Indexed as:

Hemlock Valley Electrical Services Ltd. v. British Columbia (Utilities Commission) (B.C.C.A.)

IN THE MATTER OF The Utilities Commission Act S.B.C. 1980, c. 60 as amended
Between
Hemlock Valley Electrical Services Ltd., Appellant, and The British Columbia Utilities Commission, and The Attorney General of British Columbia, Respondents

23 W.A.C. 1

12 B.C.A.C. 1

66 B.C.L.R. (2d) 1

[1992] B.C.J. No. 649

Vancouver Registry: CA013604

British Columbia Court of Appeal

Hutcheon, Cumming and Hinds JJ.A.

Heard: February 12 and 13, 1992
Judgment: March 26, 1992

(45 pp.)

Administrative tribunals -- Whether Commission properly exercised its discretion in ordering that increase to electricity rate be phased in over three years.

This was an appeal from an order permitting the appellant utility to increase the rate it charged to its customers, but ordering that the rate base costs be phased over three years to soften the shock to the ratepayers.

HELD: The appeal was allowed and the matter referred back to the Commission with a direction

that it permit or require the utility to file new tariff schedules which would enable it to earn 13 per cent on its determined rate base from a certain date. The Commission had no discretion to fix rates which did not permit recovery of a reasonable return upon the appraisal value of its property. Although the Commission correctly exercised its discretion to determine what a just and reasonable return was, it wrongly failed to permit the utility to charge a rate which gave it the opportunity to earn that return. The order could not stand.

STATUTES, REGULATIONS AND RULES CITED:

Utilities Commission Act, S.B.C. 1980, c. 60, ss. 2(1), 16(1), 16(1)(b), 44, 65, 65(3), 65(4), 65(4)(c), 66, 66(1) (a), 114, 115, 118.

Counsel for the Appellant: Chris W. Sanderson and Barbara Coinesh.
Counsel for the Respondent, (B.C. Utilities Commission): Patrick G. Fay.

CUMMIN J.A. (for the Court, allowing the appeal):--

DECISION APPEALED FROM:

> This is an appeal from Order No. G-11-91 of the British Columbia Utilities Commission (the "Commission") pronounced January 30, 1991 reaffirming the terms of Order No. G-77-90 made October 17, 1990 which permitted the appellant utility, Hemlock Valley Electrical Services Ltd. ("HVES") to increase the rate it charges for the supply of electrical services, but ordered that the rate base costs be phased in over a period of three years.

On March 7, 1991, pursuant to s. 115 of the Utilities Commission Act, S.B.C. 1980, c. 60 Toy J.A. granted leave to appeal to this Court and directed that the operation of Commission Order No. G-11-91 be stayed upon terms to which further reference will later be made.

FACTS:

HVES, a wholly owned subsidiary of Hemlock Valley Resorts Inc., is a small, special purpose utility which is the sole supplier of electrical service to a group of approximately 192 residential customers living in a single community located around the Hemlock Valley ski hill in the lower mainland of British Columbia. HVES also provides service to the ski hill itself.

HVES was incorporated in 1979 and on June 20, 1980 was granted a Certificate of Public Convenience and Necessity by Order No. C-23-80 of the British Columbia Energy Commission, the predecessor of the present Commission.

On November 13, 1982 HVES filed a rate application with the Commission (the "1982 Application"). A public hearing was held on June 7, 1983 and the Commission rendered its decision on July 8, 1983 (the "1983 decision").

At that time HVES's operations were described as follows:

> Hemlock is a subsidiary of Hemlock Valley Recreations Ltd. ("Hemlock Recreations") which company owns and leases land in the Hemlock Valley of the Lower Mainland of British Columbia for year-round recreational use. Hemlock provides underground electric service to residential consumers and to Hemlock Recreations for use in a ski lodge, lifts and a maintenance area; to Hemlock Property Management Ltd. for residential use on residential properties; and to Hemlock Valley Sanitary Service Ltd. for a sewer system serving the recreation area. All three companies are wholly-owned subsidiaries of Hemlock Recreations.

In the 1983 decision the Commission declined to allow HVES a return on its rate base and ordered that electrical rates be set at 11.5 per kW.h with a $15.00 per month minimum charge, effective July 1, 1983. The Commission noted:

(a) the Hemlock recreational area was still in the developmental stage;

(b) the development had been materially affected by a downturn in the provincial economy.

(c) HVES had taken significant steps to reduce the cost of power and improve the reliability of service through the interconnection with B.C. Hydro;

(d) undertakings were given in the prospectus of Hemlock Valley Estates Limited indicating that a purchaser of property could expect that all services would have been completed and paid for by the developer from its own resources.

The Commission concluded that in the circumstances of HVES a reasonable approach to rates would be based on a break-even approach between revenue and expenses.

In its decision of October 17, 1990 the Commission said of the 1983 decision:

> It is clear that in the 1983 Decision the inter-dependency of electric and other services with the resort enterprise at Hemlock valley was fully understood. It is also clear that the Commission felt some consternation about the 7.69% negative return on rate base flowing from the 1980 Decision. It was also apprehensive that the continued existence of Hemlock Valley as a going concern was being '... materially affected by the downturn in the provincial economy.' Moreover, it was looking at the changeover from diesel generators to a tie-line with B.C. Hydro. The change in source of power was unquestionably correct in the long-term, but it imposed an annual amortization cost of $98,840.18 for the years immediately ahead. That addition of nearly $100,000 per year materially distorted the profit and loss statement. In the circumstances, the Commission, in its 1983 Decision, chose to ignore return on rate base as an appropriate means of fixing fair and reasonable rates, and chose instead a pragmatic break-even approach between revenue and expenses. It also added a small allowance for contingencies. Management of the utility was evidently prepared to accept this approach.

By Commission Order No. G-65-83, dated August 23, 1983 HVES was again ordered to amend its rates to reflect the sale of a portion of its electric utility plant to B.C. Hydro.

On July 10, 1984 HV Recreations, the parent of HVES, went into receivership. HV Recreations remained in receivership until January 15, 1987 when Skipp L.J.S.C. (as he then was) approved the sale of the assets of HV Recreations, including the HVES shares, to one Michael Robbins or his assignee. Sometime after January 15, 1987 the HVES shares were transferred to Hemlock Valley Resorts Inc. ("HV Resorts"). HV Resorts remains the sole shareholder of HVES. Throughout 1987 and 1988 there were various changes in the ownership of HV Resorts and on October 27, 1988 its shares were acquired by Mr. Joseph Peters. There has been no change in the ownership of the assets or shares of HV Resorts since that date.

