Re

Union Gas Ltd. and Ontario Energy Board et al.

43 O.R. (2d) 489

1 D.L.R. (4th) 698

ONTARIO
HIGH COURT OF JUSTICE
DIVISIONAL COURT
STEELE, ANDERSON

AND SAUNDERS JJ.

1ST NOVEMBER 1983.

Public utilities -- Rates -- Board empowered to fix just and reasonable rates for sale of gas -- Disallowing unabsorbed demand charges as costs to be recovered -- Whether board erred -- Ontario Energy Board Act, R.S.O. 1980, c. 332, s. 19.

Pursuant to s. 19(1) of the Ontario Energy Board Act, R.S.O. 1980, c. 332, the board may make orders fixing "just and reasonable rates" for the sale of gas. On an application for the fixing of rates by the appellant public utility, the board excluded from the amount to be recovered by the rates "demand charges", a sum paid on a monthly basis whether or not the quantity of gas contracted for was actually taken. The company was then in an acute over-supply position. The result was to reduce the rate of return to shareholders. On a motion for leave to appeal and, if granted, an appeal from the order, held, the motion for leave to appeal should be granted but the appeal should be dismissed.

In balancing the conflicting interests of the enterprise, which seeks the highest possible rate of return on its operations, and the customers, who wish to be served as cheaply as possible, and in determining just and reasonable rates, the Ontario Energy Board has a wide discretion, although the exercise of its discretion must not be arbitrary or capricious. As well, it is under an obligation to approve rates which will produce a fair rate of return. The board dealt with the question of unabsorbed demand charges as part of its consideration of the whole question of over-supply of gas. Considered as one factor in dealing with the whole problem of over-supply of gas, the disallowance of the demand charge was not arbitrary or capricious.

Cases referred to

Northwestern Utilities, Ltd. v. City of Edmonton et al., [1929] S.C.R. 186, [1929] 2 D.L.R. 4; Re Western Ontario Credit Corp. Ltd. and Ontario Securities Com'n (1975), 9 O.R. (2d) 93, 59 D.L.R. (3d) 501; British Columbia Electric R. Co. Ltd. v. Public Utilities Com'n of British Columbia et al., [1960] S.C.R. 837, 25 D.L.R. (2d) 689, 33 W.W.R. 97, 82 C.R.T.C. 32

Statutes referred to

Ontario Energy Board Act, R.S.O. 1980, c. 332, ss. 1(1), para. 6, 19, 32

MOTION for leave to appeal and, if leave granted, APPEAL from an order of the Ontario Energy Board.

B. H. Kellock, Q.C., and B. MacL. Rogers, for appellant.

D. H. Rogers, Q.C., for respondent, Ontario Energy Board.

P. C. P. Thompson, Q.C., for respondent, Industrial Gas Users Association.

The judgment of the court was delivered by

ANDERSON J.:-- This is a motion by Union Gas Limited (Union) for leave to appeal from the order of the Ontario Energy Board (the O.E.B.) issued May 13, 1983, and, if leave be granted, by way of appeal from the said order. The central question for decision is whether the O.E.B., in the course of its rate-making function, having disallowed the appellant an operating cost of which the quantum was not in dispute and the propriety was not in question, committed an error of law or jurisdiction such that this court should intervene on appeal. The provisions of the Ontario Energy Board Act, R.S.O. 1980, c. 332 (the Act), in so far as they are material are in the following terms:

> 32(1) An appeal lies to the Divisional Court from any order of the Board upon a question of law or jurisdiction, but no such appeal lies unless leave to appeal is obtained from the court within one month of the making of the order sought to be appealed from or within such further time as the court under the special circumstances of the case allows.
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> (2) The Board is entitled to be heard by counsel or otherwise upon the argument of

any such appeal.

(3) The Divisional Court shall certify its opinion to the Board and the Board shall make an order in accordance with such opinion, but in no case shall such order be retroactive in its effect.

