, 9 L. Ed. 2d 207, 215-16, 83 S. Ct. 239, 245.) Application of the same rule in this case, as Citizens suggests, would preclude the Commission from urging in support of its decision an alternative *212 ground not contained in the order. Because the Commission in its order mentioned in passing that the tax benefits represented "cost-free capital" provided by ratepayers, we shall briefly consider the Commission's argument in support of the rate base reduction, rather than the alternative ground urged by Citizens.

The Commission believes that even though the tax benefits did not become a discrete component of Citizens' rate base, they represented customer-supplied funds, and therefore the company's receipt of them necessitated an offsetting reduction in rate base. In support of this theory the Commission cites Lindheimer v. Illinois Bell Telephone Co. (1934), 292 U.S. 151, 78 L. Ed. 1182, 54 S. Ct. 658, and City of Alton v. Commerce Comm'n (1960), 19 Ill. 2d 76. The Commission would derive from those cases the rule that a public utility's investors are not entitled to earn a return on sums that may be characterized as capital contributions by customers. We would note, however, that there was no contention made in either of the cited cases concerning retroactive ratemaking. The amounts at issue here were recovered by Citizens in past ratemaking orders as part of its income tax expense, and the validity of those orders cannot now be questioned.

The Commission also denies that the reduction in rate base constitutes retroactive ratemaking. Citing Citizens Utilities Co. v. Illinois Commerce Comm'n (1971), 49 Ill. 2d 458, and Amax Zinc Co. v. Illinois Commerce Comm'n (1984), 124 Ill. App.3d 4, the Commission urges that a rate order may properly be based on historical patterns or practices and that the rate base reduction ordered here correctly took account of the company's past receipt of the tax benefits in question. In Citizens Utilities the Commission had initially entered an order providing for the issuance of a certain number of shares of stock by the regulated subsidiary to its corporate parent *213 as reimbursement of sums that the parent had expended in the subsidiary's behalf. In a later rate proceeding, however, it came to the Commission's attention that the parent had not spent the amount claimed in the earlier proceeding, and therefore the Commission amended its previous order, reducing the subsidiary's capital stock. In upholding the Commission's action, this court noted that the Commission had the authority to amend its orders and that the company had had the burden of properly establishing the stock issuance. In Amax Zinc the Commission relied on past electrical consumption levels by certain customers in setting a "ratchet" provision applicable to those customers' future rates. The appellate court rejected the argument that the Commission's use of the past figures constituted retroactive ratemaking. The court noted that the rates would apply only in the future and did not believe that the reliance on the past levels of use rendered the rate schedule retroactive.

We do not believe that either case supports the Commission's action here. In Citizens Utilities the Commission properly ordered the adjustment to the company's capital stock to correct the misrepresentation made by the company in the original proceeding. Amax Zinc illustrates the principle that ratemaking, done in the context of a test year, may require the use of certain projections or extrapolations from past data. In this case, in reducing Citizens' rate base, the Commission has attempted to correct what it now perceives as errors in the past rate orders. There has been no suggestion, however, that Citizens obscured the true bases of the earlier ratemaking decisions, or otherwise misled the Commission in making those determinations.

Finally, we disagree with the Commission's theory that only an order requiring the complete disgorgement by Citizens of all proceeds resulting from its use or investment *214 of the tax benefits would constitute retroactive ratemaking. This argument suggests that the rate base reduction is in reality only an incomplete or partial remedy, because the Commission is permitting the company to retain whatever sums it has earned on the tax benefits. The Commission's order here will not be saved simply because a more thoroughgoing violation of the rule against retroactive ratemaking is imaginable.

Reduction of Depreciation Expense

Citizens argues, as grounds for cross-relief, that the Commission also erred in reducing the amount of its tax depreciation expense for the 1983 test year. Citizens makes two distinct arguments in support of this view. Citizens believes that the decision is an unwarranted departure from the Commission's established practice of permitting public utilities to retain tax benefits derived from contract plant and from other assets that are not included in rate base. Citizens also argues that the Commission's decision conflicts with certain Federal tax guidelines on depreciation benefits. Citizens asks that this part of the order be reversed outright or, in the alternative, that the cause be remanded so that the Commission may reconsider the issue.

The Commission explained in its order that it did not believe that ratepayers should pay in their rates a Federal income tax expense, computed for ratemaking purposes, that was greater than the amount of Federal income taxes actually attributable to Citizens' operations. Accordingly, the Commission reduced the company's tax depreciation expense by $403,432, the amount of the tax benefits the company otherwise would have enjoyed for the 1983 test year. In support of that reasoning the Commission cites Monarch Gas Co. v. Illinois Commerce Comm'n (1977), 51 Ill. App.3d 892. In that case the appellate court upheld a Commission decision denying any *215 income tax expense for ratemaking purposes to a public utility that did not pay Federal income taxes because it was organized as a subchapter S corporation under the Internal Revenue Code. Relying on Federal Power Comm'n v. United Gas Pipe Line Co. (1967), 386 U.S. 237, 18 L. Ed. 2d 18, 89 S. Ct. 1003, and City of Alton v. Commerce Comm'n (1960), 19 Ill. 2d 76, the appellate court in Monarch Gas concluded that the tax provisions producing the economic benefit to the utility did not also determine the ratemaking treatment of the benefit. We agree that in this case the Commission was within its statutory authority in denying Citizens an expense for ratemaking purposes that it did not actually incur.

Citizens contends, however, that the Commission's decision requiring the company to pass on to ratepayers the tax benefits derived from contract plant, an asset not included in the company's rate base, is inconsistent with the Commission's long-standing practice of permitting public utilities to retain for their own use tax benefits resulting from assets that are not included in rate base. In support of this argument Citizens asserts that the Commission has applied that same treatment to a category known as plant financed by customer advances, which, like contract plant, is not included in a public utility's rate base.

The Commission unfortunately has failed to respond to Citizens' contention in this regard. Therefore, we are denied an explanation by the Commission why its treatment of tax benefits resulting from contract plant should now differ from its treatment of tax benefits resulting from other assets that are not included in rate base. But Citizens has not suggested any reason that would forbid the Commission to treat tax benefits associated with contract plant differently from tax benefits associated with advanced plant. Therefore, we do not agree with Citizens that the Commission could not adopt a different *216 view regarding the tax benefits resulting from contract plant.

Citizens also argues that the decision reducing the income tax expense for the 1983 test year may cause the company problems under certain normalization requirements of the Federal income tax laws. According to Citizens, the Internal Revenue Code requires it to use the same depreciation method in computing, for ratemaking purposes, both its depreciation expense and its income tax expense. This insures that the tax benefits resulting from the company's use of accelerated depreciation for tax purposes do not flow through to the ratepayers by way of a reduction in the company's rates. If flow-through occurs, the company may lose the right to claim, for income tax purposes, accelerated depreciation on its property. Thus, Citizens contends that the Commission's denial of the tax benefits for test year 1983 may jeopardize the company's right to claim accelerated depreciation deductions for Federal income tax purposes. Moreover, the company asserts that the Commission has a policy of acting in conformity with normalization requirements established by the Internal Revenue Service. The result in this case, the company fears, may be the loss of the very tax benefit the Commission is ordering the company to pass on to its ratepayers.

We agree with the Commission that the company's normalization argument has been waived. The argument should have been presented to the Commission in the first instance, and Citizens' failure to include the issue in its application for rehearing with the Commission precludes the company from raising it now, on judicial review. (Ill. Rev. Stat. 1983, ch. 111 2/3, par. 71; see Independent Voters of Illinois v. Illinois Commerce Comm'n (1987), 117 Ill. 2d 90, 100-01.) The basis for the Commission's decision with respect to the denial of tax benefits for the 1983 test year was clear. As we indicated earlier, *217 in determining that Citizens had not waived consideration of its retroactive-ratemaking argument, the Commission's order was primarily a justification for its treatment of the 1983 test year benefits. The Commission believed that the ratepayers should not have to bear a tax expense greater than the amount actually attributable to the company's operations. Thus, the basis for the Commission's decision on this point was apparent, and if Citizens believed that the Commission's decision was inconsistent

with certain Federal income tax requirements, Citizens should have voiced that concern to the Commission. Instead, Citizens failed to include this issue in its application for rehearing filed with the Commission.

Moreover, we do not agree with Citizens that the normalization argument did not become available until after the Commission rendered its decision in this case. Citizens correctly observes that the private letter ruling it now cites in support of its argument was not issued by the Internal Revenue Service until July 29, 1986, after the case had left the Commission's control. But the private letter ruling, which was issued to a different taxpayer, and which has no precedential effect, was an interpretation of existing tax provisions and regulations, and Citizens makes no claim that the provisions and regulations were not in existence at the time the instant controversy arose.