In 1984 and again in 1986 increased rates were approved to reflect firstly, an increase in B.C. Hydro's water rental fees and secondly, an increase in the cost to HVES of purchasing power from

B.C. Hydro.

As of the spring of 1990 the rate being charged by HVES was 8.65 per kW.h. That rate had been in effect since September 26, 1986.

On May 31, 1990 HVES applied to the Commission to increase its tariff rates by 7.32 per kW.h, an 84.6% increase. The reasons given were to permit the recovery of recently approved rate increases to B.C. Hydro, forecast operating costs and a return on rate base. In the 1990 application, HVES proposed a rate base of $366,511.00 with a 13% return on the debt component and a 15% return on the equity component of that rate base.

Prior to a public hearing the Commission, by Order No. G-58-90, ordered that effective July 1, 1990 HVES be allowed an interim increase of 3.7 per kW.h in its rates to permit the recovery of the increased cost of purchased power from B.C. Hydro and increased operating costs. The operative part of that Order read:

1. The Rate Base costs included in the Application will not form part of the interim increase allowed in item No. 2 of this Order at this time.
2. The Commission will accept, subject to timely filing, effective July 1, 1990, an amendment to its Electric Tariff Rate Schedule incorporating an increase of 3.70 cents/kW.h over existing rates on an interim basis, with the interim increase subject to refund with interest calculated at the average prime rate of the bank with which HVES conducts its business.
3. HVES, by way of a Customer Notice, is to inform each customer, as soon as possible, of the application before the Commission, the approved interim increase and the effect on average annual billings. HVES is to provide the Commission with a copy of the Customer Notice.

On August 2, 1990 the Commission directed that a public hearing commencing September 24, 1990, be held in respect of HVES's application of May 31, 1990 and gave directions with respect to notice of the hearing and participation by intervenors and interested persons intending to participate in the public hearing.

The Hemlock Valley Ratepayers Association intervened and, we were advised, played a significant role at the hearing. Its submissions covered many areas, correcting a number of statements in the application and disputing a number of forecasts. Among other things, the rate base component in the application was opposed on the basis that the utility systems were fully paid for by the developers.

The Commission received evidence of complaints of unsatisfactory service, inadequate

HVES accounting documentation, concerns about paying for the recreational commercial venture through utility payments (commercial power use is unmetered), detailed comments on HVES's proposed operating and maintenance expenses, comparisons to residential rates in other areas, and other matters.

Following the public hearing on September 24 and 25, 1990, by Commission Order No. G-77-90 dated October 17, 1990, the Commission issued a decision (the "Original Decision") with respect to the 1990 application.

The operative part of Order No. G-77-90 reads:

1. The Rate Base and Revenue Requirement for the Test Period are set out in Schedules contained in the Decision.
2. The Commission will accept, subject to timely filing, amended Electric Tariff Rate Schedules which confirm to the terms of the Commission's October 17, 1990 Decision.
3. HVES is to proceed with refunds to its customers of record on and after July 1, 1990, where necessary. Such refunds are to include interested calculated as specified in Order No. G-51-90.
4. HVES will comply with the several directions incorporated in the Commission Decision.

I have appended, as Appendix "A" to these reasons the schedules referred to in paragraph 1. of the Commission order.

By the Original Decision the Commission declined to permit the full implementation of the approved rate increase immediately but instead directed that it be phased in by increases of 1.51 per kW.h effective July 1, 1990, and 1.51 per kW.h and 0.75 per kW.h effective May 1, 1991 and May 1, 1992 respectively.

It is this rate adjustment phase-in which is the principal focus of this appeal.

By letter dated November 8, 1990 HVES requested that the Commission reconsider certain aspects of the Original Decision pursuant to s. 114 of the Act on the basis that:

(a) Reconsideration was appropriate because HVES had not been provided with an opportunity to deal with the phase-in issue in its Rate Application;
(b) Once the Commission had determined that there was a rate base and that a 13% return on it was "just and reasonable", pursuant to the Act, the Commission was obliged to permit HVES an opportunity to recover sufficient revenue to capture that return.

On January 30, 1991, by Order No. G-11-91, the Commission ordered that the request by

HVES to vary Order No. G-77-90 be denied and that HVES was to proceed with refunds to customers and to comply with all other directions in that Order.

The operative part of Order No. G-11-91 reads:

NOW THEREFORE the Commission orders as follows:

1. The Request, by HVES to vary the October 17, 1990 Commission Decision and Order No. G-77-90, is denied and the Commission's Reasons for Decision is attached as Appendix A.
2. The Commission reaffirms and orders HVES to proceed with refunds to customers along with other directions incorporated in its October 17, 1990 Decision and Order No. G-77-90.

It is from Order No. G-11-91 that this appeal is taken.

GROUNDS OF APPEAL:

As set out in the appellant's factum the grounds of appeal are:

> [T]hat the Commission erred in pronouncing Order No. G-11-91, which reaffirmed Commission Order No. G-77-90 when Order No. G-77-90 contained an error in law ... in that the Order:
>
> (a) failed to permit HVES the opportunity to recover a portion of its rate base costs over three years notwithstanding that the Commission had determined that that portion of its rate base costs was necessaryfor the establishment of rates which were just and reasonable under the Utilities Commission Act, S.B.C. 1980, c. 60 (the "Act");
> (b) required a refund of monies which the Commission had determined were necessary to permit HVES an opportunity to receive a just and reasonable rate under the Act.

REASONS FOR THE DECISIONS OF THE COMMISSION:

1. Original Decision:

In the Original Decision of October 17, 1990, under the heading "Determination of Rate Base", the Commission, after reviewing the 1983 decision, went on to say:

> This Division of the Commission considers that the 1983 Decision was a practical decision to tide the enterprise at Hemlock Valley over a particularly difficult period. Sooner or later, however, longer-term prospects must be faced

squarely. The tie-line has been amortized over five years. Evidence (Exhibits 14 through 21) clearly indicate that recover of plant expenditures was anticipated through utility rates. Therefore the Commission believes that a return to more traditional rate-making practice is justified.