Facts

Union conducts an integrated gas utility business which combines the operations of producing, purchasing, transmitting and storing gas ("gas" as defined by s. 1(1), para. 6 of the Act). Union stores and transmits gas for others, sells gas to other utilities for resale and distributes gas to ultimate consumers in its franchise area in south-western Ontario.

By application dated July 15, 1982, Union applied to the O.E.B. pursuant to s. 19 of the Act for, inter alia, an order approving or fixing just and reasonable rates and other charges for the sale of gas, and for the storage and transmission of gas for others; such rates to be effective on April 1, 1983, the commencement of Union's 1984 fiscal year.

Union's application (given the docket No. E.B.R.O. 388) was supported by pre-filed evidence and by oral testimony and oral and written argument during the hearing. The hearing commenced December 13, 1982, and concluded February 18, 1983. The O.E.B.'s reasons for decision are dated April 22, 1983; the final order was issued May 13, 1983; and the rates thereby established became effective commencing April 22, 1983.

In its decision and by its order, the O.E.B. excluded from the amount to be recovered by the rates fixed the sum of $8,693,000, representing a portion of the cost to Union of its gas supplies from Union's major supplier, TransCanada PipeLines Limited ("T.C.P.L."), during the test year (April 1, 1983 to March 31, 1984). The treatment of this item by the O.E.B. is the focal point of this application.

Union seeks leave to appeal and, if granted, appeals from the O.E.B. order upon the grounds that the O.E.B. erred in law or exceeded its jurisdiction in purporting to fix just and reasonable rates which do not permit Union the opportunity of recovering through such rates $8,693,000 of Union's cost of gas supplies.

The respondent, the O.E.B., exercises jurisdiction over, inter alia, the sale and distribution of gas to consumers, and the construction of facilities to distribute the gas. No distributor such as Union is permitted to sell gas except in accordance with an order of the O.E.B.

A distributor desiring to sell gas is required to apply to the O.E.B. for a determination of just and reasonable rates. The O.E.B. is required to determine a rate base and a reasonable return, based upon the evidence adduced in a public hearing.

In a rate application, the O.E.B. generally proceeds, as in the case at bar, by determining:

(a) the rate base;
(b) the appropriate rate of return on that rate base;
(c) the applicant's cost of service;
(d) the revenue deficiency (or revenue surplus), and
(e) the appropriate rate increases (or decreases) for each customer class required to meet the deficiency (or surplus).

Accordingly, in each rate application the applicant utility structures the evidence filed in support of the application so as to permit the O.E.B. to determine the appropriate rate base and the appropriate cost rates for each element of the capital structure used to finance the rate base, the utility's cost of service and, finally, the amount of the revenue deficiency (if any) that existing rates would produce if they were not altered. These amounts are estimated and determined by the O.E.B. for the period covered by the application, a future "test year" during which the rates to be fixed will be in force.

Traditionally, the O.E.B., and most other utility regulators, have set rates based upon an historic "test year" utilizing actual results for a past period.

Recently, and in E.B.R.O. 388, some regulated utilities have chosen to seek rates based on a future test year. This requires forecasts or predictions of future conditions.

The future test year approach has been accepted by the O.E.B. as appropriate in specific cases. While the approach has certain advantages in times of rising costs, it does require the application of extensive judgment in all areas and increases the uncertainties involved.

The rate base is simply the depreciated cost to the utility of Union's property (plant and equipment) "used or useful" in serving the public, e.g., pipelines, compressors, trucks and typewriters, together with allowances for such items as working capital.

As Union has investments in unregulated activities (e.g., the development of oil and gas in western Canada), the O.E.B. must determine an appropriate capital structure for the utility operation alone that includes long-term debt, preference shares, common equity capital and short-term borrowings.

The O.E.B. then determines the appropriate cost rates for the test year for each component of the capital structure, i.e., long-term and short-term debt, preference shares and common equity.