For the reasons stated, the judgment of the appellate court is affirmed.

Judgment affirmed.

JUSTICE STAMOS took no part in the consideration or decision of this case.

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Case Name:

Union Gas Ltd. v. Ontario (Energy Board)

Between
Union Gas Limited, Appellant, and
Ontario Energy Board, Respondent

[2015] O.J. No. 3276

2015 ONCA 453

Docket: C58756

Ontario Court of Appeal

A. Hoy A.C.J.O., J.M. Simmons and M.H. Tulloch JJ.A.

Heard: December 16, 2014.
Judgment: June 22, 2015.

(105 paras.)

Natural resources law -- Public utilities -- Regulatory tribunals -- Licensing and rate-making -- Appeals -- Statutory appeals -- Provincial boards, tribunals and commissions -- Appeal by gas company from dismissal of appeal from Ontario Energy Board decision that certain earnings were "gas transportation costs" dismissed -- Board concluded that appellant engaged in Firm Transportation Risk Alleviation Mechanism transactions on planned basis, generating revenue, which was to be shared with customers -- Board's decision did not depart from rate-setting agreement -- Board did not engage in impermissible rate-setting -- Earnings were "encumbered", and subject to further disposition, because appellant was bringing forward accounts for review and approval and it generated and classified revenues in manner inconsistent with regulatory principle inherent in agreement.

Appeal by a gas distributor from the dismissal of its appeal from an Ontario Energy Board decision that certain earnings were "gas transportation costs". In April 2012, the appellant applied to the Board for an order amending the rates it would charge to its customers for natural gas as of October 2012. As a preliminary matter at a 2012 proceeding to determine the amount of the appellant's utilities earnings for 2011 to be returned to customers, the Board concluded that the appellant engaged in Firm Transportation Risk Alleviation Mechanism transactions on a planned basis by over-purchasing transportation contracts and selling the surplus while shipping gas to customers using lower-cost

arrangements. The Board's decision meant that the resulting profits should have been returned to the customers instead of divided in accordance with an earnings sharing mechanism that applied to "utilities revenue". The appellant appealed to the Divisional Court arguing that the Board's classification of the amount as "gas transportation costs" amounted to impermissible retroactive rate-making. The Divisional Court dismissed the appellant's appeal finding that the Board's decision was reasonable. The Court found that the Board had an overarching obligation to ensure that rates were "just and reasonable" and subject to yearly review and approval. It found that the earnings were "encumbered", and subject to further disposition, because the appellant was bringing forward its 2011 accounts for review and approval, in accordance with the statutory framework and Board policy and that the earnings for a calendar year could only be calculated after the year ended. The Court further found that it was only during the 2012 hearing that the true scope and nature of the FT-RAM program was revealed to the Board. The appellant sought to appeal the decision of the Divisional Court arguing that the Board acted unreasonably in reclassifying its 2011 FT-RAM revenues as gas supply cost reductions because the reclassification was an unauthorized departure from the terms of a rate-setting agreement that the Board had approved and that it amounted to impermissible **retroactive ratemaking.**

HELD: Appeal dismissed. The Board's finding that monies generated by the appellant's 2011 FT-RAM transactions were generated on a planned basis, and were therefore distinguishable from other revenues were findings of fact that were not subject to review on appeal. The Board's decision was nothing more than a review of the nature of the revenues brought forward for sharing and a determination that some of such revenues did not qualify for such treatment. As a result, the Board's decision could not been seen as unreasonable on the basis that it was a departure from the terms of the rate-setting agreement. The Board did not engage in impermissible retroactive rate-setting. The FT-RAM revenues were effectively encumbered and subject to further disposition by the Board. Under the terms of the agreement, following its year-end, the appellant was obliged to bring forwards for the Board's review and approval amounts it classified as utilities earnings that were subject to sharing with customers and the appellant knew that the Board's determination would impact rates. Further, the manner in which the appellant generated its 2011 FT-TAM revenues and its classification of those revenues as utility earnings was inconsistent with the agreement and violated the regulatory principle inherent in the agreement. Given that the determination was inherently retrospective and the appellant failed to disclose in advance the true nature of its intended 2011 FT-RAM activities, it was not unreasonable for the Board to treat the appellants 2011 FT-RAM revenues as encumbered and subject to further disposition in the form of a credit to customers.

Statutes, Regulations and Rules Cited:

Ontario Energy Board Act, 1998, S.O. 1998, c. 15 Sch. B, s. 19(2), s. 33(2), s. 36, s. 36(1), s. 36(2), s. 36(3), s. 36(4.1), s. 36(4.2)

Appeal From:

On appeal from the order of the Divisional Court (Justices Colin D.A. McKinnon and Susan G. Himel, Justice Herman J. Wilton-Siegel dissenting) dated December 20, 2013, with reasons reported at 2013 ONSC 7048, 316 O.A.C. 218, affirming the decision of the Ontario Energy Board, dated November 19, 2012.

Counsel:

Patricia D.S. Jackson, Crawford Smith and Alex Smith, for the appellant.

Michael Millar, for the respondent.

The judgment of the Court was delivered by

J.M. SIMMONS J.A.:--

A. INTRODUCTION

1 Union Gas Limited appeals with leave from an order of the Divisional Court dismissing Union's appeal from a decision of the Ontario Energy Board. The main issue on appeal is whether the Board's decision contravened the principle against **retroactive ratemaking.**

2 In April 2012, Union applied to the Board for an order amending the rates it would charge to its customers for natural gas as of October 2012. A primary purpose of the application was to adjust rates as a result of allocating a portion of Union's 2011 utility earnings between Union and its ratepayers under the terms of an Earnings Sharing Mechanism ("ESM") contained in an Incentive Regulation Mechanism Settlement Agreement (the "IRM Agreement").

3 In 2007, Union entered into the IRM Agreement with parties representing its major stakeholders and constituents (the "interveners") to provide for a five-year period of incentive regulation. By order made in January 2008, the Board approved the IRM Agreement. The IRM Agreement contained the ESM, under which Union agreed to share utility earnings greater than two per cent above its regulated rate of return with ratepayers.

4 As part of the IRM Agreement, Union agreed to reduce its revenue requirement by $4.3 million. In exchange for this reduction, four deferral accounts previously established by the Board were eliminated.

5 Deferral accounts allow a regulator to separately accumulate certain amounts (costs or revenues) before deciding by order, at specified intervals, to what extent, if at all, such costs or revenues will be charged to ratepayers as part of rates. Because it is contemplated from the outset that amounts in deferral accounts will be disposed of in a manner that affects rates, deferral accounts do not offend the principle against **retroactive ratemaking.**

6 At least one of the four eliminated deferral accounts tracked upstream transportation optimization revenues. Union generated upstream transportation optimization revenues through transactions with third parties in which Union disposed of upstream transportation services.

7 In the past, the Board had directed that Union share the upstream transportation optimization revenues in the eliminated deferral accounts with ratepayers based on a 75/25 split in favour of ratepayers.

8 As a result of the elimination of the four deferral accounts, under the IRM Agreement, Union was able to keep net revenues that would previously have been recorded in those accounts, subject to the ESM.

9 Union's April 2012 application for a rate order included a request to share with ratepayers $22 million in 2011 revenues Union had earned using TransCanada Pipelines Limited's ("TCPL") Firm Transportation Risk Alleviation Mechanism ("FT-RAM") program under the ESM.

10 Under the FT-RAM program, utilities earned credits for unused firm[1] transportation services, which the utilities could then use to purchase cheaper interruptible transportation services. Union was able to monetize the credits it earned under the FT-RAM program through various assignment and exchange transactions with third parties.

11 Union classified its 2011 FT-RAM earnings as upstream transportation optimization revenues -- that is, as utility earnings that would previously have been recorded in one of the eliminated deferral accounts. In a procedural order in Union's application, the Board directed that Union's classification of its 2011 FT-RAM revenues be dealt with as a preliminary issue in the proceeding.

12 In its decision on the preliminary issue, the Board rejected Union's classification of its 2011 FT-RAM revenues as utility earnings and concluded instead that the disputed $22 million should be classified as "gas supply cost reductions". As such, the revenues would ordinarily be passed through to ratepayers, and Union would not be entitled to any portion of them.

13 The Board found that Union had used the FT-RAM program to generate profits on its upstream transportation portfolio on a planned basis -- whereas Union's past upstream transportation optimization activities had occurred on an unplanned basis. Because upstream transportation costs are passed through entirely to ratepayers, the Board found that Union's planned profit-making on its upstream transportation portfolio was inconsistent with the IRM Agreement and the regulatory principle imbedded in it that a utility "cannot profit from the procurement of gas supply for its customers."