It was proposed to the Commission by the intervenors at the hearing that rate base should not be recognized. The cornerstone of rate base is appraised value of utility property, which is usually taken to be original cost of plant. The Commission cannot, by a stroke of the pen, eliminate the appraised value of the property; to do so would be confiscation of property.

and concluded:

The Commission has considered alternative calculations for rate base and concludes that no material difference results from any refinements which might be made. Therefore, the Commission accepts the Company's evidence, and finds the rate base to be $366,511 for the test period.

The Commission then continued:

4.2 Capital Structure

The Company currently has no viable capital structure of its own. Its financing has been by way of loans from the parent company. The Applicant proposes a deemed 50/50% debt/equity ratio in this Application. It is a frequent practice of regulatory tribunals to use a notional capital structure. While 50% equity is much higher than would be usual for utilities in general, the higher proportion of equity in this case can be considered as reasonable, bearing in mind the relative risks in the case of the Company.

4.3 Return on Rate Base

The Company has proposed a return of 13% on the debt component, and 15% on the equity component of the rate base. Standing alone, these figures certainly fall within a reasonable range in today's market. Nevertheless, the Commission considers it essential to consider the particular circumstances of the Company in this Decision. While it is true that risky investments typically command higher

returns, that position considers primarily the potential investors' point of view in placing funds at the utility's disposal. From the existing shareholders' point of view, the realization of an allowable rate of return depends upon the ability of management to run an efficient organization, and for external factors to favourably affect the prosperity of the Company. Bearing in mind the inter-relationship of the resort and utility elements at Hemlock, and the current circumstances of the utility, the Commission cannot accept a return on equity for rate-making purposes of 15%. For the foregoing reasons, the Commission believes that a 13% return on debt, and a 13% return on equity is both just and reasonable within the spirit of Sections 65(3) and 65(4) of the Act, which states:

(3) It is a question of fact, of which the commission is the sole judge, whether a rate is unjust or unreasonable, or whether, in any case, there is undue discrimination, preference, prejudice or disadvantage in respect of a rate of service, or whether a service is offered or furnished under substantially similar circumstances and conditions.

(4) In this section a rate is "unjust" or "unreasonable" if the rate is

(a) more than a fair and reasonable charge for service of the nature and quality furnished by the utility,

(b) insufficient to yield a fair and reasonable compensation for the service rendered by the utility, or a fair and reasonable return on the appraised value of its property, or

(c) unjust and unreasonable for any other reason.

Under the heading "Cost of Service" the Commission, over several pages, reviewed in detail various components of the cost of service which HVES estimated it would incur and for which it sought a rate sufficient to enable it to recover, and considered the objections to and criticisms of those cost components raised by the intervenors and various witnesses. It is not necessary here to review this aspect of the material in any great detail: it is sufficient to say that where the Commission did not accept in full the submissions of HVES it reduced the eligible cost component by the amounts set out in the Schedules to its Order (see, in particular, Sheet 5 of Appendix 1) with the result

that HVES's revenue requirements, for rate-making purposes, were reduced accordingly. The Commission also made a number of directions and recommendations to the Company, of which the following are examples:

> The Commission directs the Company to prepare and file with the Commission an operating budget at the beginning of each fiscal year.
>
> * * *
>
> The Commission therefore directs that the Company provide the commission with a time schedule for the completion of the work, as well as specific advice when the work is completed. In addition, the Company is directed to file a copy of its preventive maintenance program by November 1, 1990

but these did not result in any further adjustments to the estimates of allowable and recoverable costs of service.

The Commission then turned its attention to the question of "quality of service" and reviewed a number of complaints and dissatisfactions expressed by the intervenors. It concludes its discussion of this issue by saying:

> During the course of the hearing, the Commission was impressed with the sincerity, variety and degree of expertise shown by the witnesses for the principal intervenor, The Hemlock Valley Ratepayers' Association. It is suggested to the Company that consideration might well be given to drawing on this pool of talent. The Commission strongly recommends that a "Utility Consultation Committee" be established by HVES, with members from the utility and representative ratepayers. Quarterly information meetings should serve to improve communications in the interest of the common goals of all the participants on the mountain.

Apart from the recommendation which the Commission made in this passage nothing else was said by the Commission with regard to quality of service and, most importantly, as will be noted later, no further adjustments were made to the rate base, rate of return or the allowable components of recoverable cost of service (other than those specifically referred to) by reason of

any concern related to the quality of service provided by HVES to its customers.

The Commission summarized its decision as follows:

7.0 DECISION SUMMARY

7.1 Revenue Requirement

Section 44 of the Utilities Commission act requires that:

> Every public utility shall maintain its property and equipment in a condition to enable it to furnish, and it shall furnish, a service to the public that the Commission considers is in all respects adequate, safe, efficient, just and reasonable.

It is the duty of the Commission to see that this is done. It is also the duty of the Commission to ensure that the utility has sufficient revenue to enable it to perform these functions. However, it must always be satisfied that the level of funding provided for is within the Company's ability to use efficaciously.

On the basis of the evidence presented, the Commission has set a revenue requirement to satisfactorily meet the above objectives (refer to attached schedules).

7.2 Rate Adjustment Phase-In

As mentioned in Section 1.0, the Application contemplated a rate increase of 84.6% in the test year. The adjustments to the cost of service in this Decision have mitigated some of the potential rate shock. The Commission considers that a return on rate base should be allowed, however, it believes that the ratepayers should be protected from the full impact initially. In arriving at this conclusion, the Commission has recognized that there was a hiatus of some seven years between Applications. In addition, the future economics and the viability of the mountain are at stake.

> Accordingly, the Commission orders that the rate base costs be phased-in over three years. The Commission requires the utility to file amended rate schedules incorporating an increase of 1.51 per kW.h over permanent rates effective July 1, 1990, and for further increases of 1.51 per kW.h and 0.75 per kW.h. effective May 1, 1991 and May 1, 1992, respectively.