The utility's revenue requirement, which is made up of two components, its total operating costs and an appropriate return on rate base, represents the utility's cost of service for the test year. Operating costs include the cost of gas supplies, pay-roll costs, depreciation and taxes.

The revenue deficiency (if any) is calculated by comparing the total cost of service to the total estimated revenues. For this purpose, the rates in effect prior to the application are applied to the estimated volume of gas sales in the test year. The shortfall (if any) is termed the "revenue deficiency".

The last step in the process is the determination by the O.E.B. of the specific alterations to be made in the utility's rate structure so as to provide the utility with the opportunity over the test year to collect sufficient revenues from all classes of customers sufficient to cover the revenue deficiency. The O.E.B. then determines the appropriate rates for each class of customer.

Union receives more than 96% of its gas supply from T.C.P.L. in accordance with Union's contractual commitments and T.C.P.L.'s tariffs. The remaining amount is supplied by independent producers and Union's own gas wells in south-western Ontario, and by Petrosar in Sarnia, Ontario. T.C.P.L. delivers its gas from western Canada through its own pipelines to Union and other utilities in accordance with rate schedules approved by the National Energy Board ("N.E.B.").

Gas is purchased by Union from T.C.P.L. under three classes of service permitted by the N.E.B.: CD (Contract Demand), ACQ (Annual Contract Quantity) and AOI (Authorized Overrun Interruptible). CD and ACQ services are supplied pursuant to long-term contracts between Union and T.C.P.L. Approximately one-half of the contracted-for gas is purchased under six CD contracts. The other half is purchased under three ACQ contracts. AOI service is only available from time to time upon short notice and, therefore, cannot be relied upon for long-term gas supply.

Under CD service, the delivery of a specific quantity of gas, on a daily basis, is guaranteed by T.C.P.L. For this, Union must pay both demand and commodity charges. The demand charges must be paid on a monthly basis, whether or not the quantity of gas contracted for is actually taken. The demand charges represent the minimum monthly bill. In essence, the demand charges are a reservation fee to ensure a constant and secure supply of gas and are intended to recoup T.C.P.L.'s fixed costs for the CD service contracted for, recognizing that T.C.P.L. must have continually available the facilities that are necessary to deliver CD service gas on a daily basis. In addition, commodity charges are payable for the quantity of gas actually taken by Union in any particular month under the CD service contracts. Therefore, unlike the demand charges, commodity charges will vary directly with actual volumes delivered. Since the quantities guaranteed for delivery are fixed by contract, demand charges will remain constant for the period of the contract, except for changes in T.C.P.L.'s tariffs.

ACQ service is the lowest price supply service available to Union from T.C.P.L. While the price of ACQ service is lower than CD service, ACQ is offered on an interruptible basis. Union is required to pay the full cost of the annual quantities of gas contracted for, whether or not Union can accept delivery of such quantities. The quantity Union is committed to take annually (and T.C.P.L. to supply) can be reduced by no more than 10% in any year, and then only if 18 months' prior notice is given by Union to T.C.P.L. Because of the interruptible nature of ACQ service, a great deal of

storage capacity is required.

AOI service is available only when T.C.P.L. has a surplus of both gas and delivery capacity, and is offered in specific quantities and on short notice.

Union has been able in the past to take full levels of both ACQ and CD service. By taking CD service at "100% load factor", or the full contracted quantity, the demand charge component of the price for this gas has been spread over the maximum volume (or units) of gas. This reduces the unit cost of CD service gas and keeps it close to that of ACQ service gas. All of the demand charges are said to be fully "absorbed" when CD service gas is purchased at 100% load factor. "Unabsorbed demand charges" occur whenever a utility is unable to take the full volumes that have been contracted for.

As a gas utility, Union must meet customers' requirements while keeping gas costs as low as possible. Union must therefore enter into long-term contracts (20 years or more) that commit Union to purchasing specific quantities of gas over many years. When an unexpected and temporary economic downturn causes the demand for gas to fall, Union can maximize its use of storage capacity or cut back the quantity of CD service taken.

