

March 7, 2022

The Regulation of District Energy Systems in Alberta: Part 3

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Decision Commented On: [AUC Decision 26717-D01-2022](#), Calgary District Heating Inc. Exemption from Provisions of the Public Utilities Act, March 2, 2022

As the title indicates, this is my third post dealing with the regulation of district energy systems in Alberta. My first post, “[Regulatory Forbearance and The Status of District Energy Systems Under the Public Utilities Act](#)”, dealt with an application by ENMAX for relief from the entirety of Part 2 of the *Public Utilities Act*, [RSA 2000, c P-45](#), (*PUA*) as it might apply to a proposed district energy system in Edmonton ([Edmonton DE Decision](#)). The Alberta Utilities Commission (AUC) denied the application. It concluded that ENMAX had not discharged its onus to show that (at para 35) “sufficient competition will exist such that regulation of ENMAX in its provision of thermal energy within the exclusive franchise area is unnecessary; or, stated in another way, that it would be in the public interest to exempt DE Edmonton and ENMAX (as its owner and operator) from Part 2 of the *Public Utilities Act*.” Rather, the evidence that customers who agreed to take service from the district energy facility and removed their existing boilers would effectively be captive to the service provided by ENMAX. While there was some discussion of whether more limited exemptions would protect these customers, it became clear that ENMAX’s application was in the nature of an “all-or-nothing application.” Accordingly, the AUC found it unnecessary to opine on the acceptability of a more limited set of exceptions.

The [second post](#) dealt with a proposed sale by ENMAX of its Downtown District Energy Centre (DDEC) to Calgary District Heating Inc (CDHI) – a newcomer to Alberta’s electricity sector. That sale required the approval of the AUC under s 101 of the *PUA*. The Commission granted that approval and in that proceeding the new owner, CDHI, indicated its intention to bring forward its own application for relief from provisions of the *PUA*.

This third post is a comment on the AUC’s disposition of CDHI’s application.

Paragraphs 5 and 6 provide useful background on the prior regulatory treatment of DDEC:

5. All parties to this proceeding agree that the DDEC is a public utility, and that CDHI is the owner of a public utility, as those terms are defined in the *Public Utilities Act*. For this reason, the DDEC (and CDHI as its owner) would ordinarily be subject to Part 2 of the *Public Utilities Act* in its entirety, including the provisions providing for prospective economic regulation by the Commission.
6. As mentioned earlier, before it was acquired by CDHI, the DDEC was owned and operated by ENMAX. Under ENMAX’s ownership, the DDEC was exempted under

Section 78(2) of the *Public Utilities Act*, which stipulates that Part 2 of the *Public Utilities Act* does not apply to a public utility owned or operated by a municipality, unless the public utility is brought under the act by a bylaw of the municipality. Because no such bylaw was enacted, the DDEC operated for a period of approximately 11 years under the oversight of the municipality (namely, The City of Calgary) rather than the Commission. As a result, the Commission did not have a direct role in regulating the day-to-day operation of the DDEC or setting the rates charged to its customers.

CDHI, the new owner, sought an order under ss 8 and 9 of the *Alberta Utilities Commission Act*, [SA 2007, A-37.2](#) (*AUCA*) and s 79 of the *PUA*, declaring that: (a) ss 88(a), (d) and (e), 92 and 103 of the *PUA* do not apply to any of the DDEC, CDHI and the goods and services produced by the DDEC and offered or provided by CDHI; (b) the reporting requirements under Rule 005 do not apply to the DDEC and CDHI; and (c) the requirements of ss 88(a) and (d) of the *PUA* and Rule 005 be replaced with certain specified annual reporting of key metrics to the Commission (at para 9).

