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Dear Mr. Wruck:

Silver Star Property Owner Association's (SSPOA) Response to Stargas Utilities Ltd.'s (Stargas) Application for Reconsideration of BCUC Order G-59-17 Paragraph 11

We are legal counsel to the SSPOA in this matter and, further to the Commission's revised regulatory timetable in its May 29, 2017 letter, write to provide its response to Stargas' request for the Commission to revise Order G-59-17.

I. INTRODUCTION AND OVERVIEW

Stargas' reconsideration application must be rejected for three reasons.

First, Stargas' request is an inappropriate attempt to "get a second kick at the can" by raising new arguments it could have, but failed to, bring forth in either its argument or reply argument. Stargas had full notice that the SSPOA sought the relief it now challenges, and it failed to address the point. The Commission should therefore refuse Stargas' request immediately and dismiss it outright. Utilities should not be able to argue new positions on review, to avoid wasteful duplication.

Second, should the Commission nonetheless consider the merits of Stargas' request, its legal basis is deeply flawed for a myriad of reasons, reflecting little understanding of the doctrine of retroactive ratemaking. Most fundamentally, the ordered refund cannot constitute retroactive ratemaking because the past rates at issue were always subject to adjustment by tracking the Commission's benchmark rate of return. Stargas conceded this in its application and IR responses, and now in this review application. Given that Stargas "erred" (its words) by failing to adjust its rates in accordance with the prescribed methodology, the Commission's correction therefore does not give rise to retroactive ratemaking, a fact well-recognized by a rich body of law. In contrast, Stargas relies on a single paragraph of the "*Stores Block*"[1] decision in its review request, taken out of context and without any substantive analysis.

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[1] *ATCO Gas & Pipelines Ltd v Alberta (Energy & Utilities Board)* 2006 SCC 4 [*Stores Block*].

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Stargas holding out rate of return as a forecastable cost subject to risk/reward is also wrong conceptually, and thus disconnected with the principles that underpin the prohibition on retroactive ratemaking. The point of prospective, forecast-based ratemaking is to encourage utilities to find cost efficiencies on matters within their control, ensuring that they continue to operate efficiently despite the absence of competitive pressure arising from natural monopolies. Retroactive ratemaking is prohibited in order to support prospective ratemaking by ensuring that the risk of underearning, and reward from overearning, are both real.

Third, more broadly, Stargas' review application fails on policy grounds. If the Commission rules itself helpless to order utilities to return funds wrongly collected due to calculation errors, oversights, or non-compliance with Commission directions, as Stargas argues, then utilities are free to benefit from their wrongful acts. The Commission must have the power to not only prescribe just and reasonable rates, but ensure that only those same rates are collected. Ruling otherwise would create financial incentives for utilities to fail to implement Commission directions. Further, the common law prohibition should not be interpreted to prevail over the Commission's statutory public interest mandate to protect captive customers.

The SSPOA elaborates below, and provides examples of other regulators that have distinguished between enforcing past orders and retroactive ratemaking, with the Supreme Court of Canada's approval.

Additionally, the SSPOA submits that Stargas should be expected to comply with fair and standard practice for reply argument, and the Commission should reject any Stargas attempt to "backfill" its application by addressing matters for the first time that ought to have appeared in its review request. Allowing Stargas to remedy the many deficiencies with its application in reply would deny the SSPOA procedural fairness by denying it knowledge of the case it must meet.

II. ARGUMENT

1. Stargas' Reply Argument makes no mention of retroactive ratemaking despite the SSPOA directly raising the refund issue in its argument

Stargas' request is an inappropriate attempt at a second chance at arguing the issue, after failing to do so in its Reply Argument, despite the fact that the SSPOA raised the issue of a refund directly in its Argument.[2] As the BCUC has made clear in its guidelines[3], a party "cannot have a decision reconsidered or appealed merely because he or she is unhappy with the result of the decision."[4] A reconsideration or appeal is not intended to be an opportunity to argue the merits of a new claim to a new decision maker.

While the Commission has broad authority to exercise its discretion to reconsider and to set the terms of such a reconsideration,[5] the SSPOA submits that the Commission should not exercise such discretion when a utility receives an unfavorable decision after a strategic choice not to engage with the issue in the initial hearing of its rate case, given the resources demanded by a reconsideration. Stargas' request provides no justification for raising the issue at this late stage, and cannot be construed as anything other than wasteful duplication.