Union must, looking into the future, make a determination of its gas supply strategy by assessing many different factors. These include maximum and optimum storage levels, anticipated future increases in the price of gas, anticipated gas sales in the future and effect of CD service cutbacks on the price of gas for contract customers with price escalation provisions in their contracts with Union. These and other factors must be predicted for some time in the future and all but the volume of gas kept in storage are out of Union's control.

Whatever strategy is finally determined, an economic downturn causes the unit cost of gas to Union to increase. When the quantity of gas contracted for exceeds the quantities that can be sold, increased carrying costs of gas in storage or demand charges for the CD service that are no longer spread over the full quantities contracted for, or both, will be incurred.

Union's gas sales volumes fell substantially in fiscal year 1983 (April 1, 1982 to March 31, 1983) from those forecast in O.E.B. rate case E.B.R.O. 382 (which fixed rates for that year). The pre-filed evidence in E.B.R.O. 388 reflected an estimated reduction in sales from the E.B.R.O. 382 forecast. This estimate was revised twice before the final estimate was filed. The final sales volume estimates filed in E.B.R.O. 388 likewise indicated substantially reduced sales. Sales in fiscal year 1985 were also forecast to decrease. The provisions of Union's long-term contracts with T.C.P.L. combined with reduction in sales produced a substantial gas supply surplus. The decision was made by Union in 1982 to maximize the use of storage and thereby to reduce CD service. This almost totally used Union's storage capacity but was of benefit to Union by minimizing the unit cost of gas. A cut-back in the CD service was forecast for the E.B.R.O. 388 test year (1984). The reductions in sales meant that in the test year 1984 the cost of gas would be $8,693,000 more than if the CD service was continued at 100% load factor. This amount, described as unabsorbed demand charges, is a direct

cost of gas to Union in the test year 1984.

As to the return to common shareholders, the board had the evidence of three expert witnesses. The lowest estimate was given by the witness Parcell, in whose opinion a range of 15% to 16% represented the cost of equity capital for Union Gas' utility operations. The O.E.B. found a rate of 15.6% to be appropriate. The O.E.B. then determined the appropriate revenue deficiency for the purpose of fixing the rates.

Issues and law

The rate-making jurisdiction of the O.E.B. is found in s. 19 of the Act which, in so far as material to these proceedings, is in the following terms:

> 19(1) Subject to the regulations, the Board may make orders approving or fixing just and reasonable rates and other charges for the sale of gas by transmitters, distributors and storage companies, and for the transmission, distribution and storage of gas.
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> (2) In approving or fixing rates and other charges under subsection (1), the Board shall determine a rate base for the transmitter, distributor or storage company, and shall determine whether the return on the rate base produced or to be produced by such rates and other charges is reasonable.
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> (3) The rate base to be determined by the Board under subsection (2) shall be the total of,
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> (a) a reasonable allowance for the cost of the property that is used or useful in serving the public, less an amount considered adequate by the Board for depreciation, amortization and depletion;
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> (b) a reasonable allowance for working capital; and
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> (c) such other amounts as, in the opinion of the Board, ought to be included.
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> (4) In determining the reasonable allowance for the cost of the property under clause (3)(a), the Board shall ascertain the actual cost of the property to the present owner, but,

> (a) where the actual cost to the present owner of any of the property cannot be ascertained, the Board shall determine a reasonable allowance to be included in the rate base for the cost of that property; and
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> (b) where in the opinion of the Board the actual cost to the present owner of any of the property is more than a reasonable allowance for inclusion in the rate base for the cost of that property, the Board shall determine a reasonable allowance to be included in the rate base for the cost of that property.
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> (5) In considering whether the actual cost mentioned in subsection (4) exceeds a reasonable allowance for inclusion in the rate base and in determining the appropriate deductions to be made in respect of any such excess, the Board may consider all matters it considers relevant, including the public benefit resulting from the acquisition of the property, whether the acquisition at the price paid was prudent in the circumstances existing at the time and, where the property was acquired as an operating system or part thereof, the allowance made for its cost in the rate base of the former owner or, if no such rate base had been determined that included an allowance for the cost thereof, the allowance that would have been made therefor in a rate base for the former owner determined in accordance with this section.
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> (6) Findings of fact on which determinations are made by the Board under subsections (2), (3), (4) and (5) shall be based on the evidence adduced at the hearing.

