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How much discretion does a regulator have to limit the recovery of a utility's legal costs?

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Case Commented On: *ATCO Gas and Pipelines Ltd v Alberta (Utilities Commission)*, 2014 ABCA 397

In this case the Court of Appeal confirmed that the Alberta Utilities Commission (AUC) has some level of discretion as to the extent to which it allows a regulated utility to recover its prudently incurred legal costs from its customers when that utility participates in hearings called by the AUC to consider generic issues of interest to all regulated utilities and their customers and shareholders. One member of the Court (Justice Peter Martin) thought that the Commission went too far in denying recovery in relation to one set of costs and would have sent that matter back to the Commission.

The decision is interesting because it involves the intersection between an adjudicator's discretion to allow for the recovery of legal costs and the general principle that a utility ought to have *the opportunity* to recover *all* of its prudently incurred operating costs (including the legal costs associated with rate setting) through the tariff approved by the regulator. A decision that recognizes that a utility has prudently incurred certain costs but which then denies the utility even the opportunity to recover those costs will generally be unsupportable: *BC Electric Railway Company v Public Utilities Commission*, [1960] SCR 837. In this case however there were special considerations and thus while the majority found the Commission's decision both reasonable and correct, the decision is not likely of broad application – a point that Chief Justice Fraser herself seems to acknowledge at paras 70 – 73. In particular, and notwithstanding other and rather more sweeping statements from the Chief Justice (see, for example para 106, quoted below, and paras 110 - 111), it is not likely that the decision can be applied in the more routine situation in which a utility incurs legal costs as part of preparing and presenting its general rate application (GRA) to the AUC for it to set just and reasonable rates. The AUC may still scrutinize those legal costs on prudence grounds (and see here in particular Justice Martin at para 171) to ensure that the utility is not gold-plating its costs (e.g. where it chooses to retain expensive outside counsel to undertake a task that could be more economically dealt with in-house) but it likely cannot say (even on a reasonableness standard of review) that the legal costs associated with preparing and presenting a GRA are not recoverable.

The decision features (not for the first time, see also *ATCO Electric Limited v Alberta (Energy and Utilities Board)*, 2004 ABCA 215) a lengthy disquisition by the Chief Justice on rate making and the history of utility regulation in Alberta and the introduction of competition into the

generation/supply and retail elements of the energy sector while maintaining full regulation of the lines side of the business (transmission and distribution).

The background

These matters had their origin in two generic hearings convened by the AUC. The first was in response to the historic *Stores Block* decision of the Supreme Court of Canada: *Atco Gas and Pipelines Ltd v Alberta (Energy and Utilities Board)*, 2006 SCC 4. The second related to a set of hearings convened by the AUC to consider the introduction of performance based regulation (PBR) for distribution utilities in Alberta. Both proceedings are now complete. For the PBR Report see AUC Decision, 2012-237; for the *Stores Block* matters see a report known as the Utility Asset Disposition (UAD) decision (see AUC Decision, 2013-417). Leave to appeal aspects of the merits of both decisions has been granted by the Alberta Court of Appeal but those matters were not at issue in this case. For leave on the UAD matters see *FortisAlberta Inc v Alberta (Utilities Commission)*, 2014 ABCA 264. I have discussed elements of the AUC's UAD report here.

The crucial point for present purposes is that the nature of the UAD generic hearing changed over the course of its life. It began in quite an abstract way with the AUC creating a list of issues that the Commission had identified as "matters arising" from the Court's decision in *Stores Block*. At that time the Commission took the view and announced to all parties (including regulated utilities) in the most resolute terms (quoted here at para 30) that it would not consider cost claims:

> Parties who participate shall not be entitled to submit cost claims to the Commission and no funding will be awarded by the Commission to participants. **Each party shall be responsible for its own costs.** The Commission considers this Proceeding to deal with generic issues which concern all stakeholders and that utility ratepayers should not be required to underwrite the costs of the participants through regulated rates. [Emphasis in original]