2. Reconsideration Decision:

In refusing the request of HVES for reconsideration and confirming its Original Decision the Commission said, under the heading "Jurisdiction":

2.0 JURISDICTION

> The argument made on behalf of HVES has as its essence the jurisdiction of the Commission, and it is set out in the letter dated December 14, 1990.
>
> On page 2 of that letter, Section 65(4) of the Act is quoted in its entirety, as are Sections 66(1)(a) and (b). The submission then goes on:
>
> > The words of Section 65(1)(b) [reference should be 65(4)(b)] and Section 66(1)(b) of the Act are a clear statutory direction to the Commission on how to determine a just and reasonable rate. In our respectful submission, in the presence of clear language, the Commission may not disregard those statutory provisions and substitute its own opinion of what is just or reasonable in any given case.
>
> It is the Commission's view that the submission is flawed in that it evidently invites the Commission to ignore the clear language of Sections 65(4)(a) and 65(4)(c), and concentrate instead only on Section 65(4)(b) which supports the position of HVES. The Commission holds that in fixing a rate it must have due regard to the whole of Section 64. Section 66(1)(b) makes this abundantly clear:
>
> > the Commission shall have due regard, among other things, to the fixing of a rate that is not unjust or unreasonable, within the meaning of Section 65.

After referring to and distinguishing the decision of the Supreme Court of Canada in British Columbia Electric Railway Co.

Ltd. v. The Public Utilities Commission of British Columbia et al, [1960] S.C.R. 837 the Commission continued:

> The point which seems to be missed is that the Commission's Decision of October 17, 1990 must be taken as a whole and should be read and understood as such. It is not a decision on rate of return, followed by decisions at a later time on other matters. The phase-in is an integral part of the finding on just and reasonable rates. The Decision as a whole should make it abundantly clear that the Commission had concerns about "the nature and quality (of service) furnished by the utility". The impact on the customers of a large percentage increase suddenly imposed was another example of an "other reason" [Section 65(4)(c)] to which the Commission gave due regard in deciding to phase-in the increase in three steps. The Commission was not prepared to grant an immediate increase in the amount requested by the Applicant, but granted instead a modest increase initially and set a target for an allowable rate of return which HVES could work towards, together with suggestions and commentary on how the company might improve its operation.

The Commission then turned to the question of "Rate Shock" and rejected the submission of HVES with respect to the three year phase-in of the allowed rate increase. It stated its determination as follows:

> The Utilities Commission Act places a duty upon the Commission to balance all the factors which the Act includes as matters for due regard when fixing rates. HVES has emphasized one element; namely, return on the appraised value of the utility's property in terms of typical costs of money in the financial markets. It refers, in reply to argument by HVES to "...the absolute limitation imposed by Section 65(4)(b)". The Commission does not accept that any such absolute limitation applies, but is of the view that counsel for HVES, at pages 4 and 5 [There is an error in Karen Knott's quote] has correctly recognized the breadth of the Commission's mandate.

ISSUE:

The issue before us, simply stated, is: "was the Commission right?"

DISCUSSION:

Any discussion of the scope of the Commission's

rate-making
powers begins, of necessity, with the seminal decision of the Supreme Court of Canada in British Columbia Electric Railway Co.
Ltd. v. The Public Utilities Commission of British Columbia et al (supra). In that case the Supreme Court had before it a legislative scheme prescribed by the Public Utilities Act, R.S.B.C. 1948, c. 277 (the "old Act") similar to (and here the appellant submits, identical to) the scheme found in the Utilities Commission Act (supra), (the "new Act"). It will, I think, be convenient to set out side by side the relevant provisions of the two statutes so that their similarities or differences may be readily apparent.

OLD ACT	NEW ACT
Interpretation.	
2.(1) In this Act:--	
"Unjust" and "unreasonable" as applied to rates shall be construed to include respectively injustice and unreasonableness, whether arising from the fact that rates are excessive as being more than a fair and reasonable charge for service of the nature and quality furnished by the public utility, or from the fact that rates are insufficient to yield fair compensation for the service rendered, or arising in any other manner:	
16.(1) In fixing any rate	
(a) the Commission shall consider all matters which it deems proper as affecting the rate;	
(b) The Commission shall have due regard, among other things, to the protection of the public from rates that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the public utility; and to giving to the public utility a fair and reasonable return upon the appraised value of the property of the public utility used, or prudently and reasonably acquired, to enable the public utility to furnish the service;	
(c) where the public utility furnishes more than one class of service, the Commission shall segregate the various kinds of service into distinct classes or categories of service; and	

for the purpose of fixing the rate to be charged for the service rendered, each distinct class or category of service shall be considered as a self-contained unit, and the rates fixed for each unit shall be such as are considered just and reasonable for that unit without regard to the rates fixed for any other unit. If it is considered by the Lieutenant-Governor in Council that the rates as so determined might be inequitable or contrary to the general public interest, the Lieutenant-Governor in Council may direct that two or more classes or categories of service shall be considered as one unit in fixing the rate;

Discrimination in rates

65. (1) A public utility shall not make, demand or receive an unjust, unreasonable, unduly discriminatory or unduly preferential rate for a service furnished by it in the Province, or a rate that otherwise contravenes this Act, regulations, orders of the commission or other law.

(2) A public utility shall not, as to rate or service, subject any person or locality, or a particular description of traffic, to an undue prejudice or disadvantage, or extend to any person a form of agreement, a rule or a facility or privilege, unless the agreement, rule, facility or privilege is regularly and uniformly extended to all persons under substantially similar circumstances and conditions for service of the same description, and the commission may, by regulation, declare the circumstances and conditions that are substantially similar.

(3) It is a question of fact, of which the commission is the sole judge, whether a rate is unjust or unreasonable, or whether, in any case, there is undue discrimination, preference, prejudice or disadvantage in respect of a rate or service, or whether a service is offered or furnished under substantially similar circumstances and condition.

(4) In this section a rate is "unjust" or "unreasonable" if the rate is

(a) more than a fair and reasonable charge for service of the nature and quality furnished by the utility,

(b) insufficient to yield a fair and reasonable compensation for the service rendered by the utility, or a fair and reasonable return on the appraised value of its property, or

(c) unjust and unreasonable for any other reason.