The phrases "just and reasonable" or "fair and reasonable", "rate base" and "used or useful" have been employed to describe the principles and methodology to be used by public utility boards and commissions in fixing public utility rates in the United States and Canada for many years. See, for example, Northwestern Utilities, Ltd. v. City of Edmonton et al., [1929] S.C.R. 186, [1929] 2 D.L.R. 4, per Lamont J. at pp. 192-3 S.C.R., p. 8 D.L.R.:

> The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.

In support of its motion for leave and if appeal be granted, in support of its appeal, the appellant makes the following submissions:

(1) In order to be just and reasonable, the rates fixed must:

(a) cover the utility's operating cost, and

(b) provide appropriate compensation to the owners of the utility over and above the cost of providing the service.

(2) That the Act does not provide the O.E.B. with authority or jurisdiction to act as manager of the appellant's utility operation, to determine its operating costs arbitrarily, or to exercise an unlimited discretion.
(3) That the result of the O.E.B. decision is to deprive Union of its property without adequate compensation, in contravention of the language and intent of the Act.
(4) That once the appellant's gas purchase decisions have been found to be reasonable, it follows, a fortiori, that the purchase price of such gas must be found to be a reasonable operating expense and must be included in the calculation of the rates to be fixed and recoverable by the appellant.

The position of the respondent O.E.B. with which the other respondent associated itself, is that no issue of law or jurisdiction is involved. The respondent submits that:

(a) the O.E.B. is given wide powers and broad discretion to fix rates which in its opinion are "just and reasonable";
(b) that the determination of the cost of service is not strictly an issue of law or jurisdiction and is a matter in which the court should not substitute its opinion for that of the board;
(c) that in determining rates which are just and reasonable the O.E.B. should balance the interest of the customers (ratepayers) and those of the owners (shareholders);
(d) that the O.E.B. should consider the conflicting interests of present and future customers.

In the oral argument two principal areas of difference emerged.

The respondents contended that the decisions taken by the appellant to continue in fiscal year 1983 to fulfil its CD contracts and to use its storage facilities to the greatest extent possible had the effect of avoiding, for that period, unabsorbed demand charges which would otherwise have been a charge to the shareholders. It was further contended that, if the unabsorbed demand charges which resulted in the test year were allowed in full, they would operate to the detriment of customers of the utility during that year. They submitted that the disposition by the board of the over-supply problem and the disallowance of the unabsorbed demand charges represented a sharing of the latter between the shareholders and the customers of the utility, and that it was within the due and proper discretion of the O.E.B. to effect such a sharing in those circumstances.

On these points, counsel for the appellant first submitted that Union's decision to follow the

course which it did follow with respect to the over-supply problem was a legitimate management technique as to which no adverse finding was made by the O.E.B. He further submitted that the O.E.B. had no discretion or jurisdiction to effect such a sharing as to an operating cost. He submitted that, in the instant case, such sharing had the effect of reducing the return on equity from 15.6%, which on the evidence the O.E.B. had found to be appropriate, to 13.75%, which, he submitted, found no support on the evidence.