The AUC described the effect of these provisions as follows:

Sections 88(a), (d) and (e) relate to the requirement for a public utility to periodically file rate schedules and financial reports with the Commission, and the manner in which public utilities are required to maintain depreciation, amortization or depletion accounts. Section 92 prohibits rates from being fixed in a manner that automatically increases from year to year, or other period. Section 103 requires Commission approval of any change in rates, and imposes on a public utility the burden of showing that rate changes are just and reasonable. ... Rule 005 requires utilities to annually submit a report detailing their financial and operational results for the year in a manner prescribed by the Commission. (at para 10)

Before dealing with the merits of CDHI's claims, the Commission had to deal with an argument from ATCO Gas to the effect that the applied for exemptions were of such an extent that they fundamentally undermined the purpose of the *PUA*. Given the breadth of the AUC's power to exempt (discussed in my first District Energy post, above) this was evidently a hard argument to win and the AUC, after considering the purpose of the Act and the purpose of the exemption provision, rejected it, reasoning as follows:

24. ATCO Gas characterized prospective economic regulation as being fundamental to this legislative framework. In ATCO Gas's submission, the exemptions sought by CDHI would "eviscerate the scheme, leaving the Commission without the prospective rate-setting powers that are key to the entire framework." ATCO Gas stated that regulation under the *Public Utilities Act* is expressly intended to be prospective, as evidenced by the inclusion of provisions explicitly contemplating the filing and approval of rate schedules.

25. The Commission disagrees that a departure from prospective economic regulation would necessarily frustrate the purpose of the *Public Utilities Act* or undermine the intent of legislature. The Commission finds that the overarching purpose of the legislative scheme is to safeguard the public interest in a service environment that is susceptible to abuses of

monopoly power. The legislature has equipped the Commission with the tools required to fulfil this purpose, including the ability to fix rates and to exercise general oversight of the operation of public utilities. Given the nature of public utilities (which tend to be highly capital intensive, such that duplication of services by different providers is inefficient), they are often natural monopolies. In these circumstances, prospective economic regulation serves important functions, including the protection of customers. The Commission does not accept, however, that protecting the public interest, or upholding the legislative scheme, necessitates that any public utility must be subject to prospective economic regulation, regardless of its particular characteristics or the context in which it operates.

The AUC went on to observe that “[i]t would not benefit the public interest to require prospective economic regulation of any entity meeting the definition of ‘public utility’ even where the facts established – as they do in this case – that such regulation is not necessary to protect sophisticated customers in a competitive environment, and in light of other available regulatory mechanisms” (at para 26).

When it came to the merits of CDHI’s claim for exemption, the AUC considered that two sets of issues should inform its assessment of whether or not the application should be granted: just and reasonable rates issues, and the safety or reliability of service offered to customers.

Under the heading of just and reasonable rates issues, the Commission identified three key differences between this application and the application in the Edmonton DE decision that it had rejected. First, in this case, unlike in the Edmonton case, CDHI was not seeking an exclusive franchise from the city to provide district energy services within a defined geographical area. Second, CDHI had filed a non-confidential pro-forma services agreement in support of its application. In the Edmonton decision, ENMAX had declined to do. Third, and most importantly, in the Edmonton decision ENMAX had sought a blanket exemption from the entirety of Part 2 of the *PUA*. CDHI’s application was more nuanced:

36 ... CDHI has proposed a regulatory scheme under which it would remain subject to Commission oversight regarding the rates it charges in several important ways. The Commission would continue to exercise general supervision over the DDEC, and CDHI as its owner. The Commission would retain oversight to investigate and make orders regarding the nature and quality of service provided and the cost thereof.

37. Significantly, the Commission would also retain oversight and authority to consider and vary rates on a complaint basis. At the hearing, CDHI confirmed that, if the Commission were to determine in response to a customer complaint that the rates charged by CDHI were unjust or unreasonable, CDHI would accept the Commission’s authority to fix rates for the customer or class of customers affected. CDHI further confirmed that it would assist the Commission in this exercise by providing information to facilitate the determination of rates, both annually through its proposed reporting of key metrics and, in the event of a complaint, with supplemental information.