14 The Board concluded that it was entitled to reclassify the FT-RAM revenues because it was part of its mandate to ensure that revenues were being properly characterized under the IRM Agreement and in a manner that resulted in just and reasonable rates.

15 While acknowledging that gas supply costs (and gas supply cost reductions) are ordinarily passed through entirely to ratepayers, the Board directed that 90 per cent of the $22 million should be credited to ratepayers and that 10 per cent should be credited to Union as an incentive for generating the revenues. In a subsequent rate order, the Board directed that the funds should be recorded in a newly created deferral account.

16 Union appealed the Board's decision on the preliminary issue to the Divisional Court.

17 Before the Divisional Court, Union argued that the Board had already approved the gas supply cost reductions to be credited to ratepayers for 2011 through final rate orders made in Quarterly Rate Adjustment Mechanism ("QRAM") proceedings, which disposed of deferral accounts relating to upstream gas and transportation costs. Accordingly, Union maintained that by reclassifying Union's

2011 FT-RAM revenues as gas supply cost reductions, the Board engaged in impermissible **retroactive ratemaking.**

18 In a split decision, the Divisional Court found that the Board's reclassification of the 2011 FT-RAM revenues did not amount to impermissible **retroactive ratemaking.** The majority concluded that the revenues at issue were not dealt with in the 2011 QRAM proceedings. Moreover, because the revenues were brought forward as part of the ESM proceeding, they were effectively "encumbered", and therefore subject to further disposition by the Board. The majority held that the Board's statutory rate-making authority is broad and "[does not] in any manner constrain the Board from making orders respecting matters which arose in a previous year but had not been specifically dealt with as a discrete item in the rate-setting process."

19 Union now appeals to this court with leave and argues that the Board acted unreasonably in reclassifying Union's 2011 FT-RAM revenues as gas supply cost reductions for two reasons.

20 First, it says the reclassification was an unauthorized departure from the terms of the IRM Agreement, which the Board had approved as the mechanism for setting rates during the IRM period. Second, it says the reclassification amounted to impermissible **retroactive ratemaking.** This is because gas supply cost deferral accounts had already been disposed of through final orders in the 2011 QRAM proceedings and because there was no separate deferral account for FT-RAM revenues in relation to which the Board could make a further disposition. According to Union, the Board's decision is thus a classic impermissible attempt to remedy past rates the Board later concluded were excessive.

21 For the reasons that follow, I would dismiss Union's appeal.

B. BACKGROUND

(1) Union

22 Union is an Ontario corporation that sells, distributes, transmits and stores natural gas. It does not produce natural gas. From its head office in Chatham, Union services approximately 1.4 million residential, commercial and industrial customers across northern, southwestern and eastern Ontario.

(2) The Board and its Authority

23 The Board is a statutory tribunal governed by the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B. Among other powers, the Board has authority to set rates for the sale, transmission, distribution and storage of gas in the natural gas sector: s. 36(1).[2] The Board carries out its rate-setting function by issuing orders: s. 19(2). In making orders, the Board is not bound by the terms of any contract: s. 36(1).

24 Under s. 36(2) of the Act, 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" (emphasis added).

25 Just and reasonable rates permit a utility to recover its prudently incurred costs and earn a fair return on invested capital: see, for example, *Power Workers' Union, Canadian Union of Public Employees, Local 1000 v. Ontario (Energy Board)*, 2013 ONCA 359, 116 O.R. (3d) 793, at paras. 13, 30-32, leave to appeal to S.C.C. granted, [2013] S.C.C.A. No. 339, appeal heard and reserved December 3, 2014; *Northwestern Utilities Ltd. v. Edmonton (City)*, [1929] S.C.R. 186, pp. 192-3.

26 Under s. 36(3) of the Act, "[i]n approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate."

27 Deferral accounts are not defined in the Act. However, under ss. 36(4.1) and (4.2), the Board must dispose of the balances in deferral accounts at specified intervals. Deferral accounts relating to the commodity of natural gas are to be reflected in rates within a maximum of three months, and deferral accounts relating to other items, including transportation costs, are to be reflected in rates within a maximum of 12 months.

(3) The Board's Practice in Setting Union's Rates

28 Historically, the Board set Union's natural gas rates following an annual cost of service hearing at which the Board established Union's revenue requirement, consisting of a forecast of Union's costs, including a return on equity, over a future year or test period. As part of the rate-setting process, typically the Board established various deferral accounts to allow it to defer consideration of revenues and expenses that could not be forecast with certainty.

29 Between 2008 and 2012, Union's natural gas rates were set through a Board-approved Incentive Regulation Mechanism -- the IRM Agreement.

30 During incentive regulation, a utility's base rates are set initially through a cost of service proceeding and then adjusted annually using a pre-approved pricing mechanism intended to encourage productivity or efficiency improvements. If a utility is able to increase revenues or reduce costs during incentive regulation, it is permitted to retain its "over-earnings" in excess of its regulated return on equity -- but subject to the terms of any earnings sharing mechanism under which the utility has agreed to share its earnings with its ratepayers.

31 I will return later to the terms of the IRM Agreement.

(4) Upstream Transportation Optimization

32 To ensure a consistent supply of gas to its customers, Union holds a portfolio of upstream transportation contracts that provide gas transportation on a firm basis from supply basins across North America to Union's storage, transmission and distribution system in Ontario.

33 Because it is difficult to predict with accuracy how much firm transportation capacity is required in any given year, as part of maintaining a conservative gas supply plan that will ensure a consistent supply of natural gas, a utility may, from time-to-time, have excess firm transportation capacity.

34 Traditionally, the Board has passed through the cost of upstream transportation entirely to ratepayers through the use of deferral accounts. However, where a utility was able to generate revenue

by disposing of unused transportation capacity through transactions with third parties, the Board has generally permitted the utility to retain some portion of the revenues generated from these transactions to encourage the utility to dispose of the unused capacity. The transactions themselves are generally referred to as "optimization activities" or "transactional services".

35 Prior to the IRM Agreement, revenue earned from upstream transportation optimization activities was recorded in various deferral accounts. In the past, the Board had ordered that these accounts be cleared at least annually on the basis that ratepayers receive 75 per cent of the revenues through a rate reduction and Union retain the remaining 25 per cent of revenues.

(5) The IRM Agreement

36 As indicated above, for the period 2008 to 2012, Union entered into the IRM Agreement with the interveners. In January 2008, the Board approved the IRM Agreement as an acceptable incentive regulation program.

37 The following aspects of the IRM Agreement are significant for the purposes of this appeal:

* The IRM Agreement identified so-called "Y factors", which are costs incurred by Union that would be passed through entirely to customers during the term of the IRM Agreement. Items treated as "Y factors" in the IRM Agreement included upstream gas and transportation costs.

* The IRM Agreement eliminated four deferral accounts, which had been previously maintained. In return for closing these accounts, Union increased the optimization margin built into rates from $2.6 million to $6.9 million. Put another way, Union agreed to fund a $4.3 million annual decrease in rates and assumed the risk of earning sufficient optimization revenue to offset that decrease.

* The IRM Agreement included the ESM, which initially provided that utility earnings greater than two per cent above Union's regulated rate of return would be shared 50/50 with ratepayers.

* The IRM Agreement permitted the parties to re-open it if Union's earnings exceeded its regulated return on equity by more than three per cent.

38 When Union's earnings for 2008 did exceed three per cent, the parties to the IRM Agreement entered into a further Settlement Agreement amending the terms of the IRM Agreement (the "Amending Agreement"). Among other things, the Amending Agreement provided that earnings over three per cent of Union's regulated rate of return were to be shared 90/10 in favour of ratepayers. The Board approved this amendment by order.

(6) QRAM Proceedings

39 As indicated above, depending on the type of deferral account, the Act requires that they be cleared at least quarterly or annually. Given the frequency with which deferral accounts must be cleared, the Board developed QRAM proceedings. They provide an abbreviated and mechanistic hearing process used to clear some, but not all, deferral accounts.

40 In 2011, Union brought five deferral accounts forward for disposition every quarter through QRAM proceeding. Some of these accounts included gas transportation related costs. Union did not bring the disputed $22 million in FT-RAM revenues forward for disposition in any of the 2011 QRAM proceedings.

(7) Union's April 2012 Application

41 The application giving rise to this appeal was brought in April 2012. As indicated above, Union filed an application at that time seeking an order amending or varying the rates charged to customers as of October 2012. A key purpose of the application was to dispose of 2011 utility earnings in accordance with the ESM.