The arguments of counsel for the respondents may be related to concerns expressed by the O.E.B. in its reasons for decision:

> The treatment to be accorded the volume of gas in storage was one of the main issues in this hearing. As outlined later in the gas sales forecast section of these Reasons for Decision, the Company found itself in an acute gas over-supply position. However, Union proposed that only a part of the excess gas be included in inventory and consequently in rate base and that the remainder, valued at $52 million, be segregated in the capital structure as a "special assignment". As well, Union also forecasted a test year cut-back in the Contract Demand ("CD") gas supply contract of 372 106m3 which would result in unabsorbed demand charges of $8.693 million and which the Company proposed be included in its cost of gas for the test year. As the unabsorbed demand charges also result from the gas over-supply situation, the Board will include discussion of these proposals together with the excess gas in storage, in this section. The special assignment however, is discussed under its own heading in these Reasons for Decision.

> IGUA submitted that the total value of the over-supply ought to be excluded from rate base, but the cost of financing it ought to be included in the utility's cost of service for the test year and distributed on a demand rather than a commodity basis. Mr. Thompson submitted that the rate base for the test year as put forward by Union reflects this abnormally and unacceptably high level of gas in storage and a reduction ought to be made to reflect normal conditions.

> Mr. Thompson estimated that the value of the excess gas in storage was approximately $100 million and he argued that Union's ratebase ought to be reduced by that amount and the cost of service should be increased by $12 million to provide for the cost of carrying that $100 million worth of excess gas.

> Mr. Kawalec in his argument took issue with Union's entire proposal to charge its customers the excess carrying costs. He submitted that:

> "The Board [should] not bail out Union on every excess supply problem. One Petrosar

is enough. This problem should rightfully reach the shareholders, and they can hold management accountable for this excess gas supply."

Board Counsel submitted that Union, in attempting to alleviate the drastic over-supply problem in the 1983 fiscal year and the test year took the following steps:

1. deferred 122 106m3 of Annual Contract Quantity ("ACQ") purchases from the 1983 fiscal year to the test year, and then the same amount from the test year to the 1985 fiscal year;
2. curtailed 219 106m3 of ACQ purchases in the test year;
3. curtailed the purchases of ACQ gas by a further 10% in the test year;
4. reduced volumes for its short-term storage customers in the test year by 230 106m3 and increased its long-term storage volumes by 88 106m3; and
5. agreed with Consumers' that 77 106m3 of ACQ deliveries would be delayed from the 1983 fiscal year to the test year.

Board Counsel submitted that Union was transferring 198 106m3 of gas from the 1983 fiscal year to the test year. The major reason for this he submitted, was that if a CD curtailment had taken place during the 1983 fiscal year, Union's shareholders would have absorbed the total cost but if the curtailment were to take place during the test year as Union proposed, the cost would be transferred to customers in the test year.

Mr. Rogers also argued that the deferral of the 122 106m3 of ACQ gas from 1983 to 1984 and then subsequently to 1985, effectively denied the 1984 customers a benefit by removing a potential deferral and using that deferral for excess 1983 volumes. Thus, he argued, the customers in the test year are really being asked to pay for gas costs that should properly be assigned to the 1983 fiscal year. He submitted that:

"Union has endeavoured to manage its gas supply picture so as to maximize the shareholder benefit first and then to the extent it's still possible pass some benefit to the customer. This clearly is not considered appropriate."

Mr. Kellock argued that no portion of legitimate gas costs should be disallowed without evidence of "fault, bad faith, negligence or abuse of discretion." He pointed out that Union was "not in possession of a crystal ball" and could not have altered its gas supply arrangements so as to produce a lower level of costs than that claimed. He contended that cut-backs in CD deliveries must be made over the next two years and

the claimed cut-back of 372 106m3 for the test year is unavoidable. Such cut-backs are common to all three major gas utilities in Ontario, he said.

In regard to Mr. Rogers' argument about the lowering of the proposed test year cut-back to account for the fact that there should have been a cut-back in 1983, Mr. Kellock pointed out that as the ACQ deferral from 1983 is actually passed through to 1985 it does not have any effect on the test year. He said that the Consumers' arrangements in regard to storage delivery were made for Consumers' benefit and had no impact on the need for a CD cut-back in 1983. He also argued that the Consumers' short-term storage arrangements in 1983 had no impact on the level of the CD cut-back in 1984 since a like amount has been subsequently deferred through to the 1985 fiscal year. As well, he pointed out that an unscheduled cut-back in 1983 would have an adverse impact on Union's customers which have price escalations in their supply contracts.

