REGULATORY AND POLICY DEVELOPMENTS

SUPREME COURT OF CANADA RULES ON FEDERAL TELECOMMUNICATIONS JURISDICTION

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In a judgment rendered August 14, 1989, the Supreme Court of Canada unanimously ruled that Alberta Government Telephones (AGT) is a work or undertaking within exclusive federal legislative authority. (See *CCPR* December 1987 for discussion of the decisions of the Federal Court Trial Division and the Federal Court of Appeal in this case). At the same time, in a 4 to 1 split decision (the Honourable Madam Justice Wilson dissenting), the Court concluded that Alberta Government Telephones is an agent of the provincial Crown under its statute, and not subject to the federal *Railway Act*. This *Act* gives the CRTC its substantive powers in regulating the communications carriers.

The reasoning of the Court on the constitutional question closely follows that of the Federal Court Trial Division. However, the Court did place greater emphasis on the operating realities in telecommunications carriage and less emphasis on AGT's role in a relationship with Telecom Canada than had the Federal Court Trial Division. Nevertheless, the Supreme Court quoted extensively from the description of the physical interconnection between the AGT system and that of companies operating outside Alberta presented in the Trial Division's judgment.

In concluding that AGT is an undertaking connecting Alberta with other provinces or extending beyond the limits of Alberta (the constitutional definition of an extra provincial undertaking) the Supreme Court fixed on the involvement of AGT in the transmission and reception of electronic signals at the borders of Alberta. Consistent with the jurisprudence on extra-provincial undertakings, the Court expressly rejected the proposition that the issue should be determined by looking at the geographical location of the undertaking's physical facilities. Rather, it is necessary to look at the service which is provided by the undertaking through the use of its physical equipment. The Court conceded that interconnection of physical facilities in one province with those in the neighbouring province's territory or state alone may not be sufficient to characterize the undertaking or the facilities as interprovincial in nature. However, the Court emphasized that, in this case, the facts demonstrated much more than physical interconnection at a provincial border. It had been demonstrated that AGT is, through various commercial arrangements of a bi-lateral and multi-lateral nature (principally system interconnection agreements with other telephone companies), organized in a manner which "enables it to play a crucial role in the national telecommunications system."

The Court viewed the Federal Court Trial Division decision as finding that AGT itself is operating an interprovincial undertaking and that its role in Telecom Canada is only one of several arrangements through which this undertaking is operated. Therefore, the Supreme Court's decision arguably extends federal authority not only to all Telecom Canada member companies but also to any other telephone companies which are not members of Telecom Canada but which have established bi-lateral interconnection arrangements at provincial borders with companies outside the province. As well, it appears that the Supreme Court's decision would have been the same even if Telecom Canada did not exist and all carrier revenue settlement, physical interconnection, and facilities planning occurred on an *ad hoc* basis.

Nevertheless, membership in Telecom Canada was found by the Court to be an important feature in concluding that the entire undertaking of AGT

must be construed as being interprovincial. In determining this question, the Court applied the test of whether the fundamental nature of the undertaking would be altered if the essential extraprovincial elements were removed. In this respect the Court found that AGT could not separate itself from its interprovincial arrangements without significantly altering the fundamental nature of AGT's enterprise.

Finally, on the Crown agency issue, the Court concluded that the *Interpretation Act* presumption that the Crown is not bound by a statute unless it is expressly mentioned must prevail, that AGT had done nothing in participating in CRTC proceedings to suggest that it had waived its immunity from CRTC jurisdiction, and that, by entering into a federally regulated area, AGT as a provincial Crown agent could not lose immunity it would otherwise have.

The Supreme Court's decision confirms a result that had been expected by most industry watchers and constitutional experts since AGT first sought to block the CRTC from ordering it to interconnect with CNCP Telecommunications in 1982. There is now no question that all Telecom Canada member companies are subject to federal regulation under the *Railway Act* with the exception of AGT, SaskTel and Manitoba Telephones which are Crown agents. These three exceptions could be eliminated by a simple amendment to the *Railway Act* to make it binding on the federal and provincial Crowns' agents.

As a result of the decision, hearings of the Newfoundland Public Utilities Commission into customer attachment rules have been adjourned pending confirmation that the CRTC's rules would apply to Newfoundland Tel. MT&T (which provides telephone service to Nova Scotia) has entered into discussions with the CRTC on a general rate application which would otherwise have been filed before the Nova Scotia regulator. New Brunswick Tel has requested directions from the Commission on how to comply with the *Railway Act* provisions. The three prairie telephone com-panies on the other hand are now effectively unregulated since both the CRTC and the original provincial regulatory agency lack jurisdiction over them.

As expected, the decision appears to have had some effect in breaking the log jam in the development of federal telecommunications policy— an exercise that has been stalled since mid-1987. The Minister of Communications, not surprisingly, has promised to introduce legislation in the fall session of Parliament to provide some continued element of provincial decision-making power in telecommunications. A variety of options to do so have been discussed over the years. These include:

(1) delegation of some aspect of federal provincial price-setting jurisdiction to the existing provincial regulatory agencies (generally local and intra-provincial long distance rates are mentioned),
(2) providing for representation from the provinces on a restructured CRTC,
(3) continuing with the current structure of the CRTC with no delegation of jurisdiction but having the CRTC adjudicate certain hearings through the general offices and regional appointees.