Rates

66. (1) In fixing a rate under this Act or regulations

(a) the commission shall consider all matters that it considers proper and relevant affecting the rate,

(b) the commission shall have due regard, among other things, to the fixing of a rate that is not unjust or unreasonable, within the meaning of section 65, and

(c) where the public utility furnishes more than one class of service, the commission shall segregate the various kinds of service into distinct classes of service; and in fixing a rate to be charged for the particular service rendered, each distinct class of service shall be considered as a self contained unit, and shall fix a rate for each unit that it considers to be just and reasonable for that unit, without regard to the rates fixed for any other unit.

The facts giving rise to the British Columbia Electric case are succinctly set forth in the majority judgment of Martland J. (for himself and Cartwright and Ritchie JJ.) at pp. 850-851 of the Report.

The appellant and British Columbia Electric Company Limited (together called "the Company") are related companies and between them own and operate equipment and facilities for the transportation of persons and property by railway, trolley coach and motor buses and for the production, generation and furnishing of gas and electricity, all for the public compensation.

The Company is regulated by the Public Utilities Commission of British Columbia (called "the Commission") pursuant to the provisions of the Public Utilities Act.

By appraisal the Commission ascertained the value of the property of the

company used, or prudently and reasonably acquired, to enable the company to furnish its services. The appraisal was made as of December 31, 1942, and since then has been kept up to date. The appraised value is referred to as "the rate base".

By Order-in-Council No. 1627, approved on July 16, 1948, the Commission was directed to consider the classes or categories of the regulated services of the Company as one unit in fixing the rates.

On September 11, 1952, the Commission after public hearing made "Findings as to Rate of Return" and decided that, "until changed financial and market circumstances convince the Commission that a different rate should be applied, the Commission will in its continuing examination of the Company's operations apply the rate of 6.5% on the rate base as a fair and reasonable rate of return for the Company. This decision remains unchanged.

The Company from time to time amended its rate schedules with the consent of the Commission and filed with the Commission schedules showing the rates so established. On April 23, 1958, it applied for the consent of the Commission, under s. 17 of the Public Utilities Act, to file amended schedules containing increased rates for its electric service on the Mainland and on Vancouver Island. On July 28, 1958, it also applied for the consent of the Commission to file amended schedules containing increased transit fares for its transit systems in Vancouver and other Mainland areas and in Victoria and surrounding areas.

Public hearings were held by the Commission and it handed down its decision with respect to the electric applications on July 14, 1958, and with respect to the transit applications on October 30, 1958.

Briefly, the decisions of the Commission accepted the proposed rate schedules submitted by the Company, except that it refused to approve the proposed increases in the principal residential electric rates on the Mainland and on Vancouver Island. It directed that those rates be scaled down by approximately 25%. In its decision with respect to electric rates the Commission stated:

> The Commission has therefore consented to the filing to be effective July 15th, 1958, of all the rate schedules submitted by the Company for the Mainland and Vancouver Island, as modified and supplemented by the Company during the course of the hearings on its application, except the residential rate schedules and Mainland Rate 3035 for industrial users.
>
> The Commission has decided that the principal residential rate on the Mainland (Schedule 1109) and the principal residential rate on the Island (Schedule 1110 under which the principal divisions are Billing Codes 1110 and 1112) should be adjusted to yield not more than three-quarters of the additional revenue proposed. The adjustment must be applied primarily to reduce sharp changes in impact and lessen disproportionately large percentage increases in the consumption range of 60 KWH to 280 KWH per month. Comparable adjustments must also be made in some of the related special residential rates of lesser importance. Most of the relief would be given to the small residential user.
>
> At the same time the Commission decided that further increases in the commercial and industrial rates to compensate for this reduction in the proposed residential rates would not be justified.

At p. 849 Martland J. had said:

> Pursuant to the provisions of subs. (1) of s. 107 of the Public Utilities Act of British Columbia, R.S.B.C. 1948, c. 277, the Public Utilities commission of that Province stated a case for the opinion of the Court of Appeal of British Columbia. Five questions were submitted for the consideration of the Court, of which the first was as follows:

(1)

(a) Was the Commission right in deciding as appears in the said Reasons for Decision of 14th July, 1958, that no one of the matters and things referred to in clauses (a) and (b) of subsection (2) of Section 16 of the "Public Utilities Act" should as a matter of law be given priority over any other of those matters or things and that, if a conflict arises among these matters or things, it is the Commission's duty to act to the best of its discretion?

(b) If the answer to question (1) (a) is "No", what decision should the Commission have reached on the point?

Question (1)(a) was answered in the affirmative. The appellant, by special leave of this Court, has appealed from that portion of the judgment of the Court of Appeal which comprises the answer given by it to question (1). The other four questions and the answers given to them are not in issue in this appeal.

After summarizing the facts as I have set them out from the judgment of Martland J., his Lordship continued, at pp. 852-853:

In the reasons given for its decision the Commission deals with the effect of clauses (a) and (b) of s. 16(1) and says:

> With great respect, the Commission considers that although for this purpose the statutory duty of the Commission to have due regard to all
>
> matters which the Commission deems proper as affecting the rate might without any significant inaccuracy be described as the right of the commission, and its statutory duty to have due regard to giving the utility a fair and reasonable return might without significant inaccuracy be described as the Commission's responsibility for giving the utility a fair and reasonable return, there is nothing in the Act to relieve the Commission in the case now before it from complying with the language of the Act and giving due regard to all those matters to which the legislature has directed the Commission to give due regard in fixing a rate. No one of those matters should, in the opinion of the Commission, be given as a matter of law priority over any other of those matters and if, as the legislature appears to have thought possible, a conflict arises among those matters, the Commission considers that it is its duty to act to the best of its discretion.

The Court of Appeal concurred in this view. The judgment of the Court, delivered by Sheppard J.A., refers to this question in the following words:

> A further inquiry is what weight should be given to the matters required to be considered by Sec. 16(1)(b) and particularly to the "fair and reasonable return". Although clauses (a) and (b) of Sec. 16(1) require certain matters to be considered, they do not state what weight is to be assigned by the Commission. Consequently, the Statute requires only that

> the Commission consider the matters falling within Sec. 16(1)(a), namely, "all matters which it deems proper as affecting the rate" and those falling within Sec. 16(1)(b), namely, "the protection of the public" and "a fair and reasonable return" to the Utility. But the Statute does not require more, and does not require any weight to be given to these matters after they have been considered. Hence the weight to be assigned is outside any statutory requirement and must be a question of fact for the Commission in each instance.