The nature of the UAD hearing changed as a result of other proceedings before the Commission specifically ATCO Gas' GRA application and the AUC's proceeding on the Generic Cost of Capital (GCC) (both summarized here at para 37). In the GRA matter the AUC concluded (following *Stores Block*), that production assets without an operational purpose should be removed from the rate base and at the expense of the shareholders; and in the GCC case the AUC further confirmed that the risks associated with stranded assets should be borne by the shareholders. ATCO sought review and variance of both decisions. Rather than dealing with these matters directly the AUC concluded that they should be dealt with as part of the UAD proceedings once they resumed. The UAD hearings which began in April 2008 had actually been put on hold in November 2008 and did not resume until October 2012. The delay was occasioned by other post-*Stores Block* litigation specifically the *Carbon Storage* litigation (*ATCO Gas and Pipelines Ltd v Alberta (Energy and Utilities Board),* 2008 ABCA 200), the *Harvest Hills* litigation (*ATCO Gas and Pipelines Ltd v Alberta (Energy and Utilities Board),* 2009 ABCA 171) and the *Salt Cavern* litigation (*ATCO Gas and Pipelines Ltd v Alberta (Energy and Utilities Board),* 2009 ABCA 246.) One thing that is abundantly clear from this recitation is that the ATCO family wins the award for the most litigious utility in Canadian legal history, certainly in modern times – perhaps ever.

When the UAD hearing did resume the AUC again reiterated its position that participants should bear their own legal costs. On an application for review and variance of that ruling the AUC ultimately ruled (February 2013) that it would allow ATCO Utilities and other Alberta utilities to recover their legal costs in accordance with its Rule 22 Rules on Intervener Costs in Utility Rate Proceedings for the period from the reconvened hearing until close, but with no recovery for the first part of the proceedings. In sum, the AUC did allow the recovery of legal costs on fixed scale from the time when the stranded costs and production abandonment issues were added to the UAD agenda but denied recovery for the first part of the hearing. The ATCO Utilities sought leave to appeal the February 2013 decision.

The PBR matters proceeded somewhat differently but encompassed both a generic hearing of PBR issues and PBR filings by all of the distribution utilities. More than two years in to the proceedings the ATCO Utilities and other Alberta Utilities advised the AUC that they would be seeking full recovery of all of their legal costs and in excess of the scales fixed by Rule 022. The AUC ultimately awarded legal costs to the ATCO Utilities on the basis of the Rule 022 tariff plus an additional 20%.

The two leave applications were heard together and Justice Conrad ruled that the two matters should also be heard together on the merits: *Atco Gas and Pipelines Ltd v Alberta (Utilities Commission)*, 2013 ABCA 331. Leave was granted on the following terms: "Did the Commission err in law or jurisdiction by denying or limiting recovery of the Appellants' claimed regulatory costs and by treating the costs of or incidental to any hearing or other proceeding of the Commission differently than other costs?"

The relevant statutory provisions

The relevant statutes, the *Electric Utilities Act*, SA 2003, c. E-5.1, the *Gas Utilities Act*, RSA 2000, c. G-5 and the *Utilities Commission Act*, SA 2007, c. A-37.2 offer surprisingly little guidance as to the recovery by a utility of its operating costs as part of the exercise of setting just and reasonable rates. For example, while the *Gas Utilities Act* is quite prescriptive with respect to establishing a rate base and providing for a just and reasonable return on the undepreciated part of the rate base, it has nothing else to say about operating costs other than a section dealing with the cost of gas (which seems of limited applicability in a competitive retail market environment) and a general provision (mirrored in the *Public Utilities Act*, RSA 2000, c. P-45, s. 91) allowing the Commission to "consider all revenues and costs" of a utility over a particular period of time (a provision that was initially introduced to deal with the problem of regulatory lag and to provide statutory authority for a limited degree of retrospective rate making). The *Electric Utilities Act* is a little more forthcoming. Thus, section 102(1) provides that "Each owner of an electric distribution system must prepare a distribution tariff for the purpose of recovering the prudent costs of providing electric distribution service by means of the owner's electric distribution system" and section 122 provides that "When considering a tariff application, the Commission must have regard for the principle that a tariff approved by it must provide the owner of an electric utility with a reasonable opportunity to recover" *inter alia* costs related to the cost of capital and then "any other prudent costs and expenses that the Commission considers appropriate, including a fair allocation of the owner's costs and expenses that relate to any or all of the owner's electric utilities".

