

## UTILITY RATE REGULATORS GIVEN GREATER DISCRETION TO DISALLOW STAFF COMPENSATION COSTS AND COST OF LIVING ALLOWANCE

By Stanley D. Berger, B.C.L., LL.B., Certified Environmental Specialist

The Supreme Court of Canada issued two decisions dealing with the regulation of utility rates which will significantly impact on how regulated utilities manage their internal costs going forward. In *Ontario (Energy Board) (OEB) v. Ontario Power Generation Inc. (OPG)* (2015) SCC 44 and *Atco Gas and Pipelines Ltd. v Alberta (Utilities Commission)* (2015) SCC 45, the Supreme Court concluded that neither the Ontario Energy Board nor the Alberta Utilities Commission were required to apply the prudence methodology in the setting of rates. In a prudence review a decision made by utility's management with respect to its costs, is evaluated on the basis of the "circumstances that were known or ought to have been known by the utility at the time the decision was made." Hindsight is not used in determining prudence. The following summary focusses on the decision by Ontario's energy rate regulator to disallow nuclear staffing costs in *OEB v. OPG*, rather than the Alberta regulator's decision not to allow the full recovery of certain pension costs relating to an annual cost of living adjustment of 100 percent of annual consumer price index in *Atco Gas v Alberta Utilities Commission*.

OPG had applied to the Ontario Energy Board (OEB) under s.78.1 of the *Ontario Energy Board Act* 1998 S.O. 1998 c.15 sched. B to fix the rates it was entitled to charge its customers for the year following its application, ("the forward test period") a period during which employee compensation was largely set by two collective agreements, one with the Power Workers Union and the other with the Society of Energy Professionals. The OEB had reduced OPG's application for nuclear staff compensation costs by 145 million dollars. The Board used a benchmarking study of comparator employees that was not in existence at the time OPG entered into the collective agreement with its unions. That study revealed that the salaries of non-management employees were in the 75th percentile of a survey of industry salaries. The Board considered a proper benchmark salary to be the 50th percentile, the same percentile against which OPG benchmarks management compensation.

The Ontario Court of Appeal at (2013) ONCA 359 overturned the OEB's decision to reduce staff costs observing that "it is unreasonable to require that OPG manage costs that, by law, it cannot manage." (at par.37) The costs relating to staffing numbers and rates of pay were fixed by OPG's collective agreements for the future test period and OPG was bound to pay them.

"It could not reduce the rates or compel a re-opening of the agreements. OPG is also constrained by safety requirements. Equally, the number of staff positions is strictly regulated by the collective agreements. OPG could not unilaterally reduce the number, nor could it compel unionized staff to retire." (at par.35)

The Supreme Court reinstated the OEB's cost reduction of 145 million dollars. In determining that the OEB's analytical approach to disallowing the nuclear staff costs was just and reasonable the Court found it useful to review whether these costs were "forecasted" or "committed".

"[82] Forecast costs are costs which the utility has not yet paid, and over which the utility still retains discretion as to whether the disbursement will be made. A disallowance of such costs presents a utility with a choice: it may change its plans and avoid the disallowed costs, or it may incur the costs regardless of the disallowance with the knowledge that the costs will ultimately be borne by the utility's shareholders rather than its ratepayers. By contrast, committed costs are those for which, if a regulatory board disallows recovery of the costs in approved payments, the utility and its shareholders will have no choice but to bear the burden of those costs themselves. This result may occur because the utility has already spent the funds, or because the utility entered into a binding commitment or was subject to other legal obligations that leave it with no discretion as to whether



Stanley D. Berger

Partner

t: 416.864.7626  
sberger@foglers.com



Albert M. Engel

Partner

t: 416.864.7602  
aengel@foglers.com



Tom Brett

Partner

t: 416.941.8861  
tbrett@foglers.com



Yadira Flores

Associate

t: 416.365.3744  
yflores@foglers.com

to make the payment in the future."

f: 416.941.8852  
foglers.com

The Court recognized, as did the Court of Appeal, that OPG was required to abide by wage and staffing levels established by collective agreements, but further noted that OPG retained some flexibility in managing total staffing through projected attrition of a mature workforce. The statutory regime provided the OEB with some discretion in how to weigh these committed costs:

"The existence both of collective bargaining for utility employees and of the Board's power to fix payment amounts covering compensation costs indicates neither regime can trump the other. The Board cannot interfere with the collective agreement by ordering that a utility break its obligations thereunder, but nor can the collective agreement supersede the Board's duty to ensure a just and reasonable balance between utility and consumer interests." (at par. 114)

Since predicted staff attrition rates were inherently uncertain and the OEB was not equipped to micromanage OPG's business, the Board could not readily divide forecasted costs from committed ones. The Board had the methodological discretion to adopt "a mixed approach that did not rely on quantifying the exact share of compensation costs that fell into the forecast and committed categories." (at par. 117) The Majority also rejected the argument accepted both in the Court of Appeal and in Judge Abella's dissenting opinion that the Canadian Nuclear Safety Commission (CNSC) imposed staffing levels on OPG to ensure the safe and reliable operation of its nuclear stations.

"...While the regime put in place by the CNSC surely imposes operational and staffing restraints on nuclear utilities (see OPG record, at pp. 43-46), there is nothing in the Board's reasons, and no argument presented before this Court, suggesting that the Board's disallowance will result in a violation of the provisions of the Nuclear Safety and Control Act, S.C. 1997, c. 9 ".(at par. 119)

After reviewing American and Canadian case-law on the prudence investment test, the Supreme Court accepted that a regulatory board could accept a no-hindsight prudence review not only for capital costs but operating costs as well. (at par.102) However, the Court concluded that the mere decision not to apply the prudence test when considering committed costs did not render its decision on payment amounts unreasonable. (at par. 103)

"The question of whether it was reasonable to assess a particular cost using hindsight should turn instead on the circumstances of that cost. I emphasize, however, that this decision should not be read to give regulators carte blanche to disallow a utility's committed costs at will. Prudence review of committed costs may in many cases be a sound way of ensuring that utilities are treated fairly and remain able to secure required levels of investment capital..." (at par.104)

The prudence test would be of more significance in the review of capital as opposed to operating costs so as to ensure that utilities are not discouraged from optimizing investment in the development of their facilities.

"...Capital costs, particularly those pertaining to areas such as capacity expansion or upgrades to existing facilities, often entail some amount of risk, and may not always be strictly necessary to the short-term ongoing production of the utility. Nevertheless, such costs may often be a wise investment in the utility's future health and viability..." (at par. 107)

The Board's decision was intended to have the effect of making OPG more hesitant in the future about committing relatively high compensation costs. Prudence reviews tended to be focused on one-time investments not ongoing "repeat-player" relationships. The Board's disallowance, according to the Court, was animated by its effort to get OPG's ongoing compensation costs under control.