At p. 854 he observed "The necessity for giving a public utility fair compensation for the service which it renders appears in the definition of the words "unjust" and "unreasonable" in s. 2(1)" (quoted above).

At pp. 855-857, Martland J. said:

> Section 16, the section with which we are concerned in this appeal, also deals with this matter of fairness of rates. In addition, it spells out the method by which a public utility is to obtain fair compensation for its service; i.e., by a fair and reasonable return upon its rate base, which rate base, pursuant to s. 45, the Commission can determine by appraisal.
>
> Section 16 deals with the duties of the Commission in fixing rates. Clause (a) of subs. (1) states that the Commission shall consider all matters which it deems proper as affecting the rate. It confers on the Commission a discretion to determine the matters which it deems proper for consideration and it requires the Commission to consider such matters.
>
> Clause (b) of subs. (1) does not use the word "consider", which is used in clause (a), but directs that the Commission "shall have due regard", among other things, to two specific matters. These are:
>
> (i) The protection of the public from rates that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the public utility; and
> (ii) To giving to the public utility a fair and reasonable return upon the appraised value of its property used or prudently and reasonably acquired to enable the public utility to furnish the service.
>
> As I read them, the combined effect of the two clauses is that the

> Commission, when dealing with a rate case, has unlimited discretion as to the matters which it may consider as affecting the rate, but that it must, when actually setting the rate, meet the two requirements specifically mentioned in clause (b). It would appear, reading ss. 8, 16 and 20 together, that the Act contemplates these two matters to be of primary importance in the fixing of rates.
>
> In my opinion, therefore, these two factors should be given priority over any other matters which the Commission may consider under clause (a), or any other things to which it shall have due regard under clause (b), when it is fixing any rate.
>
> The second portion of question (1)(a) was as to whether, in case of conflict among the matters and things referred to in clauses (a) and (b) of s. 16(1), it was the commission's duty to act to the best of its discretion. I have already expressed my view regarding the priority as between those things specifically mentioned in clause (b) and the other matters or things referred to in clauses (a) and (b). This leaves the question as to possible conflict as between the two matters specifically mentioned in clause (b).
>
> Clearly, as between these two matters there is no priority directed by the Act, but there is a duty imposed upon the Commission to have due regard to both of them. The rate to be imposed shall be neither excessive for the service nor insufficient to provide a fair return on the rate base. There must be a balancing of interests. In my view, however, if a public utility is providing an adequate and efficient service (as it is required to do by s. 5 of the Act), without incurring unnecessary, unreasonable or excessive costs in so doing, I cannot see how a schedule of rates, which, overall, yields less revenue than would be required to provide that rate of return on its rate base which the Commission has determined to be fair and reasonable, can be considered, overall, as being excessive. It may be that within the schedule certain rates may operate unfairly, relatively, as between different classes of service or different classes of consumers. If so, the Commission has the duty to prevent such discrimination. But this can be accomplished by adjustments of the relative impact of the various rates in the schedule without having to reduce the total revenues which the whole schedule of rates is design to produce.

He then answered the question posed as follows:

> Accordingly, it is my opinion that the answer to question (1)(a) should be

> "No". My answer to question (1)(b) would be that the Commission, in priority to any other matters which it may deem proper to consider under clause (a) and any of the other things referred to in clause (b) of s. 16(1), should have due regard to the two matters specifically mentioned in clause (b). In the present case, having decided that certain of the rates proposed by the appellant would impose an unreasonable burden upon certain classes of consumers, the Commission should permit the Company to submit alternative schedules of rates, which, while yielding approximately the same overall revenues, would eliminate the comparatively excessive impact of those classes of rates to which the Commission objected, until a rate schedule is devised which meets the requirements of clause (b) of s. 16(1).

Locke J. delivered a separate concurring judgment in which, as appears at p. 849 of the Report, he agreed specifically with the answer to the second part of the question proposed by Martland J.

Both Mr. Sanderson, for the appellant and Mr. Foy, for the respondent Attorney General of British Columbia, relied heavily upon the decision in the British Columbia Electric case, each asserting that it supported their opposing points of view.

Mr. Foy firstly drew attention to the passage in the judgment of Martland J. at p. 855-856 where that learned judge focused on the fact that, in s. 16 of the old Act, clause (b) of s-s.(1) does not use the word "consider", which is used in clause (a), but directs that the Commission "shall have due regard", among other things, to two specific matters. He then pointed to the fact that, by virtue of the wording and structure of s. 66(1)(b) and 65(4), and particularly by s. 65(4)(c), of the new Act, a third matter, namely, that a rate may be "unjust and unreasonable for any other reason", has been elevated to being not merely one of the matters which the Commission "considers proper and relevant affecting the rate" (its mandate under s. 66(1)(a)), but to one of the now three (formerly only two) specific matters to which the Commission is directed to "have due regard". Mr. Foy then referred to the statement of Martland J. at p. 856 that "there must be a balancing of interests".

From this he argued that the Commission, in directing the three year phase-in of the rate adjustment to ameliorate the rate shock, was simply "balancing" the interests of HVES on the one hand and its customers on the other, and contended that is so doing it was correctly applying the law which prescribes its mandate. It was entitled to what it did, he said, because the Commission had concerns about "the nature and quality of service furnished by the utility".

Mr. Foy argued that to accede to the position of HVES would be to accord to one of the specific matters to which the Commission must have due regard (the matter referred to in s. 65(4)(b)) a priority over the other two, something which cannot be done.

Mr. Sanderson submitted that once the Commission had settled the content of the rate base and determined a rate of return which is both just and reasonable, it cannot fix a schedule of rates which yields less revenue than would be required to provide that rate of return on its rate base. In this respect he relied upon what Martland J. said at p. 856 (supra). He also referred at length to the judgment of Locke J. and drew attention firstly to this passage at p. 841:

> The real question might have been stated more clearly had it asked whether as a matter of law a duty rested upon the Commission to approve rates which would produce for the appellant a fair and reasonable return upon the appraised value of the property used or prudently and reasonably acquired by it to enable it to furnish the service described in the Act when the fact as to what constituted a fair return had previously been determined by the commission. This is the matter to be determined.

