

PUBLIC UTILITY RATE CONTROL IN ALBERTA.

The activities of companies operating in Alberta what are generally described as public utilities have been regulated and controlled now for a number of years by a Commission created under an Act based on similar American legislation. The American Commissions supervise with very wide powers the organisation and operation of the companies and regulate their relations with the municipalities on the one hand, and the public on the other. Their object is to protect both the investor and the consumer. The investor is supposed to be assured of a fair return on his money, while the consumer is protected against excessive rates.¹ In the Commission is vested a wide discretion but subject to the constitutional provisions protecting property rights. In the case of Alberta the discretion is equally wide but entirely unrestrained by anything similar to the protective provisions of the Constitution of the United States and with only a limited right of appeal. Indeed, as will be seen, acting within its jurisdiction the powers of the Alberta Commission are to all intents and purposes absolute.

The importance of the functions of the Board can be realised when it is borne in mind that the regulated utilities are monopolistic. As is well understood, of course, monopoly is complementary to regulation and control. Active competition would render control, so far at least as rates are concerned, impossible. This has been so well realised that in the case of electric power companies the Alberta Board has the power, which it has on more than one occasion exercised, to refuse to permit the entry of a competing company into territory already adequately served.²

The Alberta Public Utility Commission was constituted in 1915 pursuant to The Public Utilities Act enacted in the early part of the same year.³ That Act has been revised, consolidated and amended from time to time always with the result of extending the powers of the Board.⁴

It is not here proposed to consider any of the Board's functions other than those which relate to public utilities. It does in fact deal with municipal finance and formerly with the administration

¹ 29 *Yale Law Journal* 589; *Pond on Public Utilities*.

² 1928 Alta. Stat., c. 45, s. 2.

³ 1915 Alta. Stat., c. 6.

⁴ 1923 Alta. Stat., c. 53.

of legislation relating to dealings in corporation stocks and bonds. None of these matters are in any way involved with the supervision of public utilities which in effect constitutes a separate and distinct branch of the Board's activities.

So far as public utilities are concerned its principal function is the regulation of rates. Its power to supervise the financing of these companies and their operations, although wide, are in practice exercised only as incidental to the regulation of rates.

The Board may consist of three members although normally there are only two. The members are appointed during good behaviour for periods of ten years. They are required to devote their whole time to the performance of their duties under the Act. The Board is declared to be a body corporate with perpetual succession.

As to matters within its jurisdiction the Board has authority to hear and determine all questions of law or of fact, has all such powers, rights and privileges as are vested in the Supreme Court as to the amendment of proceedings, the attendance and examination of witnesses, the production and inspection of documents, and the payment of costs, but the conduct of hearings and investigations are governed by the Board's own rules and it is not bound by the technical rules of evidence. It may delegate its powers of investigation. Its Orders may be enforced in the same way as Orders of the Supreme Court and, subject to what will be said as to appeals, such Orders are final and are not open to question, review or restraint by prohibition, injunction, certiorari or other process of any Court.

So much for the constitution and general powers of the Board! Of more particular interest, however, is its jurisdiction over utilities and the manner of its exercise in respect to rates charged by public utilities.

With the permission of the Board a public utility may construct its works through a municipality where it has no franchise or other rights if necessary for the purpose of reaching a territory where it is authorised to carry on business. It may direct extensions of service upon terms imposed by it. It exercises a general supervision over public utilities as regards equipment, appliances and safety devices. It may investigate any matter concerning a public utility, appraise and value its property, require the filing of schedules or rates, impose and enforce regulations for the safety and protection of employees, direct the manner in which its books, records and accounts are to be kept and require it to carry such depreciation accounts and funds as it may deem advisable.

The proprietor of a public utility is not permitted to discriminate between its customers or consumers; to issue any stocks, bonds or other evidence of indebtedness payable in more than one year without the authority of the Board. It may not capitalise a franchise, sell, lease, mortgage, dispose of or encumber its property without the consent of the Board, nor may it without such consent permit the transfer of any of its stock to another public utility. The Board may for the purpose of enforcing its Orders take possession and assume the management of the property of a public utility.