All of these options contain difficulties. Perhaps the greatest difficulties from a federal-provincial perspective are contained in the first option since it would leave the provinces regulating services which are generally regarded as not covering their costs while the federal government regulates interprovincial long distance services which have traditionally been regarded as cross-subsidizing local exchange service. This first option also raises the question of how to regulate Bell Canada. It has been suggested that if Bell were regulated on a provincial basis Bell's Québec rates would be much higher than those in Ontario.

The representative agency model may not satisfy provincial interests since it can be expected that they would generally be in the minority.

The centralized CRTC model may not go far enough on its own to satisfy the political objective of reducing federal-provincial friction arising from the jurisdictional shift. It also raises the question of how to pay for the much expanded CRTC. There is, however, an answer to this question since all federally regulated telecommunications carriers now pay a fee designed to cover the operating costs of the CRTC. If the new regulatory acquisitions of the CRTC pay an equivalent fee then the costs of the expanded CRTC may not have to be borne by federal tax payers.

Whatever the institutional outcome that emerges over the next several months, the

Supreme Court's decision probably ensures that the federal government will obtain regulatory control over the activities of Telecom Canada and the interconnection arrangements provided by Telecom Canada members to competitors such as CNCP. Accordingly, were CNCP to resubmit its application now to provide competitive long distance telephone service by means of interconnection with telephone company local exchange, it would be able to base its application on a national market. In its original 1984 long distance application, CNCP had great difficulty in presenting credible financial information supporting the viability of its proposed long distance service because the application had to be limited to obtaining access to markets only in British Columbia, Ontario and Québec.

SUPREME COURT SUPPORTS CRTC REVENUE REIMBURSEMENT ORDER

In a decision released on June 22, 1989, the Supreme Court of Canada overturned a decision of the Federal Court of Appeal with respect to the jurisdiction of the CRTC to order Bell Canada to reimburse excess revenue earned between the interim approval of the Bell Canada rates and the final CRTC decision.

The critical difference between the Supreme Court and the Federal Court of Appeal was in the interpretation of the *National Transportation Act* provisions relating to the effect of granting interim approval of rates. The Federal Court of Appeal concluded that once the CRTC approves interim rates they must be regarded as just and reasonable and that the authority to "reserve further directions" in an interim rate approval did not empower the CRTC to revise the rates approved in the interim award as at the date of the interim award.

The Supreme Court unanimously concluded otherwise that the CRTC does have the power to revisit the period during which interim rates were enforced and to find that these rates, based on further evidence, were not just and reasonable. Adopting dissenting reasons of Huggeson J. in the Federal Court of Appeal, the Supreme Court concluded that such a power to revisit is necessarily implied in the power to make interim orders within the statutory scheme established by the *Railway Act* and the *National Transportation Act* and that to hold otherwise would make the interim decision power meaningless insofar as rate decisions are concerned. It is apparent in the nature of interim orders that their effect as well as any discrepancy between the interim order and the final order may be reviewed and remedied by the final order. That is, the Court found it is the interim nature of the order which makes it subject to further retrospective directions.

The Court went on to note that the circumstances under which interim orders are granted also explain and justify their being unlike final orders subject to retrospective review and remedial orders. Interim rate orders such as those issued by the CRTC and general rate cases deal in an almost interlocutory manner with issues that must remain to be decided in a final decision. They are traditionally granted for the purpose of relieving the applicant from the negative financial consequences of the time required for a proceeding leading to a final rate order. Such CRTC decisions have generally been made in an expeditious manner on the basis of evidence which would often be insufficient for the purposes of the final decision.

Consequently, the Supreme Court concluded that to hold that the interim orders in this case could not be reviewed would also frustrate and subvert the CRTC's actual and initial order approving the interim rates which, on its face, clearly indicated the Commission's intention to review the rates charged during the period of interim approval. Finally, the Court confirmed that, while the one time credit order adopted by the Commission to eliminate the calculated excess Bell Canada revenues was not perfect, since it would not necessarily benefit the customers who are actually billed excessive rates, it was nevertheless the most practical order available and "once it has found that the CRTC has the power the make a remedial order, the nature and extent of this order will remain within its jurisdiction in the absence of any specific statutory provision."

The decision of the Supreme Court confirms a generally accepted view of the role of the interim rate approval power. It raises the question of whether the Commission can achieve the same result if new facts come to light through its power

to review and vary final decisions, and, if so, whether the carrier or its consumers could compel the CRTC to follow procedural fairness principles such as those the CRTC imposed on itself in the instant case by a public notice at the time of the interim rate approval.

While the decision confirms the Commission's authority to order a considerable redistribution of income to consumers (approximately $200 million), its future practical significance may not be great. The Commission has been extremely reluctant to grant interim approval of telephone company rate increases principally because such approvals can result in telephone companies obtaining considerable revenue increases on the basis of very thin evidence. The interim approval which spawned the ultimate reimbursement decision in this case arose in very peculiar circumstances relating to the transition from a three year period of administered telephone service rates under a federal inflation restraint program.