The cost to the Commission and interveners to correct Stargas' (admitted) lack of diligence and errors (a continuing theme throughout these proceedings) will quickly outweigh the $6,000 of customer money that Stargas does not want to return, despite admitting that it was wrongfully collected. Stargas' attempt to retain wrongfully collected funds is nothing more than an attempt to further exploit captive customers. The Commission's role is to identify and deny such attempts, and it should do so here.

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[2] SSPOA Final Argument, p.17.
[3] British Columbia Utilities Commission, "Understanding Utility Regulation – A Participants' Guide to the B.C. Utilities Commission" (July 2002).
http://www.bcuc.com/Documents/Guidelines/2009/DOC_22551_Reconsideration-Criteria.pdf
[4] *Ibid*, p.36.
[5] *Ibid*, p.36-37.

2. Stargas' Submission Makes Fundamental Mistakes Concerning Retroactive Ratemaking

(a) Stargas admits the 2012 Decision intended rates to be adjusted to track the benchmark return

The ordered refund at issue does not constitute retroactive ratemaking because Stargas' approved rates were pegged to the Commission's benchmark rate of return and therefore have always been subject to adjustment. It is not retroactive ratemaking to enforce the application of a prescribed rate calculation methodology by issuing a refund. By seeking to retain the funds collected in excess of the approved methodology, it is *Stargas* that seeks prohibited retroactive change.

A recent Alberta Utilities Commission (AUC) decision[6] stresses the point that not every refund is retroactive ratemaking. It highlights the necessity of carefully discerning between what retroactive ratemaking is and, more importantly, what it is not. The proceeding concerned a refund order which enabled the utility to recover costs associated with a no-fault settlement and a late payment penalty from customers.[7] Customers argued the refund constituted a re-opening of rates, which violated the principles of retroactive ratemaking,[8] but the AUC disagreed, finding that the refund did not constitute retroactive ratemaking because the quantum of the refund, which was tied to the costs to be recovered, could not have been predetermined. The refund was not a "substitution or replacement of rates established in a prior period."[9] [emphasis added]

In its letter dated November 13, 2016, Stargas acknowledged that the return on annual preferred share dividends in fiscal 2015 and 2016 was intended to be based on the Commission's benchmark rate of return.[10] It erroneously calculated its return on preferred shares by using a rate of 10.25% instead of 9.5%, which was the benchmark rate of return in effect for the 2015 and 2016 fiscal years. Stargas admits that its failure to adjust the rate caused it to pay dividends in excess of those stipulated in the original ratemaking order.

Since rates were supposed to be adjusted to track the benchmark return, Stargas "erred" by not adjusting its rates. A refund to effect that adjustment cannot be characterized as retroactive ratemaking.

The present matter is even clearer than the one before the AUC, since the BCUC, in its original 2012 order, directed specific terms for the inclusion of the forecast preferred share dividends in Stargas' rates, with which Stargas failed to comply. The refund does not substitute or replace the past rate. Rather, the Panel's decision restores the original rate for the 2015 and 2016 fiscal years, ensuring that it was diligently fulfilled during the period in which it was in effect.

(b) The language and context of the 2012 Decision independently show rates were to be adjusted to track the benchmark return

In addition to Stargas' admission that rates were to be adjusted to track the Commission's benchmark rate of return, the language and context of the 2012 Decision reflects this fact.

Contrary to Stargas' claim that Order G-157-12 "did not have any mechanism for adjustment" of the delivery rate, the Order sets out the specific conditions by which the rate would be calculated. In including the preferred share dividends as a component of the delivery rate, it sets out that Stargas shareholders are allowed to earn a return on preferred shares, equal to the Commission's annual benchmark return on equity plus 75 basis points.[11] The relevant sections of the Order are reproduced below:

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[6] Decision 20732-D01-2016: 2015 Late Payment Penalty Charge Settlement Agreement.
[7] *Ibid*, para 223.
[8] *Ibid*, para 219.
[9] *Ibid*, para 224.
[10] Exhibit B-2, BCUC IR 7.2.
[11] Commission Order G-157-12, para 5.1.1(2).