The Board in examining the evidence is concerned about the carry-over of excess gas from the 1983 fiscal year to the test year. Mr. Kellock argued that: "because of the success of Union's negotiations with TCPL, it became evident that no cut-backs were needed for fiscal year 1983." This he pointed out, saved a further erosion in sale volumes which would have resulted from a price increase caused by the pass-through of unabsorbed demand charges to the contracts with price escalation.

There is no doubt that these points are valid reasons why a cut-back should not have taken place in the 1983 fiscal year. Union has testified that in the circumstances, storing the excess gas and paying the extra carrying cost was preferable to a cut-back.

The Board's concern is that by so doing Union has forced the cost of cut-backs on its 1984 customers. By putting the excess gas during fiscal 1983 into storage, Union has effectively reduced the storage space for any excess gas in 1984 and as the rates for 1983 were set a year ago, and did not take into account that excess, part of the cost of the excess gas should be borne by Union's shareholders. If the opposite had been the case and Union had sold more gas than was forecast when the rates were set, that extra revenue would have belonged to the shareholders and for that reason Union must bear some of the costs associated with the downturn in gas sales.

In so far as the argument was made that the CD contracts are essential, primarily for security of supply and that security of supply is a cost responsibility of customers, the

> Board is of the opinion that although security of supply is vital to Union's customers, it is also vital to its shareholders. Risk of an economic downturn is a risk that rests on Union's shareholders and they are compensated for it in the return on common equity.
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> Mr. Black's evidence was that in Union's last rate case there was available 376.1 106m3 of extra storage space and as well, a total of 330 106m3 of Authorized Overrun Interruptible ("AOI") gas which could be cancelled without notice. This amounted to a total "downside coverage" of 706.1 106m3 for the fiscal years 1983 and 1984. The ultimate result however was that Union, although it covered a large part of its sales downturn, did not do so without considerable cost. As stated earlier, Union's shareholders must bear part of the cost of the over-supply because of the sales downturn in 1983 for which the 1984 customers are not responsible.
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> The Board will therefore allow in rate base the value of the gas in inventory as proposed by Union save and except the value of the special assignment and will also disallow all forecasted unabsorbed demand charges.

It was basic to the submissions on behalf of both respondents that the rate-making process is an involved and technical one as to which the O.E.B. has special expertise. The hearing was lengthy and the reasons of the O.E.B. detailed and voluminous. The relevant textbooks and authorities are replete with admonitions that a court should be reluctant to interfere with the dispositions of such tribunals, and should do so only in circumstances which clearly require it. See, for example, Re Western Ontario Credit Corp. Ltd. and Ontario Securities Com'n (1975), 9 O.R. (2d) 93, 59 D.L.R. (3d) 501, where, at p. 103 O.R., p. 511 D.L.R., Hughes J. has this to say:

> ... where a regulatory tribunal, acting within its jurisdiction, makes an order in the public interest with the experience and understanding of what that interest consists of in a specialized field accumulated over many years, the Court will be especially loath to interfere.

It is with such admonitions as that in mind that I approach the disposition of this case.

By way of general observation, it may also be said that in the field of law with which this case is concerned there are substantial similarities between the situation here and in the United States, and authorities of courts in the United States are frequently referred to and considered in cases of this kind. In the case at bar, reference was made by counsel for all parties to both textbooks and cases originating in the United States.

As general background in considering the rate-making function performed by the O.E.B. it is useful to consider a quotation from Principles of Public Utility Regulation by A.J.G. Priest. At p. 4, the learned author quotes a speaker on this subject in the following terms:

> "In the United States, private enterprise operates a larger share of these vital industries than in almost any other country because of our balanced system of regulation by public authority. This system is designed to protect consumers against exploitation where competition is inherently unavailable or inadequate, and to ensure that these industries will serve the public interest. At the same time it provides these companies necessary assurance of an opportunity to earn a reasonable return on their investment and to attract capital for expansion."