However, the decision does confirm that CRTC and other price regulators that use a rate of return measure can, at least through use of interim rate approvals, go back in time if the assumptions upon which those rates were based turn out to be faulty and the earnings of the telephone company exceed its approved rate of return. On the other hand, it is doubtful that the Commission would consider that what is sauce for the goose should also be sauce for the gander and order a one-shot reimbursement to the telephone companies from its subscribers to compensate for inadequate revenues over the period during which interim rates were in force.

J.F.B.

NATURAL GAS PIPELINE AND EXPORT REGULATION: AN UPDATE ON THE NATIONAL ENERGY BOARD[1]

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National Energy Board (NEB) decisions of the past few months demonstrate a crystallization of the NEB's approach to gas pipeline access issues; a preoccupation with traditional concerns in the construction of major new gas pipeline facilities; and a new approach to assessing the public interest in natural gas exports.

Access to Existing Capacity

The NEB's approach to gas pipeline access and brokering issues is driven largely by competitive principles. The approach is as follows:

- Access to existing available capacity should be given to those having first requested the service.
- Admission to the queue should require a minimum of information: the name of the party requesting service; the volume; receipt and delivery points; and the dates of commencement and termination of the service.
- The party requesting service must be prepared to enter into a precedent agreement for the service requested in which any conditions precedent may be stated.
- Available capacity should be offered in order to those in the queue until all available capacity has been taken.
- The pipeline may request proof of necessary regulatory authorizations (e.g. removal permits) to the extent that action by the pipeline in transporting the gas could be unlawful in the absence of such an authorization.
- The pipeline should also be able to establish reasonable requirements for credit-worthiness and assurance of payment.
- The pipeline should not be able to refuse service merely because the gas to be transported may displace a sale being made by another shipper on the pipeline even where the displaced sale is that of the pipeline or the pipeline's affiliate.
- In the case of displacement volumes, the NEB may give relief to the displaced shipper by establishing the demand charge obligation on the basis of the operating level which is the contract demand level minus the amount of the displacement.
- Transportation rights should be assignable.
- Absolute assignments of transportation rights where the assignee is to take over the obligations of the assignor should be subject

to the consent of the pipeline, such consent not to be unreasonably withheld.

- Temporary assignments where the assignor will remain liable to the pipeline should not require the consent of the pipeline although the assignee should meet the normal requirements of the tariff.
- Diversions of gas to delivery points not named in the transportation contract should be limited only by the availability of capacity with the result that upstream diversions would normally be unconstrained subject only to the payment of an administrative fee.
- Transportation contracts may contain multiple receipt and delivery points constrained only by the availability of capacity.
- Access to existing pipeline capacity should not depend on the length of the proposed service and may be for periods of as short as a year.
- Existing shippers should have a right to renew services upon reasonable notice to the pipeline (six months).
- The pipeline's sales and transportation functions should be separated and the transportation tariff should exclude all considerations related to sales i.e. all services should be exclusively transportation services. (Note that the *NEB Act* provides for the regulation of pipeline transportation but does not regulate the sales made off the pipeline except to the extent that such sales may require an export licence.)

The NEB's June 1989 Phase II decision on TransCanada PipeLines Limited's (TCPL) 1989/90 tolls hearing, RH-1-88, is almost the last step in the development of this approach. The NEB approach is less well-developed in the case of Westcoast Energy (formerly Westcoast Transmission Company Limited) and Foothills PipeLines Limited. However, the process of evolution is well underway in the case of these pipelines. On July 5, 1989, the NEB issued a decision establishing access criteria and renewal rights for Westcoast. Access criteria and renewal rights for Foothills were addressed in the NEB's May 1989 MH-2-88 decision on the application by North Canadian Oils Limited for access to the Foothills system.

Westcoast has been directed to amend its tariff to incorporate renewal rights. The principles established by the NEB provide that all existing firm shippers are entitled to renewal rights. However, shippers must demonstrate either a firm gas supply or a firm market in order to exercise renewal rights. By contrast, the NEB in the TCPL RH-1-88 proceeding discussed the introduction of a "use it or lose it" principle which would require a shipper to demonstrate that capacity has been and would continue to be used at a reasonable level as a condition of exercising renewal rights. The proposal did not fly. In addition, the NEB in its Phase I RH-1-88 decision, directed TCPL to remove from its tariff all matters which relate to sales and marketing of natural gas. TCPL was permitted to retain only a requirement that shippers demonstrate that they have a valid removal permit in place given TCPL's potential liability if gas is removed from a province without a valid removal permit. The procedures adopted for Westcoast contemplate a six-month notice period for the exercise of renewal rights. This is consistent with the approach adopted for TCPL.

On August 31, 1989, Foothills filed with the NEB a new tariff establishing access criteria and renewal rights. The new tariff requires shippers to demonstrate to the satisfaction of Foothills that the shipper has appropriate upstream and downstream transportation arrangements and all applicable regulatory approvals for at least the initial year of service. The tariff also provides for proof of credit-worthiness and the provision of financial assurances. The tariff provisions respecting renewal rights require six months' notice, financial assurances, and proof to the satisfaction of Foothills of satisfactory upstream and downstream firm transportation arrangements and regulatory approvals.