5.1.1 Current Preferred Share Dividends

The Application includes $41,000 for forecast preferred share dividends in the fiscal 2013 revenue requirement based on the principal preferred share balance of $400,000 multiplied by the Commission's annual benchmark return of 9.5 percent[12] plus 75 basis points Stargas has not included any additional return on equity, nor have they included a long-term debt return, in the fiscal 2013 revenue requirement.

With respect to setting rates, Section 60(1)(b.1) of the *Utilities Commission Act* (the Act) notes the following:

> (b.1) the commission may use any mechanism, formula or other method of setting the rate that it considers advisable, and may order that the rate derived from such a mechanism, formula or other method is to remain in effect for a specified period, and

The Commission has considered the points outlined below in order to determine the appropriateness of including the forecast preferred share dividends in the fiscal 2013 revenue requirement, as opposed to the more conventional mechanism of including an equity and debt return on rate base.

1. Stargas submits that they intend to continue this rate-setting mechanism in future applications to the Commission. The Stargas IR Response notes the following on pages 11 and 12, respectively:

> "Including the annual amount of our preferred share dividend... has and would continue to provide a reasonable surrogate for returns that would have been generated in the conventional model."
>
> and
>
> "While [other] estimates would result in a higher delivery charge/and increased returns to equity, we believe continuing the current program reasonable and consistent with our financial goals."

2. By way of Order G-80-02, the Commission approved the issuance of $400,000 of cumulative preferred shares with a dividend rate equal to the Commission's annual benchmark return on equity plus 75 basis points and Order G-163-06 noted that "Stargas' shareholders are not allowed to earn a return on "notional equity", but they are allowed to earn a return on preferred shares."

3. Including the forecast preferred share dividends of $41,000 in the fiscal 2013 revenue requirement as compared to an equity and debt return on Stargas' rate base does not result in a higher delivery component of rates .

The Commission considers it appropriate to include the forecast preferred share dividends of $41,000 in Stargas' fiscal 2013 revenue requirement.[13]

In its language, the Commission is clear that it is continuing the existing rate calculation methodology. It found it "appropriate to include the forecast preferred share dividends" in Stargas' 2013 revenue requirement, calculated by adding a premium to the benchmark return. For the 2015 and 2016 revenue requirements, when the benchmark return changed, the calculation should have changed as well, in the manner specified above. The use of the word "forecast" supports the conclusion that the share dividends and rate of return in each given year were not fixed figures, but rather variable, based on the conditions for calculation and specifically subject to the Commission's then-approved benchmark return. If the Commission had intended fixed amounts, it would have substituted the reference to the Commission's benchmark return with a fixed number.

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[12] Commission Order G-158-09.
[13] *Ibid*, para 5.1.1.

As can be seen in the Commission's earlier orders, when this component was initially approved, the Commission also retained authority to review Stargas' payment of the dividends.[14] This suggests that rate, as charged by Stargas, was never truly permanent, since it was subject to the Commission's oversight and changes to the benchmark. Given that the rates were always subject to adjustment, as Stargas recognized in its IR responses and within its R&V request, this cannot constitute retroactive ratemaking.

(c) The Commission's refund order does not constitute retroactive ratemaking given the well-recognized exception applicable to adjustable and interim rates

Stargas has argued that since the rates set in 2012 were not labelled "interim", they were permanent, and therefore the Commission adjustment to them constitutes retroactive ratemaking. This position, however, oversimplifies the jurisprudence on the exceptions to the prohibition against retroactive ratemaking and fails to acknowledge that the past rates were subject to variances in the benchmark rate of return.

Retroactive ratemaking "establish[es] rates to replace or be substituted to those which were charged during that period"[15], and retrospective ratemaking imposes on current consumers shortfalls or surpluses incurred by previous customers. As explained by the Supreme Court of Canada, provincial utilities legislation generally requires regulators to set rates prospectively,[16] meaning it is outside regulators' jurisdiction to "award rates which [would] recover expenses incurred in the past and not recovered under rates established for past periods."[17] This principle applies equally to retroactive and retrospective ratemaking.[18]

Nonetheless, the courts have recognized at least five exceptions to the general prohibition, one of which relates to adjustments to "interim" rates.[19] As explained further below, "interim" is a matter of substance and not form.