42 In its application, Union included as utility earnings total optimization revenues for 2011 of $31.7 million, $22 million of which was attributable to FT-RAM optimization.

(8) Union's 2013 Cost of Service Proceeding

43 On November 10, 2011, Union filed an application with the Board for an order approving or fixing its rates effective January 1, 2013. The appropriate treatment of FT-RAM revenues was an issue in that proceeding. The cost of service decision is relevant because the Board incorporated the evidentiary record from the 2013 cost of service proceeding as part of the record on the preliminary issue.

C. DECISIONS BELOW

(1) The Board's decision on the Preliminary Issue

44 Prior to dealing with Union's application, the Board determined that it would address Union's treatment of upstream transportation optimization revenues in 2011 as a preliminary issue.

45 The Board described the preliminary issue as follows: "Has Union treated the upstream transportation optimization revenues appropriately in 2011 in the context of Union's existing IRM framework?"

46 In its decision on the preliminary issue, the Board accepted the argument of several interveners that TCPL's FT-RAM program allowed Union to create revenue opportunities by planning to replace higher cost firm upstream transportation services paid for by ratepayers with lower cost upstream transportation arrangements:

> The Board agrees with the submissions of parties that *the utilization of TCPL's FT-RAM program by Union allows Union to manage its upstream*

> *transportation arrangements on a planned basis by leaving pipe empty and flowing gas on a different and cheaper path. The Board finds that the effect of this activity is that higher upstream transportation costs that are paid for by Union's customers, have been substituted with lower cost upstream transportation arrangements.* [Emphasis added.]

47 As noted by the Divisional Court, the Board used even stronger language in its companion decision on the related 2012 cost of service proceeding in describing Union's actions. For example, the Board said:

> The Board finds that the record in this proceeding is clear that firm assets are being made available for transactional services on a planned basis, with releases occurring prior to the commencement of the heating season and with capacity being assigned for up to a full year. ...
>
> ... the record in this proceeding suggests that Union's optimization activities have, in their own right, become a driver of the gas supply plan and are no longer solely a consequence of it.
>
> *The Board finds that Union's ability to "manufacture" optimization opportunities undermines the credibility of Union's gas supply planning process, the planning methodology, and the resulting gas supply plan.*
>
> As submitted by various parties to this proceeding and Board staff, *Union has had an incentive to contract excessive upstream gas transportation services to the detriment of the ratepayer. Union has not filed convincing evidence that the amount and type of upstream gas transportation contracts procured on behalf of ratepayers reflects the objective application of its gas supply planning principles.* [Emphasis added.]

48 In the light of its finding that Union had acted on a planned basis, the Board concluded that treating FT-RAM revenues as utility earnings was "inconsistent" with the IRM Agreement -- and contrary to the regulatory principle inherent in it -- that the cost of upstream transportation is a pass-through item from which Union is not entitled to profit:

> The Board finds that Union has used TCPL's FT-RAM program to create a profit from the upstream transportation portfolio and has treated this profit as utility earnings, subject only to the provisions of the earnings sharing mechanism.
>
> *The Board finds that this treatment is inconsistent with the Settlement Agreement on the IRM Framework and contrary to long standing regulatory principle inherent in the IRM Framework that the cost of gas and upstream transportation are to be treated as pass-through items, and therefore that Union cannot profit from the procurement of gas supply for its customers.* [Emphasis added.]

49 Instead, the Board determined that the monies generated from FT-RAM activities should be treated as gas supply costs savings:

> As such, the Board finds that Union's upstream transportation FT-RAM optimization revenues are gas cost reductions, and are properly considered Y factor items in accordance with Union's IRM Framework.

50 However, although gas supply cost reductions would normally be passed through completely to ratepayers, the Board noted that "absent an incentive, [Union] may not have undertaken these [optimization] activities."

51 Accordingly, the Board directed that ratepayers would be entitled to 90 per cent of the $22 million net revenue amount related to Union's 2011 FT-RAM activities in the form of an offset to gas supply costs and that Union would be entitled to receive a 10 per cent incentive for having generated the net revenues.

52 In the course of its reasons, the Board rejected Union's arguments that reclassifying the FT-RAM revenues would undo the IRM Agreement and amount to **retroactive ratemaking.**

53 The Board noted that it was reclassifying revenues based on evidence filed in Union's 2013 cost of service proceeding, which the Board incorporated by reference. The Board stated that the reclassification of revenues "[was] consistent with the IRM Framework".

54 Moreover, the Board found that it had "an ongoing responsibility to determine whether activities undertaken during the IRM term [were] being characterized in accordance with the IRM Framework and have been characterized in a manner which results in just and reasonable rates."

55 Accordingly, "the annual disposition of deferral accounts, earnings sharing, and other accounts that are part of Union's IRM Framework is not merely a mechanical exercise." Instead, "it is a process that is informed by evidence relating to the balances in those accounts and whether those balances reflect the appropriate application of the IRM Framework and the regulatory principles inherent in it."

56 The Board also rejected Union's arguments that its FT-RAM activities were no different than optimization activities or transactional services in which Union had engaged in the past and that treating its FT-RAM activities as gas supply cost reductions would be inconsistent with the descriptions and historical use of deferral accounts.

57 The Board found that evidence in prior proceedings led to the conclusion that upstream optimization opportunities were generally only available on an *unplanned* basis. Further, Union had not pointed to any evidence filed prior to the concurrent cost of service proceeding that fully explained how the FT-RAM revenues were being generated.

58 In this regard, the Board noted that an "information asymmetry ... exists" between Union and its ratepayers and that Union had an obligation to make "a much higher level of disclosure than was produced in prior proceedings" concerning "departures or potential departures ... from regulatory principle inherent in the IRM Framework".

59 Despite its findings concerning the 2011 FT-RAM revenues, the Board rejected submissions from some of the interveners that it should address FT-RAM revenues earned prior to 2011.

60 The Board directed Union to advise it of the gas supply related deferral account(s) in which the reduction to ratepayers would be recorded and to file a draft accounting order for the account(s).

61 The Board subsequently issued a decision and rate order on February 28, 2013, under which the revenues from the 2011 FT-RAM optimization activities were to be recorded in a newly created deferral account.

(2) The Divisional Court's Decision

62 Union appealed the Board's decision on the preliminary issue to the Divisional Court. Before the Divisional Court, Union argued that all 2011 gas supply related costs had been dealt with through final orders in 2011 QRAM proceedings. Accordingly, by reclassifying the utility revenues as gas supply cost reductions to be passed through to ratepayers, the Board varied what were final rate orders and engaged in impermissible **retroactive ratemaking.**

63 The majority dismissed the appeal, holding that the Board's findings were clear that the disputed $22 million had not been dealt with as part of the 2011 QRAM proceedings and that Union had not met its disclosure obligations concerning the FT-RAM revenue. Because the "true scope and nature of the FT-RAM program" was only revealed during the 2012 rate hearing, that revenue could only be properly classified following the 2012 hearing. It followed that the $22 million was "encumbered" because "Union, in accordance with the statutory framework and Board policy, was bringing forward its 2011 accounts for review and approval."

64 During the course of their reasons, the majority stated, "the provisions of section 36 of the Act are liberal in construction and do not in any manner constrain the Board from making orders respecting matters which arose in a previous year but had not been specifically dealt with as a discrete item in the ratesetting process".

65 In the dissenting judge's view, the elimination of the deferral accounts when the IRM Agreement was entered into led to the conclusion "that the intended Y factor under the [IRM Agreement] was gross transportation costs".

66 In other words, because the upstream transportation optimization deferral accounts were eliminated, the Y factor described as upstream transportation costs in the IRM Agreement referred to the costs associated with Union's firm transportation contracts "without regard for any netting or pass-through of profits or losses on the sale of any such contracts."

67 Accordingly, under the terms of the IRM Agreement, the FT-RAM revenues were to be treated as utility revenues subject to the ESM because there was "no other account or provision that would mandate different treatment" for them.

68 The dissenting judge also rejected the Board's conclusion that a meaningful distinction could be made under the terms of IRM Agreement between FT-RAM revenues and other transactional services revenues. In his view, the Board's conclusion that a distinction existed between planned and

unplanned upstream transportation optimization activities was not justified. He concluded, "[T]he concept of 'transactional services revenues' does not, by itself, provide a basis for the re-classification of FT-RAM related revenues as gas supply costs."

69 Having concluded that the Y factor described in the IRM Agreement referred to gross transportation costs -- and therefore that FT-RAM revenues were subject to the ESM -- the dissenting judge turned to the question of the Board's authority to reclassify such revenues as gas supply cost reductions. He rejected the Board's submission on appeal that the amounts brought forward by Union were "encumbered" and questioned how, in the absence of an applicable deferral account, that condition could arise.