The *Utilities Commission Act* is silent with respect to the recovery of the operating costs for a utility (evidently this is left to the subject specific statutes) but it does expressly address the subject of costs in section 21 in these terms:

> The Commission may order by whom and to whom its costs and any other costs of or incidental to any hearing or other proceeding of the Commission are to be paid.

While there was some argument in the case to the effect that this provision was intended to deal with the costs incurred by the Commission and any interveners in proceedings before it Chief Justice Fraser (at para 85) rejected those submissions and chose to emphasise that this provision included both applicants and interveners and accorded the Commission a broad discretion in disposing of costs issues.

Standard of review

Chief Justice Fraser concluded that the standard of review of AUC decisions on the recovery of legal costs was reasonableness. She rejected (at para 65) ATCO's suggestions that the AUC's decision to award costs on any basis other than the prudently incurred standard raised a true question of jurisdiction that attracted a correctness standard. Rather, in Chief Justice Fraser's view this was a case which dealt with the AUC's interpretation and application of its home statutes and which presumptively attracted a reasonableness standard (at paras 58 and 68). The Chief Justice would also have upheld the AUC's decisions on a correctness standard (at paras 69 and 79).

The Grounds for Dismissing the Appeal – Chief Justice Fraser

Chief Justice Fraser offered six reasons for her conclusion. I have already referred above to the first reason namely that section 21 of the *UCA* clearly afforded the Commission a broad discretion and that that discretion extended to applicants as well as interveners. Furthermore, as a matter of practice the AUC had engaged in rule making on the matter of legal costs and the relevant Rule, Rule 22, did, notwithstanding its title, deal with the costs of both applicants and interveners (and *quaere* at para 123 whether Rule 22 embodies a standard of prudence or whether there is a mismatch between Rule 22 and the prudence standard?). Second, and also alluded to above, Alberta utility legislation does not provide an express right for a utility to recover all of its legal costs but rather afforded the AUC a degree of discretion in relation to these matters (at paras 102 – 105). Third, public policy supported the Legislature's decision to grant the AUC some discretion (at para 106):

> Without the ability to regulate legal costs as the Commission considers appropriate, the Commission would be unduly restricted in its ability to govern its proceedings. Without this control, there would be no effective incentive on any party in proceedings before the Commission to minimize their legal costs. If all legal costs (I am here referring to those that meet the prudence standard) can be paid from the ratepayer purse, where is the incentive for a utility to hold legal costs in check and minimize challenges and objections or the scope of the subject proceedings? And if all legal costs are recoverable, where is the incentive not to seek review and variance of every Commission decision adverse to the utility? Finally, if all legal costs of a utility company are recoverable as prudent costs no

> matter the nature of the proceedings before the Commission, where is the balance between the utility company and the ratepayers?

Fourth, ATCO could not rely on the regulatory compact theory to trump the statutory scheme. In any event, properly interpreted the compact does not afford a utility any more than an *opportunity* to earn a reasonable return or (at para 110) "to recover prudent costs" and furthermore neither the *EUA* nor the *GUA* (as we have seen) "provides for legal costs to be characterized and treated as prudent costs." Furthermore, even if the regulatory compact could be said to guarantee recovery of prudent legal costs such a guarantee must be revised and modified in light of the language of Alberta statutes. Fifth, the matters in dispute here and the nature of the proceedings were not traditional rate setting proceedings but generic proceedings. While the utilities clearly had a self interest in participating in these proceedings to protect their interest they were not required to do so and the Commission had clearly advertised the terms of participation. Furthermore, and in the end, the AUC had actually allowed a measure of recovery. And finally, by denying full recovery the Commission was not (at para 119) negatively impacting a utility's "rate of return in an improper or unfair manner" because the AUC would have in mind its rules and practices, including Rule 22, when setting the rate of return for a utility.

