

Supreme Court of Newfoundland and Labrador, Court of Appeal
Section 101 of the Public Utilities Act (Newfoundland) (Re)
Date: 1998-06-15

V. Randell J. Earle, Q.C., for the Board of Commissioners of Public Utilities;
Ian F. Kelly, Q.C., for Newfoundland Light and Power Co.;
Mark Kennedy, for the Consumer Advocate.

(96/141)

June 15, 1998.

[1] **GREEN, J.A.:** The Board of Commissioners of Public Utilities has stated a case for the opinion of this court, pursuant to s. 101 of the **Public Utilities Act** [see footnote 1]. The questions posed concern the jurisdiction and powers of the Board as they affect the approach of the Board to the determination of a "just and reasonable return" on the rate base of a utility, as well as related matters.

The Stated Case in Context

[2] The Board is the statutory body which has the authority and duty for the "general supervision of all public utilities" in Newfoundland and Labrador and in the course of exercising that supervisory role has general authority to "make all necessary examinations and inquiries and keep itself informed as to the compliance by public utilities with the law" and, as well, it has the right "to obtain from a public utility all information necessary to enable the Board to fulfil its duties" [see footnote 2].

[3] One of the Board's primary functions with respect to electrical utilities is the regulation and approval of rates, tolls and charges [see footnote 3]. In so doing, the Board must take account of the statutory requirement that the utility is entitled to earn annually a "just and reasonable return" as determined by the Board on the rate base as fixed and determined by the Board [see footnote 4]. The process essentially involves the fixing and determining of the appropriate rate base, the determination of a "just and reasonable return" on that rate base and then the approval of a schedule of rates, tolls and charges that would be appropriate to generate the revenue which, in the Board's estimation, would be necessary to provide the determined rate of return. Once rates, tolls and charges are

[114] Accordingly, the technical answer to Question 5 is "no" but so as to limit any confusion over the implications of the wording of the question, I would add that the Board has jurisdiction to define excess revenue for the purposes of maintenance of a reserve account by reference to the maximum level of return on common equity (or any other appropriate measure for that matter) but that does not mean that the Board may for all purposes define the level of excess revenue to which the utility is not entitled by reference to that measure; rather, the Board must determine, on the specific circumstances of the case, what is to be done with respect to any excess revenue measured against a just and reasonable return on rate base. If all or a portion of the excess revenue, measured against the return on rate base, is not ordered to be paid into a reserve account, it must nevertheless be dealt with in some other manner consistent with the objects and policies of the legislation. It should not be simply assumed that such excess revenue if not required to be paid into a reserve account belongs to the utility to be dealt with as it sees fit.

Question 6

"Does the Board have jurisdiction to order the rates, tolls and charges of the public utility shall be approved taking into account the amount of expenses previously incurred by the public utility which the Board may now consider inappropriate to be allowed as reasonable and prudent and properly chargeable to operating account notwithstanding that such classes of expenses were allowed as reasonable and prudent and properly chargeable to operating account."

[115] The just and reasonable return on rate base which the Board determines that the utility is entitled to earn annually is "in addition to those expenses which the Board may allow as reasonable and prudent and properly chargeable to the operating account...". [see footnote 80] Thus, in the process leading up to the prospective setting of rates, the Board may look at the type and level of projected expenses of the utility in the test year and determine whether they are reasonable and, if not, only allow, for the purposes of calculation of a just and reasonable return on rate base, such types and levels of expenses as are, in the opinion of the Board, reasonable.

[116] In the 1991 rate hearing, certain types and levels of projected advertising expenses were approved by the Board. At the 1996 rate hearing, it was suggested that in

the light of what actually happened in the years subsequent to 1991, the utility had in fact incurred advertising expenses well in excess of the amounts approved as reasonable and also of a type different from those which were approved, i.e. for corporate image building rather than related to the supply of service. The issue posed by Question No. 6 is whether expenses of a class which were previously approved as reasonable but which are in excess of the projected amounts can be disallowed by the Board for the purposes of rate regulation.

[117] The level of operating costs is obviously an important factor in fixing rates. It is generally accepted that Board supervision as to reasonableness of such costs is therefore essential to effective regulation [see footnote 81]. Phillips describes the matter thus:

"Commissions seldom challenge expenditures controlled by competitive forces, such as those for plant maintenance, raw materials and labor. Conflicts do arise over whether certain expenditures should be charged to operating expenses or paid for by owners out of earnings.

"Management might vote itself high salaries and pensions. Payments to affiliated companies for fuel and services might be excessive. Expenses for advertising, rate investigations, litigation and public relations should be closely scrutinized by the commissions to determine if they are extravagant or if they represent an abuse of discretion. In all cases, moreover, the commissions should require proof as to the reasonableness of a utility's charges to operating expenses." [see footnote 82]

Accordingly, the power to determine reasonable rates necessarily requires supervision of operating expenses.

[118] In defining the parameters of such supervisory power, however, the Board must account for a competing principle, namely, that the Board is not the manager of the utility and should not as a general rule substitute its judgment on managerial and business issues for that of the officers of the enterprise. [see footnote 83]

[119] Nevertheless, it is recognized that regulatory boards have a wide discretion to disallow or adjust the components of both rate base and expense [see footnote 84]. In an American case [see footnote 85] the matter was put as follows:

"The contention is that the amount to be expended for these purposes is purely a question of managerial judgment. But this overlooks the consideration that the