70 The dissenting judge concluded that neither the IRM Agreement nor the Act authorized the Board to reclassify Union's FT-RAM revenues. Rather, the Board's reclassification of Union's 2011 FT-RAM related earnings for the purposes of the ESM constituted **retroactive ratemaking,** and was, "by definition, unreasonable".

D. ANALYSIS

(1) Standard of Review

71 Under s. 33(2) of the Act, an appeal lies to the Divisional Court from an order of the Board "only upon a question of law or jurisdiction".

72 The parties agree that decisions of the Board are reviewable on appeal to the Divisional Court on a standard of reasonableness. I agree. (See, for example, *Power Workers'*).

(2) Discussion

73 Union submits that the Board's decision to reclassify the FT-RAM revenues as gas supply cost reductions is unreasonable because it is an unauthorized departure from the terms of the IRM Agreement, which the Board had approved as the mechanism for setting just and reasonable rates during the incentive regulation period, and because it constitutes impermissible **retroactive ratemaking.**

74 Union points out that, under the terms of the IRM Agreement, it reduced its revenue requirement in exchange for the elimination of the upstream transportation optimization deferral accounts. Union contends that its FT-RAM optimization activities were no different than other optimization activities in which it had previously engaged and that it is undisputed that, absent the IRM Agreement, such revenues would have fallen within the one of the eliminated upstream transportation optimization deferral accounts. By reclassifying FT-RAM revenues as gas supply cost reductions, the Board effectively unwound the IRM Agreement. Moreover, the reclassification is inconsistent with the Board's past treatment of such revenues.

75 In any event, all permissible 2011 rate adjustments based on gas supply cost reductions had already been made through final orders in the QRAM proceedings. In the absence of a deferral account that segregated specified amounts for future disposition, reclassifying the FT-RAM revenues from utility earnings to gas supply cost reductions was nothing more than an impermissible attempt to

adjust rates that had been previously set based on unanticipated circumstances -- namely, the unanticipated amount of revenue Union was able to generate by using the FT-RAM program. By definition, the Board's decision constitutes impermissible **retroactive ratemaking.**

76 I would not accept these submissions.

77 As a starting point, contrary to Union's position, the Board made an explicit finding that monies generated by Union's 2011 FT-RAM activities would not have fallen into one of the deferral accounts eliminated under the IRM Agreement. In the Board's view, this was because Union was using the program to create optimization opportunities on a planned basis, whereas the deferral accounts recorded optimization activities carried out on an unplanned basis:

> The Board notes that *Union has classified the revenues generated from its upstream transportation FT-RAM optimization activities as transactional service revenues because it believes that these activities are no different than its traditional transactional service activities.* However, *the Board finds that a review of the evidence* filed by Union in previous proceedings to answer the question: "what are transactional services" *does not lead to this conclusion.*
>
> ...
>
> The Board finds that *Union's evidence* in the RP-2003-0063 / EB-2003-0087 proceeding, when taken as whole, *does not support the conclusion that the planned optimization of gas supply related assets would be considered a transactional service. The evidence* in the above noted proceeding *explicitly speaks to the fact that with a balanced gas supply portfolio there will be few, if any, firm assets available to support transactional services on a future planned basis. In the Board's view, this statement speaks to the fact that the portion of utility gas supply assets that is available to support transactional service activities is only the portion of those assets that is temporarily surplus to the gas supply plan as a result of factors beyond Union's control. Therefore, a clear distinction can be made between Union's transactional services (including exchanges) and Union's FT-RAM related activities.* [Emphasis added.]

78 In my view, the Board's findings that monies generated by Union's 2011 FT-RAM activities were generated on a planned basis, and were thus distinguishable from upstream transportation optimization revenues that would have fallen within the eliminated deferral accounts, are findings of fact that were not subject to review on appeal to the Divisional Court.

79 In the result, rather than being a departure from the IRM Agreement that had the effect of unwinding the IRM Agreement, the Board's decision was nothing more than a review of the nature of the revenues brought forward for sharing under the ESM and a determination that some of such revenues did not qualify for that treatment. Accordingly, in my view, the Board's decision cannot be seen as unreasonable on the basis that it was a departure from the IRM Agreement. Nor was its conclusion that the FT-RAM revenues did not qualify for sharing under the ESM unreasonable.

80 Moreover, I am not convinced that the fact that the FT-RAM revenues were not segregated in a special deferral account relating specifically to gas supply cost reductions means that the Board engaged in impermissible **retroactive ratemaking** by reclassifying them as gas supply cost reductions. Rather, I conclude that the FT-RAM revenues brought forward by Union for disposition as part of the ESM proceeding were effectively "encumbered" and subject to further disposition by the Board.

81 This issue requires a discussion of the principle against **retroactive ratemaking.**

82 It is well established that an economic regulatory tribunal, such as the Board, operating under a positive approval scheme of ratemaking must exercise its rate-making authority on a prospective basis. Generally speaking, absent express statutory authorization, such a regulator may not exercise its rate-making authority retroactively or retrospectively.

83 As noted by the Divisional Court majority, the classic explanation for the general presumption against the retroactive operation of statutes is set out in *Young v. Adams*, [1898] A.C. 469, at p. 476:

> [I]t manifestly shocks one's sense of justice that an act legal at the time of doing it should be made unlawful by some new enactment.

84 In *Bell Canada v. Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722, ("*Bell Canada 1989*"), at p. 1749, Gonthier J. writing for the court, characterized **retroactive ratemaking** as ratemaking the purpose of which "is to remedy the imposition of rates approved in the past and found in the final analysis to be excessive."

85 At p. 1759 of the same case, Gonthier J. explained that "the power to review its own previous final decision on the fairness and reasonableness of rates would threaten the stability of the regulated entity's financial situation."

86 From the ratepayers' perspective, **retroactive ratemaking** may create unfairness because it "redistributes the cost of utility service by asking today's customers to pay for the expenses incurred by yesterday's customers": *Atco Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2014 ABCA 28, 566 A.R. 323, at para. 51.

87 Nonetheless, courts have recognized qualifications on the principle against **retroactive ratemaking.**

88 In *Bell Canada 1989*, at pp. 1752-1761, the Supreme Court concluded that the power to make interim orders necessarily implies the power to modify, by final order, the rates created under an interim order.

89 In *Bell Canada v. Bell Alliant Regional Communications*, 2009 SCC 40, [2009] 2 S.C.R. 764, ("*Bell Alliant*"), the Supreme Court noted, at para. 54, that deferral accounts are "accepted regulatory tools" that "'enabl[e] a regulator to defer consideration of a particular item of expense or revenue that is incapable of being forecast with certainty for the test year'".

argument. The court found, at para. 53, that "the utility must also be taken to know that the rates will be subject to change as a result of the non-inclusion of those assets in the rate base."

94 In this case, Union does not dispute that, under the terms of the IRM Agreement, following its year-end, it was obliged to bring forward for the Board's review and approval amounts it classified as utility earnings that were subject to sharing under the ESM. Union also knew, from the outset of the IRM Agreement, that the Board's ESM determination would impact rates. The ESM determination under the IRM Agreement was thus inherently retrospective -- and Union always knew that.

95 Further, on the Board's findings, the manner in which Union generated its 2011 FT-RAM revenues and its classification of those revenues as utility earnings was inconsistent with the IRM Agreement and violated the regulatory principle inherent in the IRM Agreement that the cost of upstream transportation is a pass-through item and that a utility "cannot profit from the procurement of gas supply for its customers."

96 Although Union argued that its 2011 FT-RAM activities were no different than its previous upstream optimization activities, the Board made a specific finding that "a clear distinction can be made between Union's [unplanned] transactional services ... and Union's [planned] FT-RAM activities."

97 Significantly, prior to the 2012 hearings, the fact that the 2011 FT-RAM revenues were generated on a planned basis -- and thus in a fashion inconsistent with regulatory principle and the IRM Agreement -- was uniquely within Union's knowledge.

98 In this regard, the Board found that Union had an obligation to "be mindful of the information asymmetry that exists between it and [its] ratepayers" and "to disclose departures or potential departures that it intends to make from regulatory principle inherent in the IRM Framework."

99 In circumstances where Union knew that it was generating its 2011 FT-RAM revenues on a planned basis, Union must be fixed with knowledge, as of the date it generated those revenues, that the Board would be obliged to characterize them as a Y factor, or pass-through item, under the IRM Agreement.

100 Although the Board had permitted profit-taking on optimization activities in the past, on the Board's findings, the prior optimization activities involved disposing of unplanned surpluses of firm transportation. The 2011 FT-RAM activities were qualitatively different because they involved disposing of planned surpluses of firm transportation. Prior to the 2012 hearings, Union was the only party in a position to know that -- and must also be taken to have known that -- its actions were inconsistent with the regulatory principle inherent in the IRM Agreement.