No franchise has validity until approved by the Board, while if the corporation to which a franchise is proposed to be granted is not subject to the legislative authority of the province, it must in the franchise agree to submit its business and operations to the control and supervision of the Board.

Utilities operated or owned by municipal corporations are not controlled by the Board although provision is made for bringing them within its jurisdiction at the option of the municipality.

The term "public utility" is defined as follows:

"Public utility" shall mean any system, works, plant or equipment for the conveyance of telegraph or telephone messages or for the conveyance of travellers or goods over a railway, street railway or tramway, or for the production, transmission, delivery or furnishing of water, gas, heat, light or power, either directly or indirectly, to or for the public.⁶

So far as natural gas is concerned this definition was extended by an amendment⁶ to include any corporation or person who supplied natural gas to a proprietor of a public utility or who contracted with such a proprietor for the transportation, scrubbing, cleansing or otherwise treating natural gas. Obviously this amendment was for the purpose of forestalling any attempt to establish excessive prices on the sale in bulk by the producers in those cases where the ownership of the natural gas field and the ownership of the distribution or transmission system were in different hands. By so doing the hands of the Board might be badly tied when fixing domestic rates. As matters now stand, insofar as natural gas which is used for distribution purposes is concerned, the Board may control the price to be charged for its production, transportation and distribution.

Just how far the Board can go in controlling a public utility created by a Federal Act or Charter is a matter of some doubt. As

⁶ 1923 Alta. Stat., c. 53, s. 2 (h).

⁶ 1927 Alta. Stat., c. 39, s. (3).

already pointed out, an effort has been made to do so by requiring that a company not subject to the legislative jurisdiction of the province, i.e., not incorporated under a Provincial Act, shall before entering into a franchise agreement submit its business and operations to the control and supervision of the Board. This would clearly seem to refer merely to business and operations in connection with the particular franchise agreement. For instance, it could hardly be extended to mean that the Board would thereby acquire any control over the right of a Dominion company to issue stock, transfer its shares to another utility or indeed to mortgage or charge its properties.

The Board is expressly given authority to increase, decrease and alter all rates, tolls and charges "as it may deem fair and reasonable." The present Act provides, however, that in the case of contracts made before the 1st day of May, 1923, this provision shall not apply except with the consent of both parties but nothing in this provision "shall be deemed to be or involve any declaration as to the state of the law in force prior to this section coming into force." The Act of 1915 made no reference to pre-existing contracts, and the Alberta Appellate Division held in the case of the *Northern Alberta Natural Gas Development Company v. City of Edmonton*,⁷ where gas rates were in question, that the Board had no power to vary rates fixed by a contract made prior to the coming into force of that Act. On appeal this point was not decided by the Supreme Court of Canada⁸ and since that time as the result of a series of decisions the Judgment of the Appellate Division, if not in terms directly over-ruled, can no longer be taken to be a correct statement of the law.⁹

The result is that the Board has and exercises the right to increase, decrease or vary contract rates regardless of whether the contract was or was not entered into prior to 1915.

In fixing rates the Board does not proceed on the basis of determining the value of the services rendered or the commodity sold,¹⁰ but adopting the practice of the American Boards ascertains the cost of the service or commodity to the Company plus a fair profit. To do this it values the property "used and useful;" in other words,

⁷ 15 Alta. L.R. 416; (1920) 1 W.W.R. 31.

⁸ 1920, 61 S.C.R. 213.

⁹ *Lethbridge v. Canadian Western Natural Gas Co.* (1923) 3 W.W.R. 976; [1923] S.C.R. 652; affirming (1923), 1 W.W.R. 838; 19 Alta. L.R. 143; *Red Deer v. Western General Electric Co.* (1924) 1 W.W.R. 1092; 20 Alta. L.R. 372; *Lethbridge v. Canadian Western Natural Gas Co.*, 20 Alta. L.R. 529.