Locke J., in his reasons commencing at p. 841, reviewed the legislative history of the old Act and of its predecessor, The Water Act Amendment Act, S.B.C. 1929, c.-67, American regulatory jurisprudence, and the common law and said, at 846:

> In my opinion the true meaning of the relevant sections of the Public Utilities Act is that a utility is given a statutory right to the approval of rates which will afford to it fair compensation for the services rendered and that the quantum of that compensation is to be a fair and reasonable rate of return upon the appraised value of the property of the company referred to in s. 16(1)(b).

Locke J. continued, at 847:

> Rates that fail to yield fair compensation for the service rendered are declared by s. 2 to be unjust and unreasonable as they were by s. 2 of the Water Act Amendment Act of 1929. The commission is directed by s. 16(1)(b) to have due regard to fixing a rate which will give to the utility a fair and reasonable return upon the appraised value of its property used or prudently and reasonably acquired to enable it to furnish the service. It is the inclusion of the expression "shall have due regard" which has led the Commission and the Court of Appeal to conclude that this means that allowing a fair return upon the appraised value is simply one of the matters to be considered by the Commission in fixing the rate. Clearly no such interpretation could have been placed upon this expression under the provisions of the Water Act in view of the express provisions of s. 141C, and with great respect I think no such interpretation should be given to it in the present statute.

and at 847-848:

> I can find nothing in this legislation indicating an intention on the part of the Legislature to empower the Commission to deprive the utility of its common law right to be paid fair compensation for the varying services rendered or to depart from the declared intention of the Legislature in the Water Act Amendment Act that such companies upon whom these obligations are imposed are entitled to have the quantum of such fair compensation determined as a fair return upon the appraised value of the properties required.

and finally, at 848:

> The obligation to approve rates which will produce the fair return to which the utility has been found entitled is, in my opinion, absolute, which does not mean that the obligation of the Commission to have due regard to the protection of the public, as required by s. 16(1)(b), is not to be discharged. It is not a question of considering priorities between "the matters and things referred to in Clauses (a) and (b) of subsection (1) of s. 16". The Commission is directed by s. 16(1)(a) to consider all matters which it deems proper as affecting the rate but that

> consideration is to be given in the light of the fact that the obligation to approve rates which will give a fair and reasonable return is absolute.

Mr. Sanderson accepted that the Commission is required to have due regard to what is referred to in s. 65(4)(c) but submitted that, in directing the three year phase-in of the rate adjustment with no offsetting provision to permit HVES to obtain sufficient revenue to recover the shortfall, the Commission has committed the very sin which Mr. Foy charges against the utility, namely, that instead of having due regard - and giving effect - to the three specific matters set out in s. 65(4) it has accorded priority to either s. 65(4)(a) or 65(4)(c) and relegated s. 65(4)(b) to simply "a matter to be considered".

Mr. Sanderson contended that if the Commission was properly concerned to ameliorate the rate shock of a sharp rise in rates to be charged it could do so but only if, at the same time, it directed the filing of rate schedules which, over a reasonable period of time, would provide sufficient revenues to enable the utility to catch up and recover the shortfall. HVES, he said, is entitled to be made whole by the standards, in terms of the rate base and allowable rate of return thereon, which the Commission itself fixed. It is only in this way that the Commission can properly discharge its mandate and comply with the direction to have due regard to all the matters referred to in s. 65(4) without according priority to one or another of them.

The addition of s. 65(4)(c) in the Act, however, is not an alternative to ss. 65(4)(a) and (b), but rather is an additional basis on which rates may be found to be unjust and unreasonable. Accordingly, while rates may be unjust or unreasonable for reasons other than those set out in ss. 65(4)(a) and (b), it remains the law that if a rate is insufficient to yield a fair and reasonable return on rate base, it is necessarily "unjust

and unreasonable" within the meaning of s. 65(4)(b).

Mr. Sanderson's submissions continued as follows:

A distinction has been drawn in the case law between regulatory systems which afford the administrative tribunal an unfettered discretion to fix rates and those which provide the tribunal with specific statutory directions as to how these rates are to be fixed. (See B.C. Hydro and Power Authority v. West Coast Transmission Company Ltd. et al (1981), 36 N.R. 33 (Fed. C.A.).

The current Utilities Commission Act is an example of the latter. Sections 65(4)(b) and 66(1)(b) amount to a statutory direction as to how the Commission is to determine a just and reasonable rate. If, as posited by Martland J., a public utility is providing an adequate and efficient service, the statute is clear: a rate is unjust or unreasonable if it fails to yield a just and reasonable return on rate base. Here, while there may be room for improvement, the Commission's recommendations with respect to quality of service referred to above are calculated to achieve what is desired. Accordingly, the Commission has no discretion to fix rates which do not permit recovery of that return.

The virtually identical nature of the relevant provisions of the old Act and the new Act compel the conclusion that pursuant to the new Act, HVES is similarly given a statutory right to the approval of rates which will afford it the opportunity to earn a fair and reasonable rate of return upon the appraised value of its property. Commission Order No. G-77-90 denies HVES that opportunity.

In my view Mr. Sanderson's submissions are sound and must be accepted.

The Utilities Commission Act empowers the Commission to determine what is a fair and reasonable rate of return upon the appraised value of the property of regulated utilities, but, having done so, requires the Commission to set rates so as to allow recovery of a rate which permits an opportunity to earn that return. In this case, the Commission correctly exercised its discretion to determine what a just and reasonable return was, but wrongly failed to permit HVES to charge a rate which gave it an opportunity to earn that return. For this reason, it is my view that Commission Order No. G-77-90 cannot stand, and that Order No. G-11-91 must fall with it.

With respect to Mr. Foy's able and forceful submissions they are, in my view, flawed, and for these reasons.

Firstly, in directing the three year phase-in the Commission was not balancing interests or, if it was purporting to do, it acted improperly. The proper balancing of interests which the Commission carried out was done and completed when it settled the rate base, fixed the rate of return and determined the costs of operation allowable for rate-making purposes. It must be remembered that the rate base itself was the subject of much contention at the public hearing and that only after the Commission had considered alternative calculations for rate base did it decide to accept HVES's evidence in this regard. It must be remembered as well that HVES had proposed a rate of return of 13% on the debt component and 15% on the equity component of the rate base. The Commission denied HVES's request and fixed 13% as the just and reasonable rate of return on both components. In addition, as can be seen from Sheet 5 of the Appendix to these reasons, the Commission made substantial downward adjustments to many of HVES's estimates of its costs of operation.