New Facilities Issues

Access to service where new capacity must be constructed is less well-defined. One finds in the NEB's July 1988 GH-2-87 decision a recognition that in a competitive marketplace long-term markets may be served by a series of short-term contracts with the result that it may be desirable to construct new facilities even if the initiating request for transportation service is of a short-

term nature. Similarly, the NEB in its January 1989 GH-4-88 decision expressed sympathy for the notion of building some flexibility into the pipeline system where markets are growing and new requests for service can be anticipated by permitting the pipeline to build some capacity in advance of requests for service. Likewise, the NEB has approved (in part on competitive grounds) the construction of short by-pass pipelines such as the St. Clair pipeline which will connect the Union Gas system in Ontario with the Michigan Consolidated system. However, with mega expansions to serve U.S. markets looming, the NEB is demonstrating the traditional concern for the long-term utilization of pipeline facilities. The adequacy of Canadian supply sources to support a major expansion in the long-term is a particular focus of the NEB's attention.

The NEB's concern with the supply underpinning a pipeline expansion surfaced in the recently completed TCPL 1990 facilities hearing, GH-1-89. In that hearing, the NEB went beyond the supply underpinning the specific projects making up the application and asked TCPL to provide general evidence on the supply capability of the Western Sedimentary Basin. The NEB rejected the view of Gaz Métropolitain, inc. that it should be sufficient that GMi had signed a long-term firm service agreement without the need to demonstrate a contracted long-term supply which would utilize the service. The supply issue has also emerged in TCPL's recently filed 1991/92 facilities application. TCPL established a cut-off date for shippers to provide evidence of firm gas supply. A number of domestic shippers were excluded from the application because they failed to meet TCPL's requirement. The NEB has now ordered a written hearing, GHW-3-89, to determine what supply evidence should be required to support TCPL's 1991/92 facilities application. That is the application related primarily to the Iroquois and Champlain export projects.

The NEB's July 5, 1989, decision regarding Westcoast authorizes the company, where new facilities must be constructed, to require shippers to provide evidence that the intended market is secure and long-term; that the prospective shipper has a secure and long-term source of supply; and that the prospective shipper will obtain all necessary regulatory approvals in a timely manner. Foothills has incorporated similar conditions into its latest tariff amendment.

There is plainly tension between the dictates of competition, on the one hand, and, on the other hand, concerns related to the efficient allocation of society's resources to pipeline construction given the uncertainties of a finite yet indefinite supply of natural gas and potential competition in end use markets, particularly export markets, which may affect pipeline utilization. The NEB's task in finding a balance on this issue is made more difficult by the fact that the issue brings into the open the very different economic interests of producers and consumers. A number of significant producers would like to see the market revert to longer term supply arrangements. This view was advanced in the 1988 security of supply hearing before the Ontario Energy Board (OEB) and would have given producers, had it not been rejected by the OEB, the market stability which was lost with the onset of competition. There was also a strong producer voice in the recently completed GH-1-89 hearing on TCPL's 1990 facilities application opposing unnecessary slack in the TCPL system. In an August 24, 1989, decision without reasons, the NEB approved TCPL's facilities but denied that portion of the facilities application required to provide loss of critical compressor unit protection on TCPL's Western Section. This protection had given TCPL an extra level of flexibility and security in its system. Parties at the consuming end of the pipeline, however, see a value in flexibility in the pipeline system in terms of their ability to engage quickly in spot and other short-term transactions. In addition, local distribution companies (LDC) which have the financial where-with-all to contract for capacity in the absence of long-term sales and supply arrangements may wish to be able to initiate pipeline construction simply by committing to long-term firm service agreements. It has been argued that the long lead times required for pipeline approval and construction make it unreasonable for LDCs to demonstrate long-term firm supply as part of the pipeline facilities approval process. The NEB's decision on the pending GHW-3-89 hearing on gas supply may give some guidance on this issue.

The NEB has been wrestling with developing an appropriate measure of the economic efficiency

of a major pipeline expansion. The issue was canvassed in TCPL's 1990 facilities application, GH-1-89. The Canadian Petroleum Association advocated a test based on the impact of the expansion on existing shippers. The NEB had requested TCPL to submit a social benefit/cost analysis in support of the facilities expansion and a number of parties supported the use of social benefit/cost analysis as the appropriate measure of economic efficiency. It seems clear that whatever other factors the NEB takes into account in assessing a major facilities expansion– including the impact on existing shippers– the NEB will place greater emphasis on social benefit/cost analysis.