¹⁰ *King v. Board of Public Utility Commissioners ex parte Moncton Tramways, etc. Limited*, 53 N.B.R. 469.

fixes the rate base. It then determines the rate of return or interest on the investment which the company should receive, taking into consideration the cost of the money invested, the secure, speculative or hazardous nature of the enterprise. Next it estimates the cost of operation under normal conditions, assuming a reasonable degree of economy, the annual maintenance charges and finally the amount which should be annually set aside in the form of a depreciation, amortisation or Sinking Fund account to assure to the company the return of its investment at the termination of the life of the property.

In a typical natural gas case it would, therefore, add together the amount allowed as the annual rate of return or interest on the capital investment, the annual operating and maintenance charges, together with the annual allowance for depreciation or amortisation. In principle the total so arrived at is then divided by the number of units of gas which it is estimated will be sold in the course of the year and the result is the rate or price to the consumers. To put it another way, the cost to the consumer of a unit of natural gas is the quotient arrived at by dividing the total number of units which it is estimated will be sold into the amount annually required to take care of operating costs, maintenance, depreciation and interest on the investment.

Although nominally the Board exercises its functions in connection with operating concerns it has on occasion fixed rates before the actual construction of the plant or system. In both cases the same principles are, however applied.

Whether the system or plant is actually in existence or contemplated the Board has applied in determining value the actual or historic cost theory. Although on many occasions pressed to do so it has not taken into consideration the "replacement new less depreciation" theory which has played so very large a part in the American decisions. This has presented no difficulties as on only one occasion has it been impossible owing to the paucity of evidence to arrive at the actual cost of the plant (*Red Deer and Western General Electric Co. Rate Case, supra*). In that case the Board took "what the plant is actually worth today taking into account its condition by reason of wear and tear and considering also the extent to which it has now become obsolete." Such a rough and ready method no doubt in that particular instance was justified and resulted in a fair value being arrived at but it is without any sound basis and could only be defended on the peculiar facts of that particular case.

In arriving at value the Board has in addition to the actual price paid for the plant, machinery or equipment, made allowances for organisation and administration, interest during construction, omissions and contingencies, necessary working capital, promotion and development, bond discount or money cost and actual deficits during the first lean years of operation. So far as organisation, administration, interest during construction and omissions and contingencies are concerned no comment is necessary. As to working capital it is assumed that the company necessarily employs a certain amount of money in its day to day operations and such reasonable amount is included in the cost or value of the property.

The cost of raising the money required for construction, already referred to as "bond discount," has been allowed where the utility concerned had sold mortgage bonds to underwriters on the best possible terms obtainable but at an amount substantially less than par. In one instance at a subsequent hearing it developed that during a period of general financial depression part of the bonds had been redeemed at a figure considerably less than the price at which they had been sold with a resulting profit sufficient to more than off-set the capitalised bond discount. The Board thereupon removed the bond discount from the rate base.

Although cogent reasons have been advanced to establish that on logical grounds the amount paid for money should not be allowed as part of the rate base or value of the property, on close examination it becomes obvious that if the cost of the money is not allowed to the company then the rate of return must be increased. In other words, if the character of the industry is such that money will be invested in it only on a 10% basis it matters little whether the securities are sold at 80% of par with a return of 8% or at par with a return of 10%. In each instance the company pays the same. No doubt the logical method of dealing with the cost of the money and the one which eventually may be adopted will be to amortise this amount over a short period of years without carrying into the rate base.

An allowance for promotion and development of the property is certainly an intangible but the very existence of the service which the public enjoys is founded on it. No doubt the amount should vary with the nature of the utility. One which serves an undeveloped territory where energy, initiative and optimism were essential to its inception and successful completion should be rewarded in a manner more generous than the proprietors of a similar prop-

erty established in a thickly populated and prosperous territory where the people were already educated to the use and were prepared to immediately adopt the utility in question.

It being assumed that the proprietors are entitled to a certain annual return and that during the first years of operation such an amount cannot be earned it is generally conceded that the deficiencies should be made up during the more prosperous subsequent years. In the most striking instance which has come before the Board the deficiencies during the first three years of operation were added to the rate base and thereafter discontinued as the company had by then established itself on a sound basis.