The Commission concluded that these arrangements were appropriate in the circumstances.

39. The Commission finds that CDHI operates in an environment that is sufficiently competitive that its customers have a degree of choice about their service provider that is not present in a traditional monopolistic industry. Specifically, customers of CDHI can elect to take service from the DDEC or acquire a boiler (powered by either gas or electricity) from a variety of providers to meet their thermal energy needs. In the future, given that CDHI has no exclusive franchise, its customers may elect to take service from new entrants to the district energy market. The services agreements executed between CDHI and its customers for the provision of district energy are based on mutually acceptable terms negotiated between sophisticated commercial parties. Further, in the event that they are dissatisfied with the rates they pay, or service they receive, CDHI customers retain the ability to raise a complaint with the Commission. Taken together, the Commission considers that these factors are sufficient to ensure that the rates paid by CDHI customers will be just and reasonable, in the sense that they are fair to both customers and the utility, as intended by the legislative scheme.

As for the safety and reliability of service, the AUC concluded that there could be no concerns since CDHI would be “subject to the legislative requirement to furnish safe, adequate and proper service, and the Commission’s general oversight and investigatory powers” (at para 44). The AUC did spend relatively more time under this same heading considering an argument from ATCO Gas to the effect that a decision to grant regulatory relief to CDHI for its district energy scheme would confer an unfair advantage on CDHI. Since CDHI would have no duty to serve, CDHI would be able to contract with the most profitable companies in ATCO Gas’ service area and ignore those who would be less profitable to serve. These customers would be lost to ATCO leading to potentially increased costs for continuing to provide service, and, possibly, the loss of additional customers over time.

It is far from clear what legislative authority ATCO Gas was relying on for these claims other than a general understanding that the Commission could only exercise its power to grant exemptions if it considered the exemptions to be in the public interest. Nevertheless, the Commission gave three reasons for dismissing the concerns of ATCO Gas. First, the AUC noted that ATCO Gas failed to provide “detailed quantitative evidence substantiating the harm that would be created by future defections from its system, or harm caused by the historical operation of the DDEC since 2010” (at para 48). Second, CDHI would itself remain a customer of ATCO Gas. And third, ATCO Gas is itself engaged in a number of district heating initiatives within its natural gas franchise area. All of this led the Commission to conclude that while

ATCO Gas may lose some customers to the DDEC, the Commission does not believe that the DDEC’s continuing operation or expansion within its current capacity will alter the character of ATCO Gas’s statutory obligation to serve customers within its franchise area, impair ATGO Gas’s ability to charge just and reasonable rates to its customers, or limit its opportunity to recover its prudently incurred costs and earn a fair rate of return. Moreover, the impacts on ATCO Gas’s revenue in this particular case will be immaterial due to the relatively small size of the DDEC’s operation. (at para 49)

The Commission rejected only one part of CDHI’s application. This was CDHI’s application for relief from s 92 of the *PUA* which constrains the ability of the AUC to approve a tariff that has an

automatic escalator. The Commission concluded that it was not necessary to include this exemption at the present time since this provision would only be triggered if the AUC did engage in prospective rate making.

In conclusion, the Commission has confirmed that district energy projects will be public utilities within the meaning of the *PUA*. At the same time, the AUC has also confirmed that it is open to considering flexible and proportionate forms of light-handed regulation to accommodate the particular needs of district energy projects. While the AUC is unlikely to sanction blanket exemptions from the provisions of the *PUA*, this decision demonstrates that a utility that puts forward a balanced proposal that protects consumer interests by preserving the Commission's supervisory and complaint jurisdiction will likely achieve the Commission's endorsement.

This post may be cited as: Nigel Bankes, "The Regulation of District Energy Systems in Alberta: Part 3" (March 7, 2022), online: ABlawg, http://ablawg.ca/wp-content/uploads/2022/03/Blog_NB_Regulation_District_Energy_Systems_3.pdf

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