This is the balancing of interests which the Commission carried out in performing its function. HVES has accepted the Commission's decision in these respects. None are the subject of this appeal. Once this balancing of interests had been performed it was the Commission's duty to have due regard to the factors referred to in s. 65(4).

Secondly, I cannot accept Mr. Foy's contention that the three year phase-in was the result of the Commission's expressed concern over the quality of service. The analysis I have made of the Original Decision and of the reconsideration decision in my view refutes this contention. Alternatively, if in fact the Commission decreed the three year phase-in for this suggested reason it was wrong in law in doing so for it gave an unwarranted priority to one or another of the matters set out in

s. 65(4) at the sacrifice of s. 65(4)(b).

Thirdly, Mr. Foy submitted that "rate shock" is a recognized phenomenon which has attracted a number of rate moderation plans, including rate base phase-ins, in the utility regulation field, and he referred to the following authorities: Bonbright, Danielsen and Kamerschen, Principles of Public Utility Rates (1988), 260-4; Scotto, D. "Post-Operational Phase-in of Utility Plan: Prolonging the Inevitable" (1983) Public Utilities Fortnightly, September 1, 112:28-34; Massella, I.M., "Rate Moderation Plans - Cushioning 'Rate Shock'" (1984) Public Utilities Fortnightly, February 16, 113:52-56; Re California-Pacific Utilities Company (1964), 52 P.U.R. (3d) 446; and Re The Pacific Telephone and Telegraph Company (1966), 65 P.U.R. (3d) 517.

The underlying principle of this theory of gradualism in the implementation of new rate schedules is perhaps best explained in the article by Scotto, "Post-Operational Phase-in of Utility Plant: Prolonging the Inevitable". There the author wrote, at p. 28:

> In 1982 two new terms were added to the electric utility industry's lexicon: "rate shock" and "phase-in." Rate shock refers to a sudden and "substantial" increase in electric rates. The concept can be illusive because the demarcation between "substantial" and nonsubstantial" rate increases is usually a function of local political and economic sensitivities rather than a definitive, universal percentage increase. However, a 50 per cent jolt in rates would generally be considered substantial--well beyond the tolerance levels of most state commissions and ratepayers. Increases in the 20 per cent to 30 per cent vicinity, though, are more ambiguous. Rate shock is really a manifestation of the dollar disparity between rate base and new generating plant investment--the construction work in progress (CWIP) account. For a number of utilities the CWIP to net plant ratio can exceed 100 per cent, necessitating a high revenue increase--a rate shock--to reflect the plan in rate base upon commercial operation. As an alternative to the conventional one-shot hike in rates, new rate-making techniques have been proposed which are designed to spread the revenue impact of new plan investment into the postoperative years--hence, the term "phase-in".

> Post-operational phase-in can be accomplished in a variety of ways, most of which rely on accounting adjustments to protect the integrity of reported earnings. The basic thesis in each case is the same: Capital recovery is spread over the asset's useful life with no economic loss (at least in theory) to the utility. (emphasis added)

It can be seen that the purpose of "phase-in" is two-fold: to ameliorate the shock of suddenly imposed significant rate increases and, at the same time, to protect the integrity of the utility's earnings. As the title to Mr. Scotto's article itself indicates, it is merely "prolonging the inevitable".

The two regulatory decisions, Re California-Pacific Utilities Company, decided in 1964, and Re The Pacific Telephone and Telegraph Company, decided in 1966, appear to be out of step with the main stream of American regulatory jurisprudence for, like the decision of the Commission under consideration here, they did not provide for any catch up so that the utility could, over time, realize its authorized rate of return. I cannot regard them as binding or even persuasive.

The power of the Commission to phase in rates was perhaps presaged by Martland, J. in the penultimate paragraph is his judgment in the British Columbia Electric case where he said at p. 857:

> . . . the Commission should permit the Company to submit alternative schedules of rates, which, while yielding approximately the same overall revenues, would eliminate the comparatively excessive impact of those classes of rates to which the Commission objected, <u>until a rate schedule is devised which meets the requirements of clause (b) of s. 16(1)</u>.

(Emphasis added)

What the Commission did here fails to meet the requirements of the legislation.

DISPOSITION:

In Part 4 of its factum, under the heading Nature of Order Sought, the appellant seeks an order that:

> (a) the decision of the British Columbia Utilities Commission, dated January 30, 1991 be quashed;
> (b) that portion of the decision of the British Columbia Utilities Commission, dated October 17, 1990 requiring rates to be phased in and directing a refund be quashed;
> (c) the British Columbia Utilities Commission be directed to order HVES to file new tariff schedules permitting it to recover 13% on rate base from July 1, 1990;
> (d) monies held by Lawson, Lundell, Lawson & McIntosh pursuant to the order of Mr. Justice Toy of March 7, 1990 be paid to HVES;
> (e) costs; and
> (f) such further relief as to this Honourable Court may seem just.

I think the proper course for this Court to adopt is to allow this appeal and to refer the matter back to the Commission with the direction that it permit, or require, HVES to file new tariff schedules which will enable it to earn 13 per cent on its determined rate base from July 1, 1990.

If the Commission considers it necessary or appropriate to ameliorate rate shock by directing the phasing in of such revised rates, it shall do so in a way which meets the requirements of s. 65(4) as set out in these reasons.

It will be for the Commission to make an order for the appropriate disposition of the funds referred to in para. (d) above.

Section 118 of the Act exempts the Commission from any liability for the costs of this appeal. I do not think it appropriate to order that the Attorney General, and thereby the general public, bear those costs. However, I note from para. 5.3 of the Original Decision and from Sheet 3 of the Appendix that provision was made for the recovery, through the rates to be charged, of the sum of $35,000 for HVES's rate application costs before the Commission.

Accordingly, I would direct that, failing agreement between the parties, HVES tax its costs for fees and disbursements of and incidental to this appeal and that the amount so determined be included in the rate application costs in the schedule.

CUMMING J.A.
HUTCHEON J.A.:-- I agree.
HINDS J.A.:-- I agree.