101 In these circumstances, where the ESM determination was inherently retrospective, and where Union failed to disclose in advance the true nature of its intended 2011 FT-RAM activities, it was not unreasonable for the Board to treat Union's 2011 FT-RAM revenues as encumbered and therefore subject to further disposition by the Board in the form of a credit to ratepayers.

102 Union argues that the Board never made an express finding that Union was acquiring excess firm transportation during 2011. While the Board may not have said so expressly, on a fair reading of

90 Although *Bell Alliant* involved the disposition of funds in a deferral account, at paras. 61 and 63, Abella J. also used the term "encumbered" to explain why the disposition of funds in a deferral account for one-time credits to ratepayers did not constitute impermissible **retroactive ratemaking.** A key feature of her reasoning was that it was known from the beginning that funds accumulated in the deferral accounts at issue were subject to further disposition by the regulator in the form of credits to ratepayers. She said:

> [61] In my view, because this case concerns encumbered revenues in deferral accounts ... we are not dealing with the variation of final rates. As Sharlow J.A. pointed out, [the principle from] *Bell Canada 1989* [that retroactive or retrospective ratesetting is impermissible] is inapplicable because *it was known from the outset in the case before us that Bell Canada would be obliged to use the balance of its deferral account in accordance with the CRTC's subsequent direction.*
>
> ...
>
> [63] In my view, the credits ordered out of the deferral accounts in the case before us are neither retroactive nor retrospective. They do not vary the original rate as approved, which included the deferral accounts, nor do they seek to remedy a deficiency in the rate order through later measures, since *these credits or reductions were contemplated as a possible disposition of the deferral account balances from the beginning. These funds can properly be characterized as encumbered revenues, because the rates always remained subject to the deferral accounts mechanism established in the Price Caps Decision.* The use of deferral accounts therefore precludes a finding of retroactivity or retrospectivity. Furthermore, using deferral accounts to account for the difference between forecast and actual costs and revenues has traditionally been held not to constitute retroactive rate-setting [Citations omitted and emphasis added.]

91 More recently in *Atco Gas,* the Alberta Court of Appeal explained that "[s]lavish adherence to the use of interim rates and deferral accounts should not prohibit adjustments" in a proper case: at para. 62. Moreover, "[s]imply because a ratemaking decision has an impact on a past rate does not mean it is an impermissible retroactive decision": at para. 56. Rather, "[t]he critical factor for determining whether the regulator is engaging in **retroactive ratemaking** is the parties' knowledge [that the rates were subject to change]": at para. 56.

92 In that case, the regulator directed Atco to remove certain surplus assets from its rate base and revenue requirement, and backdated the effective date of the removal to an earlier date. The earlier date was the day after the Alberta Court of Appeal issued a decision indicating that Atco did not require the regulator's consent to remove the asset from its rate base. Removal of the assets from the rate base and revenue requirement caused a decrease in rates, and since the regulator backdated the effective date of the removal, rates were decreased after the fact.

93 On appeal to the Alberta Court of Appeal, Atco argued that the regulator could only change the rates by using an interim order or deferral account. The Alberta Court of Appeal rejected that

their decision on the preliminary issue in combination with their decision on the 2012 cost of service proceeding, in my view, that message is very clear.

103 Having regard to all the circumstances, I am not persuaded that the majority of the Divisional Court erred in characterizing the 2011 FT-RAM revenues that Union brought forward in its 2012 application as encumbered or that the Board's decision to reclassify those revenues as gas supply cost reductions was unreasonable.

E. DISPOSITION

104 Based on the foregoing reasons, the appeal is dismissed.

105 Neither party requested costs and none are awarded.

J.M. SIMMONS J.A.
A. HOY A.C.J.O.:-- I agree.
M.H. TULLOCH J.A.:-- I agree.

* * * * *

Appendix "A"

Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B.

19. (2) The Board shall make any determination in a proceeding by order.

33. (1) An appeal lies to the Divisional Court from,

(a) an order of the Board ...

(2) An appeal may be made only upon a question of law or jurisdiction and must be commenced not later than 30 days after the making of the order or rule or the issuance of the code.

36. (1) No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract.

...(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.

(3) In approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate.

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...

(4.1) If a gas distributor has a deferral or variance account that relates to the commodity of gas, the Board shall, at least once every three months, make an order under this section that determines whether and how amounts recorded in the account shall be reflected in rates.

(4.2) If a gas distributor has a deferral or variance account that does not relate to the commodity of gas, the Board shall, at least once every 12 months, or such shorter period as is prescribed by the regulations, make an order under this section that determines whether and how amounts recorded in the account shall be reflected in rates.

1 Firm transportation refers to the quality of upstream transportation. Firm transportation cannot be interrupted by the transportation supplier, whereas interruptible transportation can be interrupted.

2 The text of relevant provisions under the Act is included in Appendix "A".

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Indexed as:

Trusts and Guarantee Co. v. National Debenture Corp. (Trustee of)

Between
The Trusts and Guarantee Company Limited, and
The Trustee of the Property of the National Debenture Corporation Limited

[1946] O.J. No. 82

[1946] O.W.N. 385

[1946] 3 D.L.R. 28

1946 CarswellOnt 180

Ontario Supreme Court - Court of Appeal
Toronto, Ontario

Robertson C.J.O., Laidlaw and Hogg JJ.A.

Heard: February 19, 1946.
Judgment: released April 2, 1946.

(36 paras.)

Counsel:

H.E. Manning, K.C., for the appellant.
S.A. Shoemaker, K.C., for the respondent.

Separate reasons for judgment were delivered by Robertson C.J.O., Laidlaw and Hogg JJ.A.

1 **ROBERTSON C.J.O.**:-- In this case, by order of April 24th, 1931, the Plaintiff as trustee under an indenture of mortgage and charge of the property of The National Debenture Corporation Limited,

was appointed receiver of the mortgage premises, with a proviso that until further order of the Court the appointment of receiver should not apply to any assets of The National Debenture Corporation Limited except the securities and assets then in the hands of The Trusts and Guarantee Company Limited as trustee under the said indenture. Mr. G.T. Clarkson, who was appointed as trustee in the bankruptcy of The National Debenture Corporation Limited, and receiver of certain assets and undertaking of the said Company on behalf of the holders of the second floating charge debentures, having in his possession certain of the assets of The National Debenture Corporation Limited, wrote the solicitors for the Plaintiff under date of May 15th, 1931, stating his understanding that the Plaintiff would at once take the requisite steps to sell the specifically mortgaged premises, or collateral which was then in the hands of the Plaintiff, with a view to paying the bondholders, and the incidental costs to which the Plaintiff would be entitled. By the same letter Mr. Clarkson undertook that should there be a deficiency through the Plaintiff realizing from the sale of the collateral less than the amount required to pay off the bonds, with accrued interest and costs, he would forthwith pay to the Plaintiff out of the first moneys of The National Debenture Corporation Limited coming into his hands, the full amount of such deficiency. By a further letter of May 19th, 1931, Mr. Clarkson wrote the Plaintiff's solicitor assuring him that there were assets sufficient to take care of any deficiency that might occur in connection with the debenture issue for which the Plaintiff was trustee.

2 The effect of these letters was to make Mr. Clarkson, as trustee and receiver, substantially a guarantor of the deficiency, if any, that might arise upon the realization of the assets in the Plaintiff's hands. It is incomprehensible to me that there should ever have been any question of Mr. Clarkson's right to notice of the passing of the Plaintiff's accounts. The purpose of passing the accounts was to ascertain how much he had to pay under the undertaking aforesaid.

3 There has been some confusion owing to the unfortunate treatment of the Master's report on passing accounts, as an order. The judgment of April 24th, 1931, leaves no room for doubt as to the character of the proceedings before the Master under the order of reference contained in that judgment. No doubt, some misunderstanding is to be attributed to the fact that some years elapsed between the date of the judgment and the final passing of accounts, and the solicitors who acted in the passing of accounts may not have been familiar with what had occurred at the time the judgment was taken out and immediately following thereupon.

4 I agree that the appeal should be allowed, and that the Appellant should have an order requiring the Plaintiff to pass its accounts, on proper notice to the Appellant. The Appellant should have the costs of the motion below and of this appeal.

5 LAIDLAW J.A.:-- The appellant is trustee of the property of The National Debenture Corporation Limited appointed pursuant to the provisions of The Bankruptcy Act, R.S.O. 1927 ch. 11, after an authorized assignment by that corporation, and is defendant in an action brought by the respondent as trustee for bondholders and holder of a certain debenture under a certain indenture of mortgage and charge made by the corporation under date the 1st day of May, 1926.