Put another way, it is the function of the O.E.B. to balance the interest of the appellant in earning the highest possible return on the operation of its enterprise (a monopoly) with the conflicting interest of its customers to be served as cheaply as possible.

That in balancing these conflicting interests and determining rates that are just and reasonable the O.E.B. has a wide discretion, is not in issue or in doubt. Findings of fact upon which its determinations under s-ss. (2), (3), (4) and (5) of s. 19 of the Act are made are required by s-s. (6) to be based on the evidence adduced at the hearing. In the exercise of that discretion and subject to that requirement, for the purpose of determining a rate base, the O.E.B. can fix a reasonable allowance for the cost of the property that is "used or useful" in providing service, a reasonable allowance for working capital and such other amounts as, in its opinion, are fit to be included. In the instant case, for example, it adjusted, determined, and allowed amounts for gas in storage and working capital. It declined to allow a change in accounting policy as applied to capitalization of overhead expenses. It approved a capital structure including long-term debt, short-term debt, preference shares and equity. In this context, it allowed a "special assignment" of $52 million for gas in storage. Likewise, in determining cost of service, the O.E.B. has a wide discretion as to what will be included and in what amount. It can apportion common costs as between utility and non-utility operations.

Looking at the obligation of the O.E.B. to have regard for the interests of the appellant, the O.E.B. is under an obligation to approve rates which will produce a fair return. In British Columbia Electric R. Co. Ltd. v. Public Utilities Com'n of British Columbia et al., [1960] S.C.R. 837, 25 D.L.R. (2d) 689, 33 W.W.R. 97, Locke J. says, at p. 848 S.C.R., p. 698 D.L.R.:

> The obligation to approve rates which will produce the fair return to which the utility has been found entitled is, in my opinion, absolute ... 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.

The question of what is a fair return is addressed in North-western Utilities, Ltd. v. City of Edmonton et al., [1929] S.C.R. 186, [1929] 2 D.L.R. 4, where, at p. 193 S.C.R., p. 8 D.L.R., is found the following language in the judgment of Lamont J.:

> By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive

> if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.

(Emphasis added.) The provision of the fair return is essential to preservation of the financial integrity of the appellant which is of mutual concern both to the appellant and to its customers.

The relatively narrow question presented by the appellant for determination by this court concerns the disallowance of the $8,693,000 of unabsorbed demand charges which were forecast for the test year and whether such disallowance was a question of law or jurisdiction such as to give rise to a right of appeal under s. 32 of the Act.

I am not satisfied that the item of $8,693,000 can be dealt with thus in isolation. It was not so dealt with by the O.E.B.

It is apparent from the reasons for decision, and in particular the portions quoted above, that the O.E.B. dealt with this item as part of its consideration of the whole question of over-supply of gas. This included its treatment of gas in storage as well as the disputed item. It is only fair to conclude that its disposition of the problem of gas in storage, necessary in determination of the rate base, and as to which no sound objection could be taken, was related to and conditioned by its concomitant disposition of the disputed item.

The O.E.B. has a wide discretion as has already been observed to allow, disallow or adjust the components of both rate base and expense. It may not, in the exercise of its discretion, be arbitrary or capricious in either area. It therefore ought not, as a general rule, to disallow an item of expense which will be properly incurred by the utility.

I am not persuaded that it did so in this case. Considered as one factor in dealing with the whole problem of over-supply of gas, it cannot be said that the disallowance was arbitrary or capricious. In my view, it did not involve any reversible error of law or jurisdiction.

At the same time, the appeal does raise a question of law or jurisdiction as to which leave ought properly to be granted.

I would grant leave but dismiss the appeal. I would give the respondent I.G.U.A. its costs and make no other order as to costs.

Leave to appeal granted; appeal dismissed.