The NEB is taking steps to ensure that adequate notice is given to the public of proposed applications having potential environmental and social effects to ensure that the Board is in a position to evaluate the level of public concern. To this end, the NEB has issued a Draft Memorandum of Guidance dated September 6, 1989, requiring applicants to implement a public information program to explain the proposal in advance of filing an application. Applicants must provide adequate information to interested parties; provide interested parties adequate time to comment on the proposal; and ensure that senior officials and expert staff are responsive to any questions that may be put to them by the public. The details of the public information program must be filed with the application. This new procedure does not apply, among other things, to routine work performed on the right-of-way or to oil and natural gas import and export applications except exports of oil by marine vessel from the west coast of Canada. The NEB has had two recent experiences with environmental or land owner concerns arising after the completion of a hearing. After the decision was issued on the St. Clair pipeline, residents raised a number of environmental concerns which has led to the Board instituting a review of the environmental conditions attached to the authorization for that pipeline. Following the completion of the hearing on TCPL's 1990 facilities application, GH-1-89, the Board received a number of letters from concerned land owners about TCPL's proposed spur pipeline crossing the St. Lawrence River near Gananoque. The NEB has deferred its approval of the Gananoque extension and will hear the concerns of land owners before authorizing that line.

Gas Exports

Since July, 1987, the NEB has been assessing natural gas export applications on the basis of its market-based surplus determination procedure. Three recent decisions illustrate the NEB's market-based approach and in some respects mark a new point of departure in the evolution of a market-based approach to gas exports.

In May, 1989, the NEB in its GH-5-88 decision granted Alberta & Southern (A & S) an extension of its existing export licence to the year 2005, five years less than the term requested. On the NEB's assessment of A & S's supply, A & S began to rely on supply from potential reserves under development contracts starting in 1995 with the extent of the reliance increasing to the point that in the latter years of the requested terms, over 80% of requirements were dependent on such supply. As a result, the NEB cut back the requested term by five years. The decision plainly involves the application of judgment since the reliance on supply from potential reserves under development contracts in the year 2000 is estimated by the NEB to be in excess of 60% increasing to almost 80% by the year 2005. The NEB also took into account any commercial reasons which A & S might have for requesting the longer term. In this case, the export would flow through existing facilities and the NEB concluded that there was no commercial necessity for the longer term. Interestingly, the GH-5-88 decision describes A & S's benefit/cost analysis but does not set out the NEB's own quantitative assessment of that analysis. Rather the NEB makes a few qualitative comments and concludes with the statement that it is satisfied that the export will provide net benefits to Canada although less than A & S has estimated. This approach to assessing an applicant's benefit/cost analysis changed dramatically afterwards when the NEB issued its GH-3-89 decision on an export by Amoco Canada to the Pacific Northwest. In that decision, the NEB sets out its own quantitative analysis of the benefits and costs of the proposed export and gives specific guidance as to how costs– including user costs– should be calculated

for that purpose. The "user cost," at any time, is the difference in present value between selling the next unit of gas in the future rather than selling it now. The NEB considers user cost to be a valid component of the price for today's gas because it compensates the resource owner for selling the gas today rather than holding it in the ground until it becomes more valuable at some future date.

The combination of supply and benefit/cost concerns reflected in the GH-3-88 and GH-5-88 decisions came home to roost in the NEB's GH-8-88 decision dated June, 1989, concerning proposed exports by Canterra Energy, Norcen Energy, POCO Petroleums, Shell Canada, and WGML to the Midland Cogeneration Venture and to Consumers' Power, and by Vector Energy to a cogeneration project developed by Altresco. In the GH-8-88 decision, the NEB denied the export licence sought by Vector Energy. The NEB was not satisfied that Vector had sufficient supply to support its licence. The NEB's estimate of supply indicated that Vector had less than 50% of the established supply required for the export. The NEB also found that, using its own analysis, the proposed export yielded net costs rather than net benefits to Canada. The price of the gas to be exported by Vector was tied heavily to coal and No. 6 oil. Vector has since re-applied to the NEB for an export licence providing additional information as to supply, negotiating a higher price for its export sale, and submitting a revised benefit/cost analysis using the NEB's methodology showing a positive net benefit to Canada.

In the GH-8-88 decision, the NEB's concerns with respect to the benefits and costs of an export led to a restriction on the licence sought by other applicants to serve Consumers' Power and the Midland Cogeneration Venture (MCV). The price of the sale to MCV was tied largely to the price of coal and the sale to MCV on its own, in the Board's assessment, would not yield positive net benefits to Canada. As a result, the NEB imposed a term on the exports to Consumers' Power and MCV such that the volume of gas to be exported for MCV should not exceed the volume of gas exported to Consumers' Power. The combined export was found by the NEB to be likely to recover costs incurred in Canada. MCV has sought leave to appeal this decision to the Federal Court of Appeal.

While the GH-3-88, GH-5-88, and GH-8-88 decisions are interesting for what they say, they are equally interesting for what they do not say. There is no discussion of the constraints imposed by the *Free Trade Agreement*, nor is there any discussion of the constraints introduced into the *NEB Act* to give effect to the *Free Trade Agreement*. It is fair to conclude, therefore, that the NEB did not consider that the action taken in any of these three decisions raised issues under the *Free Trade Agreement*. As a result, one can conclude that the NEB is of the view that it can grant an applicant for an export licence a shorter term than that requested; that the NEB may restrict a new export by imposing restrictive conditions on the export; and that the NEB may deny a new export in its entirety if it is not satisfied that the export is in the Canadian public interest.