In discussing the retroactive ratemaking prohibition, the Alberta Court of Appeal in *Salt Caverns II* affirmed that "whether a decision is impermissible retroactive ratemaking is an issue of fact,"[20] and summarized the law on the exceptions as follows:

> Simply because a ratemaking decision has an impact on a past rate does not mean it is an impermissible retroactive decision. The critical factor for determining whether the regulator is engaging in retroactive ratemaking is the parties' knowledge...'were the affected parties aware that the rates were subject to change?'[21] [emphasis added]

Stargas has repeatedly told the Commission that it understood its rates were subject to change. The Commission should take Stargas at its word.

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[14] Commission Order G-163-06 at para 11 states that Stargas was to provide a reconciliation of the dividend payment on the preferred shares at a specified rate for the Commission's review in a timely manner.
[15] *Bell Canada v. Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722 *[Bell Canada]*, p.1749.
[16] *Northwestern Utilities Ltd v Edmonton (City)* (1978) [1979] 1 SCR 784 (SCC) [*Northwestern Utilities*], p. 691; *Stores Block*, para 136.
[17] *Northwestern Utilities*, p. 691.
[18] Decision 790-D02-2015: Phase 2 Module A decision re Milner Power Inc. and ATCO Power Ltd., para 152.
[19] Decision 790-D02-2015, para 153. (adjustments to interim rates; use of deferral accounts to deal with differences between forecast and actual costs and revenues; changes to rates as a result of the operation of a negative disallowance scheme; changes to rates where affected parties knew or ought to have known that the rates were subject to change (i.e., the "knowledge exception"); and replacing rates in a tariff that has been determined to be a nullity.)
[20] *Salt Caverns II*, para 51.
[21] *Ibid*, para 56.

The AUC has interpreted *Salt Caverns II* as finding that the knowledge that rates may change in more than one way.[22] It is not necessarily because the rates are labelled as "interim" that retroactivity is permissible, but rather because parties knew or ought to have known from the outset that rates may change.[23]

This follows the law set down by the Supreme Court of Canada in *Bell Canada*, which upheld a one-time credit in favour of customers, despite the fact that it was "retrospective in the sense that its purpose [was] to remedy the imposition of rates approved in the past and found in the final analysis to be excessive."[24] [emphasis added]

Applied here, the Panel's refund order in favour of the SSPOA is permissibly retrospective, since it was intended to remedy an overpayment by customers. *Bell Canada* recognized that this type of order may cause some intergenerational inequity such that current customers would be rewarded with lower rates that should have been enjoyed by previous customers, but found that it was justified to ensure that the rates were just and reasonable.[25]

The nature of the words and actions of the BCUC in its reasons in Order G-157-12 show that Stargas ought to have had knowledge that the amounts at issue were subject to change – and Stargas admits it had such knowledge. The rate at issue included the forecast preferred share dividends based on the applicable benchmark rate of return. Since it was pegged against the benchmark rate of return, Stargas knew the rate could vary from year to year and that it bore the responsibility to diligently calculate this figure to ensure rates were appropriately charged.

(d) Retroactive ratemaking cases typically involve rate changes to track the outcome of legitimately forecastable costs, and it is common for regulators to adjust rates in response to changes in the benchmark return

The prohibition against retroactive ratemaking exists to encourage prospective ratemaking, which generally better realizes the goals of the legislation. In particular, prospective ratemaking incentivizes utilities to operate efficiently, despite the absence of competitive pressures that arises from their status as natural monopolies. This is because forecast-based ratemaking encourages utilities to find cost-efficiencies on items within their control by allowing them to "overearn" (i.e., the utility shareholders not only receive the utility's authorized return on equity, but any additional profits attributable to more efficient operations), commensurate with the symmetrical risk of underearning. Any efficiencies found are passed on to ratepayers in the next test period when the utility presents its cost structure to the regulator. This point was explained by the Alberta Energy and Utilities Board (EUB) (predecessor of the AUC) as follows:

> The Board views prospective rate making as a process that is in the interests of both the Company and its customers. When the revenue requirement is set and rates are implemented for a test year, it is expected that they will be in place for some time before the next [General Rate Application] is required. In the interim, the utility can except to be able to benefit from efficiency gains it achieves during that period. In this process, the Board acts as a substitute for normal competitive forces. In a competitive environment, gains in revenues due to efficiencies are realized for a short term but are quickly matched by competitors. Once this occurs, the savings from increased efficiencies are transferred to consumers in the form of reduced prices. In a regulated environment, this transfer of savings to consumers occurs following the subsequent [General Rate Application] and the setting of new rates, which reflect any reductions in the utilities' revenue requirements that arise from its increased efficiency.[26]

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[22] Decision 790-D02-2015, para 196.
[23] *Ibid*.
[24] *Bell Canada*, p. 1749.
[25] *Ibid*, p. 1762-1763.
[26] EUB Decision 2000-82: Request to Withdraw the 1999 General Rate Application and Assessment of the need for a 2000 General Rate Application, p.15.

But Stargas has no control over the benchmark return. It was adopted by the Commission as a standard with which to track the return on preferred share dividends. Stargas' argument suggests that this benchmark rate of return was a forecastable cost subject to risk and reward, akin to other components that may be considered in prospective ratemaking. This is baseless.

Prospective ratemaking has inherent risks, but unlike the examples offered in Stargas' letter, this is not a circumstance of a forecast which failed to materialize. An overpayment of dividends due to the use of the wrong benchmark return rate is not comparable to variations between the actual and forecast volumes. The variations in the 2015 and 2016 fiscal years were entirely attributable to Stargas failing to adopt the correct benchmark rate in its calculations; this is not a circumstance that fits the traditional risks accounted for with forecastable costs.

Rates are consistently adjusted in response to benchmark returns without giving rise to retroactive ratemaking. It The practice has been common in the past before the BCUC, the AUC, and the National Energy Board of Canada.

Furthermore, Stargas should not be allowed to benefit from its own error to the detriment of ratepayers. The Act does not permit shareholders to profit from careless oversight where a rate was subject to adjustment. The general common law prohibition against retroactive ratemaking is not intended to enable the behaviour that regulators are charged by statute to monitor and guard against. Interpreting the retroactive ratemaking prohibition this way would be contrary to the policy set by courts with respect to the exceptions.

(e) Retroactive ratemaking cases involve careful scrutiny of a regulator's statutory powers and public interest considerations, which may vary in specific circumstances

As an administrative tribunal, the BCUC obtains its jurisdiction from its enabling statute, either explicitly or by necessary implication.[27] As such, its authority to retroactively or retrospectively alter previously approved rates must be interpreted in light of its statutory grant of authority.

In particular, the SSPOA submits that the Commission has authority to order a refund to customers in light of the error in calculating the return on the preferred share dividends, grounded in its the broad powers granted under section 60 of the Act. The relevant subsections state:

> 60 (1) In setting a rate under this Act
>
> (a) the commission must consider all matters that it considers proper and relevant affecting the rate,
>
> (b.1) the commission may use any mechanism, formula or other method of setting the rate that it considers advisable, and may order that the rate derived from such a mechanism, formula or other method is to remain in effect for a specified period…

The Commission has previously held that the Act "provides the Commission with broad powers to achieve its mandate, the regulation of public utilities."[28] Generally, the legislature is required to use clear statutory language to derogate from the common law. As indicated in *Stores Block*, "broadly drawn powers will necessarily be limited to only what is rationally related to the purpose of the regulatory framework."[29]

In these circumstances, however, the refund ordered is rationally related to the purpose of the regulatory framework. In fixing the 2012 rate, the BCUC gave due regard to setting a rate that was not unjust or unreasonable, providing Stargas a fair and reasonable return while encouraging Stargas to increase efficiency,

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[27] *Stores Block*, para. 38.
[28] Order G-63-10, Reasons for Decision, section 3.1.3.
[29] *Stores Block,* para. 74.

reduce costs and enhance performance. The overpayment that Order G-59-17 Paragraph 11 intends to rectify was not charged in accordance with this previously set rate.

In these circumstances, the BCUC must be held as having jurisdiction to issue a refund. To find otherwise, would frustrate the Commission's ability to enforce compliance with its directives. The prohibition against retroactive ratemaking cannot be reasonably interpreted to limit the BCUC's ability to ensure proper compliance with its orders.