Justice Côté's separate concurring opinion

Justice Côté concurred in the result on both appeals but clearly found the UAD matter much more challenging. Thus, while the AUC's principal argument (which I take to be the section 21 of the *UCA* argument that the matter is simply a question of statutory 'discretion'" (at para 128)) gave him "grave misgivings", he felt able to concur in the result principally on the basis that the AUC was not dealing with an ordinary rate application. Hence (at para 134):

> In these rather unusual circumstances, the respondent Commission had to use its experience and expertise to craft a fair and reasonable solution to the appellants' request for indemnification of its hearing expenses. … I am of the view that the Commission did so properly and reasonably here. That entails no error of law, given these circumstances, and even if there were one, it could not have affected the result.

And just to be sure (at para 133):

> So I find it unnecessary to reach any final conclusion about anything else. For example, about how to handle a utility company's hearing expenses in the more ordinary type of rate hearing for a traditionally-regulated public utility.

As for the PBR matters, since the standard for review was reasonableness and since it was an argument about the amount of costs that the Commission had awarded (and perhaps whether it amounted to full indemnity), these were matters that engaged the experience and expertise of the Commission and ATCO had not met the onus of showing that the Commission's decision was unreasonable.

Justice Martin's Dissenting (in Part) Opinion

Justice Martin agreed with the disposition of the PBR matters but would have allowed the appeal on the UAD matters. He did agree that section 21 of the *UCA* did cover fee matters for both interveners and applicants but concluded that in denying ATCO its costs for the first part of the UAD generic hearing the Commission was acting arbitrarily. For Justice Martin there was only one test for the recovery of legal costs and that was the prudence test and the Commission was entitled to use its Rule 22 as a measure of prudence in any particular case. But to exclude recovery completely, whether costs were prudently incurred or not, was arbitrary; and it was no answer to say that participation in the generic hearings was voluntary, for (at para 165) "had they elected not to participate it would have been at their peril; policies and procedures that directly affected them would have been developed without their input, perhaps to their detriment."

ATCO's record suggests that the ATCO Utilities will seek leave to appeal this decision. The outcome of both that application and any subsequent hearing on the merits may well be affected by two decisions which we are now awaiting from the Supreme Court of Canada: *ATCO Gas and Pipelines Ltd v Alberta (Utilities Commission)*, [2013] SCCA 459 on appeal from 2013 ABCA 310 (*ATCO Pension case*) and *Ontario Energy Board v Ontario Power Generation Inc*, [2013] SCCA 339 on appeal from 2013 ONCA 349. As luck would have it these appeals were both heard on December 3, 2014, the day after judgement came down in this case. Both cases raise the connection between prudently incurred costs and the right or opportunity of recovery. In particular it seems that the questions that the Court will have to answer in these cases include the following: (1) if a utility claims a set of operating costs, must the regulator rule on the prudency of the utility in incurring those costs, and (2) if the regulator rules that the costs incurred were indeed prudently incurred, must the regulator allow the utility at least the opportunity to recover those costs. In the *ATCO Pension Case* the AUC denied ATCO full recovery of the pension costs that it had incurred on the basis of independent actuarial advice. In the course of refusing to interfere with the Commission's decision, the Court (at para 9) ruled as follows:

> The appellants argue that the applicable statutes mandate a two-stage analysis. First the Commission must determine if the expenditures were prudently incurred. If so, they must be included in the second stage of the analysis, which is the setting of just and reasonable rates. While a two-stage analysis might often be helpful and appropriate, the applicable statutes do not mandate that line of analysis. The decisions of the Commission are entitled to deference, and that includes the selection by the Commission of its line of analysis. Given the focussed objective of the 2011 pension hearing, the analytical framework selected by the Commission was not unreasonable.