Conclusion

In a 1989 study entitled "Regulatory Failure and Renewal: The Evolution of the Natural Monopoly Contract" prepared for the Economic Council of Canada, John Baldwin of Queen's University utilizes a number of case studies to demonstrate that the forms of regulation which we presently have in Canada have evolved from an earlier period where relationships with public utilities were governed by contract. The contractual arrangements broke down and were replaced by either public ownership or rate regulation. Among the reasons for failure of the earlier arrangements were, in some cases, the inability of fixed term contracts to adjust to changing circumstances with resulting prejudice to the financial well-being of the utility and, in other cases, a perception that the utility was earning monopoly rents, having become the sole supplier of the service, actual and potential, in a situation where at an earlier time there were a number of parties willing and able to provide the service. In the NEB's consideration of export proposals, one can see a concern for the economic health of the project over its life. In the NEB's approach to pipeline access, at least with respect to existing capacity, one sees an appreciation of the need to maintain opportunities for shippers both large and small for both long and short-term transactions. It is fair to say, therefore, that the

NEB has a firm grasp of the broad concepts which are at play and which must remain in play if this is to be a period of regulatory renewal. It may also be expected that the NEB will, over time, integrate the new ideas of free, deregulated, and competitive gas markets with the traditional and enduring regulatory concerns of managing a finite, if somewhat indefinite, gas supply, and the need to pass judgment on major projects involving the commitment of significant resources.

Notes

1. This article is based in large part on a speech given by N.J. Schultz to the International Association of Energy Economics Second Annual North American Natural Gas Supply & Markets Industry Conference at Denver, Colorado September 6-7, 1989.

DRUG PRICES REVIEW BOARD PUBLISHES FURTHER GUIDELINES

The Patented Medicine Prices Review Board (PMPRB) has published for comment proposed supplementary guidelines with respect to the determination of excessive prices for patented medicines (Bulletin No. 3, July, 1989).

The proposed supplementary guidelines are intended to provide some greater certainty on the approach the Board will be taking to defining medicine and market for price review purposes. In addition, using the approach taken for determining the "unit of price review" the Board proposes criteria for determining whether a medicine would be classified as an existing medicine or a new medicine for price review purposes.

Finally, the proposed guidelines, when compared to the Board's initial guidelines of July, 1988, provide considerable elaboration of the limits the Board wishes to impose upon the initial prices of medicines first marketed in Canada subsequent to the Board's price review jurisdiction coming into force.

Unit of Price Review

The Board has indicated that, for the purposes of its price review function relating to patented medicines, it will review the price of each strength of each individual dosage form of a medicine. Each strength of a medicine's dosage form is generally assigned a unique identifier known as a Drug Identification Number (DIN) when the medicine receives its Notice of Compliance (NOC) from Health and Welfare Canada. Under the *Patented Medicine Regulations* patentees are required to report prices and sales volume according to DIN. The Board has elected to use the prices of DIN's first marketed before December 7, 1987, as benchmark prices for existing medicines. In August, 1989, the Board forwarded to all reporting patentees its calculated benchmark prices for the patentees' DINs marketed prior to December 7, 1987. If after applying the Consumer Price Index standard presented in the Board's initial price guidelines the current price of a DIN is greater than the CPI adjusted price, the current price would be presumed by the Board to be excessive unless there is "significant evidence to the contrary." The Board has not yet provided an elaboration of what might constitute significant evidence to the contrary.

New Medicines

The DIN based approach has led the Board to defining three groups of new medicines each having somewhat different excessive price criteria:

1. A new DIN of an existing dosage form of an existing medicine;
2. A new DIN of a different dosage form of an existing medicine or the first DIN of a new chemical entity— breakthrough or substantial improvement; and
3. A new DIN of a different dosage form of an existing medicine or the first DIN of a new chemical entity— other new medicine.

The Board has elected to include within the first group (new DIN of an existing dosage form of an existing medicine) a new DIN of another dosage form of the medicine which is "comparable" to the existing dosage form. The Board has proposed a set of "comparable" dosage forms for the purpose of these comparisons. For example, oral liquid and injectibles are considered to be separate dosage forms. Both capsules and film coated tablets would be regarded as the same oral solid dosage form. Sublingual tablets would be regarded

as a separate oral solid dosage form.

For these medicines the Board proposes to apply the following tests all of which turn on the fairly vague standard of "reasonable relationship" among DIN prices. The principal test is: where the price per kilogram of the DIN does not bear a reasonable relationship to the price per kilogram of DINs of the same medicine in the same or comparable dosage forms sold by the same patentee, the initial price would be presumed to be excessive. Alternatively, in descending order (where the preceding test is "neither adequate nor appropriate") the Board may apply this reasonable relationship test to a base consisting of DINs of other medicines in the same therapeutic class having the same or comparable dosage forms, DINs of other medicines in other therapeutic classes having the same or comparable dosage forms, or the Board may conduct a "therapeutic class comparison" (discussed below) in determining whether the initial price of a new DIN is excessive.