The rate of return on the valuation or rate base has varied from 8% to 10%. As will be later pointed out the Board has the right and deems it proper to vary the rate of return from time to time.

It is unnecessary to comment on the allowances made for operation and ordinary maintenance beyond saying that the Board assumes and requires a reasonable degree of astuteness and economy in management.

That rates charged to the public may be kept at a low level and that the money invested in the enterprise may at the same time obtain a reasonable return it is of course essential that the earning capitalisation of the utility company should not become unduly swollen. As a utility grows more plant is of course required from time to time. This involves the investment of additional money. If provision is not made for withdrawal from the enterprise of the money originally and later invested the capitalisation and the rate earning value of the plant rapidly pyramid with the result that the investors have to be satisfied with a continually shrinking return or the public have to be saddled with steadily increasing rates. To meet this various experiments were initiated and abandoned by the Board until finally a scheme of amortisation which appears to be reasonably satisfactory to the investor and adequately protects the public was developed. Under this arrangement the various elements going into the rate base are divided into classes to each of which an assumed life time is assigned. The salvage value of tangibles at the end of that life time is also estimated. The difference between the cost and the salvage value is then amortised over the period of the estimated life. To do this in each year an amount is charged against operating sufficient with interest compounded at 4% to realise at the end of the life period the value of the asset less the amortisable value. The money so charged in each year against

revenue is set aside in a special investment fund where it is eventually available for the repayment of capital or at the option of the company for re-investment in extensions and betterments of the system. At the end of a life period the amortisable value of the asset is withdrawn from the rate base and thereafter there remains in the rate base as representing that asset for revenue earning purposes only its salvage value. Should the life time of the asset be under-estimated it may mean that it will continue to play a part in the life of the property for many years after its amortisation has been completed and during that time the Company would earn a return only on its salvage value. On the other hand, the life time might be over-estimated, in which case the company would be earning a return on something which did not exist. The one possibility it is safely assumed will off-set the other. To make this explanation clearer it might be well to use a concrete example: The value of a distribution plant in 1913 is \$290,985.84. It has an estimated life of forty years at the end of which time it would still have a salvage value of 30% of its original cost, namely, \$87,295.00. The amount, therefore, to be amortised during the forty year period is \$203,690.00. The annual amortisation charge to be set aside at 4% would be \$2,143.00. This latter amount is each year charged against revenue and paid into the credit of the special amortisation fund. At the end of the forty year period the value of the company's assets will be reduced by \$203,690.00, which amount will then stand in actual cash or securities to the credit of the amortisation fund and may then or perhaps already has been used for the repayment of invested capital or for capital additions and betterments to the property.

The intangibles are dealt with in the same way although the element of salvage is absent and the period of amortisation is purely arbitrary.

With powers so wide and with a method of determining rates so involved it can be seen that a decision of the Board might readily cause great hardship to a regulated undertaking or indeed to the public and it would not be unnatural to expect that some method of review or some limitation on the exercise of the powers of the Board would be provided. Such, however, is not the case. The Board acting within the ambit of its jurisdiction seems to have an absolute and completely uncontrolled discretion.

The Act under which it is created follows closely the Statutes under which similar Boards or Commissions have for years past

been operating in the United States. Although under those Statutes provision is generally made for appeals to the State Courts, such appeals are not so necessary as in Canada owing to the safeguards contained in the American Constitution which contains a constitutional guarantee or limitation permitting the expropriation of private property only on the payment of just compensation. Relying on this the Courts have established a principle that the power to regulate rates does not give a power to destroy. To require a privately owned public utility to render its service or dispose of its commodity at unjust rates would in effect amount to expropriation without just compensation. Consequently the Courts hold that the Commissions cannot fix unjust rates for this in law amounts to the taking of private property for public use without compensation or without due process of law.¹¹ The moment that a Commission so values the property of a utility or so fixes the rate of return or the rates themselves that it is no longer possible to earn a fair return on the just value of the property a constitutional question is raised and the matter can be removed into the Federal Courts.

The Alberta utility owners enjoy no such protection. There is indeed an appeal to the Appellate Division of the Supreme Court of Alberta but only with the leave of a Judge and in respect to matters which involve questions of jurisdiction or of law.