6 The appeal is from an order of Hope J. dated the 22nd day of November, 1945, dismissing an application made in court on behalf of the appellant for an order requiring the respondent to bring in to the Master's Office and to pass its accounts from the 24th day of April 1931 to the date of passing the accounts and requiring the respondent to submit the bill of costs of its solicitor for examination and taxation as against the appellant.

7 The history and course of proceedings in the action have been given in the reasons for judgment of my brother Hogg and it is unnecessary for me to repeat what has been so clearly said by him.

8 The judgment of Sedgewick J. dated the 24th April 1931 expressly provides that the appointment of the respondent as receiver on behalf of the bondholders of The National Debenture Corporation Limited shall apply only to the securities and assets in the hands of the respondent as trustee at the date of the judgment. It directs a sale of the specifically mortgaged premises and enumerates the items to which the purchase money shall be applied. The Master of the Supreme Court is also directed to take and make certain accounts and enquiries including inter alia "what the property comprised in the said indenture and debenture consists and in whom the same is vested"; "what property charged by the said indenture and debenture (if any) and not described in the said indenture and debenture consists, and in whom the same is vested"; "an account of the Trust Estate and effects comprised in the said indenture coming to the hands of the Receiver or of any person or persons by the order or for the use of the plaintiff"; "an account of what is due to the plaintiff as Trustee of the said indenture". The Receiver is given certain authority to pay debts of The National Debenture Corporation Limited which have priority over the claims of the bondholders and is allowed all such payments in its accounts. And by the provisions of the judgment the Receiver is directed to pass its accounts before the Master from time to time.

9 It will be abundantly plain from the scope of the reference directed by the judgment that the appellant is a party substantially interested therein and affected thereby. It is of the utmost importance, if not a necessity, that the appellant be represented on proceedings before the Master to take accounts. It would, I think, be a breach of duty on its part to permit the accounts to be taken in the absence of its representative or to acquiesce in a report made under such circumstances. No doubt the Master fully realized the nature of the appellant's interest as Trustee in bankruptcy because upon application by the solicitor for the respondent for an appointment to pass accounts, he expressly directed that notice be given to the appellant.

10 There was no such notice given to or received by the appellant. Nevertheless the enquiry was proceeded with and a report made by the Master under date the tenth day of September 1937. I agree that the document containing the report is not an order even though it be in that form. It was described (on the back page thereof) as a report and was dealt with as such by filing it in the Registrar's Office under date September 15, 1937 as appears from a notation thereon.

11 The fact that no notice of the appointment to pass accounts and the absence of prior knowledge on the part of the appellant of the proceeding makes the enquiry by the Master and his report a nullity in law. The defect is not a mere irregularity and is not curable by the court. It goes to the very root of judicature in the matter. Rule 403(1) of The Rules of Practice an& Procedure makes it plain that "unless otherwise directed by the Master, notice of the first proceeding before him shall be given to every party affected by or interested in the inquiry --". "The first proceeding" referred to in this rule means, in my opinion, the first proceeding in the inquiry to be made by the Master. The proceedings taken by solicitor for the respondent to obtain a direction to advertise and sell certain mortgages, and subsequently to approve an advertisement cannot be considered a first proceeding in the matter of an enquiry to take accounts. Nor has the proceeding taken to obtain an order to pay a certain sum to the bondholders any relation whatever in procedure to such an enquiry. The first proceeding in the enquiry was on September 10th, 1937 being the date appointed by the Master to take accounts and the appellant was entitled both by virtue of rule 403(1) and by express direction of the Master, to notice thereof.

12 It remains only to mention the proceedings before Roach J. Counsel making the application on behalf of the present appellant treated the report made by the Master and dated the tenth day of September 1937, as an order and apparently that error was not noticed during the hearing. But because the hearing before the Master and the report made by him are null and void, no subsequent proceedings can give validity thereto and the appellant is not now prejudiced by the inappropriate and erroneous proceeding previously taken by it.

13 The appeal should be allowed and order made by Hope J. should, in my opinion, be set aside. In place thereof an order should be made in the terms of the application of the appellant. The appellant should be allowed the costs of the appeal and of the motion in the court below.

14 HOGG J.A.:-- This is an appeal against an order of Hope, J. (now J.A.) made on the 22nd November, 1945, dismissing a motion on behalf of the appellant for an order requiring the respondent to pass its accounts as receiver and to have its costs taxed.

15 The circumstances in connection with this matter are somewhat involved. On the 14th January, 1931, the National Debenture Corporation Limited made an authorized assignment under the Bankruptcy Act and Mr. G.T. Clarkson was appointed the trustee of its property. On the 24th April, 1931, a motion was heard by Sedgewick, J. -- which was turned into a motion for judgment -- on behalf of the respondent as trustee under a mortgage and charge dated 1st May, 1926, made between the National Debenture Corporation Limited and the respondent as such trustee, and judgment was given whereby the respondent was appointed receiver on behalf of the holders of certain bonds issued under the provisions of the said mortgage but provided that the appointment of receiver should not apply to any assets of the National Debenture Corporation except the securities and assets now in the hands of the respondent as trustee under the indenture of mortgage. A reference was directed by the judgment to the Master to make an inquiry into the matters set out in the judgment, inter alia, to take an account of what was due to the respondent as trustee of the said bond and mortgage. The judgment also ordered that the receiver should from time to time pass its accounts before the Master and pay its balances as the Master should direct. Leave was given to apply for such other order as the parties might be advised.

16 On the 15th May, 1931, Mr. Clarkson wrote to the solicitors for the respondent in the matter, stating that it was his understanding that they would sell the mortgaged premises, or collateral, pay the bondholders and the costs of the respondent, and that if the sum realized was not sufficient to do this, he agreed he would pay the deficiency out of the moneys of the National Debenture Corporation; also that upon the realization of the collateral and the receipt of the amount of the deficiency, if any, the respondent would pay off the bonds, refrain from taking any other proceedings in its action, and secure its discharge as receiver. Several days later Mr. Clarkson notified the solicitors for the respondent that he had assets sufficient to take care of any deficiency.

17 The first note with respect to this matter which appears in the Reference Book of Mr. I. Hilliard, K.C., the Master at the time, is dated the 18th September, 1931, when a copy of the judgment was filed by the solicitor for the respondent with the Master and a direction was given to advertise and if possible, sell certain mortgages and the bondholders were to be notified to send in their list of bonds. There is a further note that, "Mr. Clarkson authorized assignee consenting". The second entry in the Reference Book is dated the 26th September, 1931, when the solicitor for the respondent obtained approval of an advertisement directed to the bondholders. On the 11th March, 1932, it appears from a further note in the Reference Book, that an order was obtained on behalf of the respondent to pay a

certain sum to the bondholders: the order was to obtain the approval of Mr. Clarkson, who was not represented upon this application to the Master. There is evidence that the appellant was served with a notice of the motion and an affidavit in support of the same. The order was apparently taken out on the 14th March, 1932, and by it the respondent was authorized to pay the solicitors for the respondent, as trustees, the sum of $1,000 and to pay this $1,000 on account of compensation fees and disbursements. There is evidence that a copy of this order was served on the trustee, Mr. Clarkson.

18 On the 10th September, 1937, upon application by counsel for the respondent, and in the presence of Mr. J.M. Garvey, counsel for the bondholders, but in the absence of the appellant or of counsel on his behalf, the accounts of the respondent and the account of its solicitor, the late Hon. J.H. Spence, K.C., were passed before the Master. The respondent received as compensation for its services the sum of $3,225, and Mr. Spence was allowed $2,200. The report of the Master, based upon the proceedings before him, may be likened, in so far as its form is concerned, to an order, but in reality, as is stated by Hope, J., it must be taken as a report. In any event, the solicitors for the respondent regarded the document as a report of the Master and filed it on the 15th September, 1937. Notice of filing was given to Mr. Garvey. No notice of the application to the Master, which resulted in the passing of the accounts and of the report of the 10th September, 1937, was given to, or received by, Mr. Clarkson nor of the filing of the report, and he did not learn of these proceedings or of the report or the contents thereof, until the year 1940. In the Reference Book of the Master the following note appears under the date, 9th July 1937:

> "Trusts & Guarantee Co. v. National Debenture
>
> Wishart Spence for Receiver Mgr. obtained appointment to pass accts. on the 8th Sept. at 2.30. Direct that Receiver be at liberty to pay an disbursement of 25 cents on the dollar.
>
> J. M. Garvey appointed to represent bondholders on passing - notice of appt. to pass & appmt of Mr. Garvey to be gn to bondholders by ordinary mail. Also notice to Trustee in bankruptcy"

The Reference Book shows that on the 8th September, 1937, the appointment was enlarged to the 10th September, and the entry dated the 10th September, 1937, as well as the report itself, shows that the accounts in question were passed for the period from 15th March, 1932, to 7th September, 1937, in the presence of Mr. Wishart Spence for the respondent and receiver, Mr. J.M. Garvey for the bondholders, and Mr. Keegan from the respondent company.