The Board proposes to conduct a "therapeutic class price comparison" by comparing the price of the DIN under review with those of DINs that:

(a) are clinically equivalent, and
(b) are sold in the same market and at prices that the Board considers not to be excessive.

Comparable medicines would be considered to be clinically equivalent if they address the indication which is anticipated to be the primary use of the new DIN, the price of which is under review. The Board has proposed the ATC (Anatomical Therapeutic Chemical) classification system for selecting comparable medicines. Finally, the Board proposes to compare the prices of comparable DINs taking into account the dosage regimen and other clinically relevant variables required to produce a clinically equivalent effect.

The Board has suggested that this comparison would normally be based on a dosage regimen not higher than the maximum of the usual recommended dosage taking into account relevant clinical variables. The Board would choose the most appropriate strength of the medicine for a particular dosage regimen.

These price comparisons would be made in terms of the price per day or price per course of treatment whichever is more applicable in the eyes of the Board. Generally, the Board has indicated that the price per course of treatment would be applicable to acute indications, whereas the price per day (based upon maintenance dose) would be applicable to chronic situations. The Board has indicated that it may rely on product monographs, credible scientific literature, expert advice, or any combination of these to facilitate determination of the maximum usual recommended dosage, relevant clinical variables, clinically equivalent effects, and other matters relating to price measurement in a therapeutic class comparison.

This somewhat complex therapeutic class comparison also is relevant with respect to price reviews of new DINs falling into the second and third category of new medicines.

The second new medicine category noted above is a medicine which constitutes a "breakthrough or substantial improvement." The Board has defined a breakthrough product as the first one sold in Canada which treats effectively a particular illness or addresses a particular indication. A drug product constituting a substantial improvement would be one that, relative to other drug products sold in Canada, provides substantial improvement in therapeutic effects (such as increased efficacy or major reductions in dangerous adverse reactions) or provides significant savings to the Canadian health care system.

The Board proposes that, where there is reliable evidence that a DIN belongs to the breakthrough or substantial improvement group, its initial price would be presumed to be excessive if it exceeds both the prices of all medicines in the same therapeutic class and the median international price of the medicine. The selection of medicines in the same therapeutic class and the calculation of their prices would be determined by the therapeutic class comparison method discussed above. The median international price of the DIN under review will be determined by examining the simple average ex factory price per kilogram of the active ingredient for the same strength and dosage form in each country listed in the *Patented Medicine Regulations*. If a direct comparison of the DIN under review is not possible the most similar strengths of comparable dosage forms would be considered. The exchange rate used in the international price comparison would

be a six month average for the period ending four months before the first sale of the medicine or the issuing of the NOC, whichever comes first.

The approach taken for breakthrough or substantial improvement medicines is intended to provide patentees greater upward pricing flexibility where the prevailing international price of that medicine has been established and it exceeds the highest price of a comparable medicine in the therapeutic class in Canada using the therapeutic comparison method discussed above. The onus is intended to lie with the patentee to establish a medicine (DIN) is appropriately classified as a breakthrough or substantial improvement.

The third group of new DINs is the residual, i.e. medicines which do not constitute breakthroughs or substantial improvements, but do constitute a new DIN of a different dosage form of an existing medicine or the first DIN of a new chemical entity. The Board has stated that it expects that a very substantial majority of the new DINs of a different dosage form or a new chemical entity will fall into this group. For DINs in this group, the Board has proposed that the initial price would be presumed to be excessive if it exceeds the prices of all medicines in the same therapeutic class, applying the therapeutic class determination method discussed above.

While the proposed supplementary guidelines provide a more careful elaboration of the Board's approach to evaluating the initial price of new medicines, it is apparent that in an effort to provide some greater certainty to the vague statutory concept of "excessive price" the Board has also introduced a large number of highly judgmental criteria which can be further elaborated only on a case-by-case basis through enforcement of the *Act*.

It is expected that the Board will review comments on the proposed guidelines during the Fall and will confirm or amend the guidelines before the end of the year.

J.F.B.

FEDERAL LOBBYISTS REGISTRATION ACT PROCLAIMED

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On September 30, 1989, the new federal *Lobbyists Registration Act* came into force. This legislation, enacted by Parliament in 1988, requires that individuals who engage in certain lobbying activities for pay must register as lobbyists. The *Act* does not regulate the lobbying activities *per se*– it simply requires that lobbyists register.

The *Act* does not apply to the following persons when they act in their official capacity:

- members of the legislature of a province or territory or their staff;
- employees of provincial and territorial governments;
- members of local or municipal governments or their staff;
- employees of local or municipal governments;
- members of the council of a band (as defined by the *Indian Act*), staff, and council employees;
- diplomatic agents, consular officers, or official representatives of foreign governments;
- officials of a specialized agency of the United Nations or officials of any other international organization granted privileges and immunities by Parliament.

Also, registration is not required if the lobbying activity is:

- an oral or written submission made to a committee of the Senate or House of Commons in proceedings that are a matter of public record;
- an oral or written submission made to any person or body which has jurisdiction or powers under a federal statute, in proceedings that are a matter of public record;
- an oral or written submission made to a public official with respect to the enforcement, interpretation, or application of any federal statute or regulation by that official.