The narrowness of this right of appeal is emphasized by the recent judgment of the Supreme Court of Canada in *Northwestern Utilities v. City of Edmonton*.¹² In that case the Board had in 1922 prior to the construction of the plant of the company determined the rates in accordance with the principles described for a three year operating period, the rate of return being fixed at 10%. It had included in the rate base or value of the property the difference between the par value of the bonds of the company and the price at which they were actually sold to the underwriters. The plant was constructed and after it had been in operation for some years a hearing was held for the purpose of revising the rates. In the second award, the one in question on the appeal to the Supreme Court, the Board declined to remove from the rate base the bond discount but reduced the rate of return from 10% to 9%. The city appealed against the Board's refusal to eliminate the bond discount and the company against the reduction in the rate of return.

The Supreme Court of Canada was unanimously of the opinion that no question of law or of jurisdiction was involved in the

¹¹ *Stone v. Farmers Loan & Trust Company*, 116 U.S. 307.

¹² [1929] S.C.R. 186.

city's appeal. In other words, whether the Board did or did not include the bond discount, which in this case amounted to \$650,000.00, in the value of the property, was a matter entirely within the discretion of the Board and that discretion could not be questioned.

The Court found the question of the rate of return more difficult of solution. The Board's stated reason for reducing the rate of return was "altered conditions of the money market," which according to the interpretation of Lamont, J., meant "that the returns for money invested in securities in which moneys were ordinarily invested had decreased during the period in question." In fact no evidence had been given as to the money market and the company contended that without hearing evidence upon the point the Board was without jurisdiction to make the reduction. The Chief Justice, with whom Mignault, J., concurred, was of opinion that this did not raise either a question of law or jurisdiction, but as to this the opinion of the majority was to the contrary. Nevertheless he inclined to the view that the company might have "some reason to complain of unfairness in the judgment of" the Board reducing the rate of return.

Lamont, J., in whose judgment Rinfret, J., concurred, held that "the intention of the Legislature was to leave it largely to the discretion of the Board to say in what manner it should obtain the information required for the proper exercise of its functions." It could in his opinion have sent out its Secretary to obtain evidence. It would not have been necessary to call witnesses to verify his report, "nor would it have been necessary to afford to either party an opportunity to controvert before the Board the information so obtained." He could find nothing in the Act which would have required the Board to mention in the award that such evidence had been obtained or the manner of obtaining it.

According to Smith, J., the Board had "laid down a proper principle and applied it in other instances but failed to apply it to this item as to which I think it was particularly applicable." He did not agree "with the observations of my brother Lamont in reference to the sending out of some one to gather evidence as to the state of the money market and acting on that party's report without the knowledge of the company." The objection to such a course would be the failure to disclose the evidence to the company and afford it an opportunity of answering. The question was, however, whether the Court could set aside the finding of the Board.

He said "it is with some regret that I feel bound to agree with him (Lamont, J.) that the Board had jurisdiction to make the change in rate without evidence and without giving the company an opportunity to offer evidence."

Apparently the view of Lamont, J. is that the Board can obtain and act upon evidence, the existence of which is not disclosed to the parties at issue, while Smith, J. considers that it may reach its conclusions without any evidence at all.

The result of all this would seem to be that investors in public utilities in Alberta are dependent for their security entirely on the good faith, honesty of purpose, integrity and sound judgment of the personnel of the Board.

In exercising its functions the duty of the Board is not only to see to it that the public receives proper service at fair rates but also that the proprietors of the utility obtain a revenue sufficient to enable the property to be maintained in good operating condition, and to themselves receive a fair return on their investment, taking into consideration of course the character of the service rendered or commodity supplied. That it has succeeded in doing this to the satisfaction of all parties during periods of rising and falling costs is an achievement which reflects no small credit on the members of the Board. Nevertheless both the public and the investor are dependent, the one for service and the other for the safety of his property, on the uncontrolled ability and good faith of the personnel of the Board.

H. R. MILNER.

Edmonton.