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19 On the 13th November, 1942, application was made on behalf of the appellant before Roach, J. (now J.A.), in Chambers, for an order to set aside the, so-called, order of the Master of the 10th September, 1937. This application was dismissed with costs. The next step in the matter was the application and order which is the subject of this appeal.

20 The appellant contends that the proceedings of the 10th September, 1937, are a nullity in so far as the appellant is concerned, for the reason that notice of the appointment to pass the accounts as directed by the Master, was not given to him, and that, in any case, the report based upon the aforesaid proceedings has never been confirmed, as no notice of filing was ever served upon the

respondent, nor was an order obtained confirming the report. It is also argued that the order of Roach, J. of the 13th November, 1942, because of the circumstances, was, and is, of no force and effect.

21 Rule 403(1) provides that "unless otherwise directed by the Master, notice of the first proceeding before him shall be given to every party affected by or interested in the inquiry though any such party may not have appeared or pleaded in the action; but in the absence of special direction when default is made in appearance upon the notice, no further notice need be given unless the party in default files a written request for notice with an address for service." Notice was given to the appellant of the application of the 11th March, 1932, but several steps had been taken in the matter of the reference, apparently without notice to the appellant, prior to this date as, for instance, the approval of the advertisement respecting bondholders.

22 If what was done on the 18th and 26th September, 1931, are considered to be "first proceedings" before the Master, no notice of such proceedings was given to the appellant and the provisions of Rule 403(1) would, therefore, not apply. But whether or not the above reasoning is adopted, I do not think the terms of Rule 403(1) have any application to the present circumstances. The proceeding of the 10th September, 1937, was taken approximately five years after those of 1931 and 1932, and my conclusion is that this later proceeding must be looked at as being entirely separate from those taken formerly and is to be considered as a matter referred to the Master by the original judgment which had not before been taken up and with respect to which the Master properly directed that notice should be given to the appellant.

23 Because of the direction of the Master, before whom the application was made, which culminated in the passing of the accounts and the report of the 10th September, 1937, that notice was to be given to the appellant of the proceedings taken on that date, the effect of the failure to carry out such direction in its relation to the whole of the proceedings must be considered. The passing of the accounts was a serious and important step in the action in so far as the appellant was concerned.

24 It is argued on behalf of the respondent that Rule 185 is an answer to the claim advanced by the appellant that the proceedings may now be opened up. This rule reads:

> "An application to set aside any proceeding for irregularity shall be made within a reasonable time, and shall not be allowed if the party applying has taken a fresh step after knowledge of the irregularity."

The respondent contends, - (1) that the failure to give notice of the passing of accounts to the appellant, as directed by the Master, was merely an irregularity; and (2) that the application to set aside the proceedings was not made within a reasonable time and not before the appellant had "taken a fresh step after knowledge of the irregularity".

25 The appellant's answer is one which goes to the root of the matter, namely, that the failure to give notice was not merely an irregularity but that it rendered the whole of the proceedings respecting the passing of the accounts of the 10th September, 1937, void and of no effect. If this should be the result of the lack of notice to the appellant that the accounts were to be passed, the provisions of Rule 185 would play no part in the disposition of this matter.

26 In Fuller v. McLean (1881) 8 P.R. 549, Chancellor Boyd held that a report made by the Master upon a taking of accounts during long vacation in contravention of G.O. 425, requiring his office to be

closed at that time, is as against the defendant, who had no notice of the proceedings in the Master's office, entirely null and void.

27 In Hoffman v. Crerar 18 P.R. 473 Armour, C.J. said, quoting from Wharton's Law Lexicon, 9th ed., p. 521:

> "Nullity is an error in litigation which is incurable, and thus differs from an irregularity which is amendable."

And he said further, at p. 479:

> "A nullity cannot be waived by an act of the party against whom it has been taken, and cannot be waived by lapse of time."

28 In Hewgill v. Chadwick (1899) 18 P.R. 359, Ferguson, J. at p. 364, spoke of the terms "irregularity" and "Nullity" as follows,

> "Again where the proceeding adopted is that prescribed by the practice of the Court, and the error is merely in the manner of taking it, such error is an irregularity. But where the proceeding itself is altogether unwarranted and different from that which, if any, ought to have been taken, then the proceeding is a nullity."

29 The word "irregularity" was discussed as to its meaning in a Statute relating to the location and recording of mining claims in Callahan v. Copeland, (1899) 7 B.C.R. 422, where it was said that the word "irregularity" has as its nearest equivalent the word "informality" or "not according to form".

30 In the appeal of The Dominion Canners v. Costanza (1923) S.C.R. 46 Anglin, J. (afterwards C.J.C.) quoted, at p. 65, the words of Erle, C.J. in In re Brook and Delcomyn (1864) 16 C.B.N.S. 403 at p. 416:

> "It is one of the first principles in the administration of justice, that the tribunal which is to decide must hear both sides and give both an opportunity of hearing the evidence upon which the decision is to turn ... I find the master minds of every century are consentaneous in holding it to be an indispensable requirement of justice that the party who is to decide shall hear both sides giving each an opportunity of hearing what is urged against him."

Anglin J. said, further, that lack of jurisdiction to pronounce a judgment deprives it of any effect whatever.

31 In The Queen v. Cheshire Lines Committee, L.R. 8 Q.E. 344, Blackburn, J. said that the general rule of law "is, that every man before a decision is given against him in a judicial proceeding is entitled to be heard, although the legislature may by enactment (not necessarily by express words, if their intention can be otherwise clearly gathered) authorize a proceeding ex parte. This, however, cannot be presumed."

32 Capel v. Child, (1932) 2 Crompton & Jervis 558; Smith v. The Queen, (1878) L.R. 3 App. Cas. 614; Oswald v. Earl Grey, 24 L.J.Q.B. 72 are other well known cases. Several of the more modern cases are, The King v. Tribunal of Appeal under the Housing Act 1919 (1920) 3 K.B. 334, the judgment of the Earl of Reading, C.J. at p. 341, and Sankey, J. at p. 344; The King v. North, ex parte Oakey, (1927) 1 K.B. 491. The order with which we are concerned is, in its nature, final and not interlocutory. It declares while it stands, that the passing of accounts, while that proceeding stands, is good and valid. See Voight v. Orth, 5 O.L.R. 433.

33 Since the year 1942 there is evidence that negotiations were, from time to time, being carried on between the parties in an attempt on the part of the defendant to have the passing of accounts opened up and the whole matter settled, and this would account, in some measure at least, for the delay on the part of the defendant in taking steps to have the proceeding of the 10th September 1937 set aside. However, if the proceedings involving the passing of the accounts and the report are invalid and a nullity, and the defendant is entitled to have the proceeding set aside, lapse of time does not necessarily deprive the defendant of such right; Muir v. Jenks, (1913) 2 K.B. 412; Hoffman v. Crerar (supra). In the notes to Order 70, Rule 1, in the English Annual Practice 1933, it is said that a proceeding which is a nullity cannot be cured under the Rule, and the party affected is entitled to have it set aside ex debito justitiae.

34 It is contended on behalf of the respondent that the whole question is res judicata by the order of Roach, J. dismissing the application in Chambers made by the appellant to set aside the report. It may be that Roach, J. had not jurisdiction, sitting in Chambers, to entertain this motion, for the reason that although the report of the Master was assumed to be an order, it was in reality a report and not an order, and application should have been made in Court according to the provisions of Rule 507, but I am not called upon to decide this question if the original proceeding, namely, the passing of accounts, and taxation of costs, was a nullity.

35 I have reached the conclusion that the matter is not one of form, but one of substance, and that, in the words of Buckley L.J. in Muir v. Jenks (supra) the appellant is entitled to say, "This is a wrong judgment; set it aside." I think that the passing of the accounts and the taxation of costs on the 10th September, 1937, without notice to the appellant, was not merely an irregularity, but was a nullity, and that as a consequence, that proceeding and the subsequent proceedings, cannot stand.

36 The appeal should be allowed, with costs, and the passing of accounts and taxation of costs of the 10th September, 1937, set aside, and the whole matter of passing the accounts and the taxation, in question should be taken up de novo before the Master.