A decision by the EUB illustrates this very point. The Board held that adjustments made to rectify imprudence or non-compliance were not the same as retroactive ratemaking.[30] The Board recognized that the general prohibition against retroactive ratemaking is intended to further its public interest mandate, not limit it. Ultimately it determined that its adjustments were warranted, as "customers are not really protected if the harm done in a previous period due to imprudence or non-compliance is not mitigated."[31]

In light of that decision, it must be held that the purpose of the regulatory framework is not limited to setting just and reasonable rates, but also ensuring proper compliance with such directives. The refund is necessary, and therefore permissible, notwithstanding any retrospective effect, to ensure such compliance and the effectiveness of its regime more generally.

III. CONCLUSION

This reconsideration application must be rejected for the reasons outlined above.

Stargas has raised new arguments, which it could have, but failed to bring forth in the original application. It had adequate notice that the SSPOA was seeking a refund in relation to the preferred share dividend overpayments, but made the strategic choice not to engage with the issue at the initial hearing. Although the Commission has broad discretion when it comes to reconsidering an application, it should be wary of enabling parties to abuse the process in this manner.

Further, Stargas' argument cannot be successful on its merits. It has relied on a flawed understanding of the doctrine of retroactive ratemaking to suggest that the refund is beyond the Commission's jurisdiction. This cannot be the case because, as conceded by Stargas, the past rates at issue were always subject to adjustment since they tracked the Commission's benchmark rate of return.

Stargas argument also relies on the incomprehensible suggestion that rate of return is a forecastable cost subject to risk/reward. The prohibition on retroactive ratemaking is intended to support prospective ratemaking, in order to encourage utilities to find cost efficiencies on matters within their control. Adjustments to utility rates made based on benchmark returns are common, and not the subject of this general prohibition.

Regardless, the Commission retains broad powers to ensure rates are just and reasonable and that parties comply with its directives. Stargas failed to comply with Order G-157-12 when it used an incorrect rate of return in calculating the preferred share dividends. The refund ordered enables the Commission to rectify this error and ensure its past rate was honoured.

While there is undoubtedly concern around regulatory authorities issuing orders with retroactive or retrospective effect, courts have on many occasions recognized that there are circumstances where the potential unfairness of such an order is outweighed by greater hardships and an overriding duty to ensure that rates are just and reasonable.

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[30] E.U.B. Decision 2002-069: Affiliate Transactions and Code of Conduct Proceeding, Part A: Asset Transfer, Outsourcing Arrangements, and G.R.A. Issues, p.12.
[31] *Ibid*, p.13.

To draw from an observation by the AUC, if, in finding that regulated utility has failed to comply with an order of the Commission, the Commission is limited to providing prospective relief, there will undoubtedly be an "increased potential for strategic or opportunistic behaviour by parties seeking to retain the benefit of unlawful rates."[32]

If the prohibition on retroactive ratemaking is interpreted in a manner that permits utilities to retain funds attributable to their errors, oversights, or non-compliance, as is the case here, then it encourages utilities to be careless in implementing the Commission's orders.

This financial incentive would run counterintuitive to the very purpose of the BCUC and its enabling legislation, which was passed to protect the public.[33] As explained its own profile, the BCUC's mission is "to ensure that ratepayers receive safe, reliable, and nondiscriminatory energy services at fair rates from the utilities it regulates, and that shareholders of those utilities are afforded a reasonable opportunity to earn a fair return on their invested capital."[34] The interpretation proposed by Stargas cannot be reconciled with the mission or purpose of the BCUC. There can be no legitimate argument that a refund, in these circumstances, denies Stargas' shareholders a reasonable opportunity to earn a fair return; however there is no possible interpretation of the facts that suggests that its customers were receiving fair rates in the 2015 and 2016 fiscal years.

Given that it was Stargas's error, as admitted by Stargas, which caused rates to be charged contrary to the Commission's 2012 order, the only unfairness lies with the ratepayers. A refund is the only just and reasonable solution in these circumstances.

]Respectfully submitted,

per: Matthew D. Keen*
Partner

MDK/roe

**Law Corporation*

[32] Decision 790-D02-2015, para 190.
[33] *Crowley, Re* (1954), 12 W.W.R. (N.S.) 626 (B.C.S.C.), para 8.
[34] British Columbia Utilities Commission, "Organizational Profile: Our Mission" <http://www.bcuc.com/CorpProfile.aspx> accessed 5 June 2017.