This last clause will be of particular interest to lawyers and other professional advisors who engage in routine dealings with government officials such as regulatory inspectors, law

enforcement officers, patent examiners, taxation auditors, customs officials, licensing authorities, etc.

Lobbying of virtually all federal public office holders is caught within the ambit of the new legislation. In framing the legislation, the government decided that broad coverage was necessary, but that the registration requirements should be kept as simple and straightforward as possible. The *Act* covers lobbying directed to a "public office holder," defined as "any officer or employee of Her Majesty in right of Canada." Keeping in mind the exceptions noted above, this would include:

- employees of federal departments;
- members of the House of Commons, the Senate, and their staff;
- any person appointed to any office or body by a minister or the Governor in Council (i.e. Cabinet);
- any officer, director, or employee of any federal board, commission, or other tribunal;
- any member of the Canadian Armed Forces; and
- any member of the RCMP.

Judges, lieutenant governors of a province, and employees of some federal organizations (such as the Canada Post Corporation and the Canada Council) are not considered to be "public office holders" under the *Act*.

The legislation distinguishes between 2 types of lobbyists: Tier I and Tier II. In essence, a Tier I lobbyist is an individual who, for pay, provides certain types of lobbying services on behalf of a "client." Tier I covers "professional lobbyists" such as government relations consultants as well as lawyers, accountants, and other professional advisors who may provide lobbying services for their clients. A Tier II lobbyist is an employee whose job involves a significant amount of lobbying for his or her employer.

Tier I Lobbyists

Under the legislation, a multi-partite test is applied to determine whether an individual is required to register as a Tier I lobbyist. First, the activity must have been undertaken for payment, which is given a broad definition under section 2 of the legislation. Second, the activity must fall within the class of lobbying "undertakings" described in section 5.

Registerable lobbying activities for Tier I lobbyists are defined in section 5 as "undertaking to arrange a meeting with a public office holder or to communicate with a public office holder in an attempt to influence" a variety of matters:

- the development of a legislative proposal;
- the introduction, passage, defeat, or amendment of any bill or resolution;
- the making or amending of any regulation;
- the development or amendment of any policy or program;
- the awarding of any monetary grant, contribution, or other financial benefit;
- the awarding of any contract by, or on behalf of, the federal government.

It should be noted that simply undertaking to arrange a meeting for a client can trigger the registration requirement for Tier I lobbyists.

Tier I lobbyists must register within 10 days after undertaking a lobbying activity. The government has indicated, in a guide to the *Act*, that registration will be required for lobbying activities that take place after September 30, 1989, whether or not they are a continuation of a lobbying effort that began before the *Act* was proclaimed in force.

Under the *Act*, the Registrar of Lobbyists must be notified of any change in information that has been filed by a lobbyist. The information required on filing is specified in the *Lobbyists Registration Regulations* which were promulgated on September 30 as well.

For Tier I lobbyists, the following information is required:

- name, title, business address, and telephone number;
- name of the firm for which the lobbyist works;
- name, address and telephone number of the client;
- if the client is a corporation, information on the parent corporation and any subsidiaries;
- identification of the subject area of the lobbying activities and the type of activities involved.

The Tier I registration form lists general subject matter categories; the registrant simply indicates which are applicable to the lobbying undertaking. The requirement that information be provided on

the parent and subsidiary corporations of a client will be of particular interest to Tier I lobbyists and their clients.

Tier II Lobbyists

As was noted above, persons who carry out lobbying activities on behalf of their employers are required to register as Tier II lobbyists if the activities constitute a significant part of their duties.

Again, the *Lobbyists Registration Act* specifies a separate multi-partite test for determining if an employee must register, but there are important variations from the test employed for Tier I lobbyists. First, the person must be an employee. Second, the activities which trigger the registration requirement are slightly different. Arranging a meeting is not included for Tier II lobbyists, nor is communicating with a public office holder for the purpose of attempting to influence the awarding of any contract by, or on behalf of, the federal government (s.5 (1)(f). (The latter exception was included in the legislation to ensure that marketing/sales personnel of companies who deal with the federal government on a regular basis were not brought under the registration regime.) Finally, even if an employee engages in the relevant lobbying activities, registration as a Tier II lobbyist is not required unless this work constitutes a significant part of his or her duties.

Tier II lobbyists must register by November 30, 1989, or within 2 months after they take on lobbying duties for their employers. They must also renew their registration within 2 months after the end of each calendar year.

The registration form for Tier II lobbyists requires relatively little information: their name, title, and telephone number as well as the name, address, and telephone number of their employer.

The Lobbyists Registry

Information filed by lobbyists will be entered into the official Registry of Lobbyists which is maintained by the Registrar in the Lobbyists Registration Branch of Consumer and Corporate Affairs Canada. The Registry is based on a state-of-the-art system combining optical scanning and storage of the data which is linked to a system allowing computerized retrieval of the filed information. Information contained in filings will be transferred into a computer database which will allow automated searches by client, employer, lobbyist, subject area, etc. The registration forms themselves will also be optically scanned and maintained in electronic form.

All information filed by lobbyists is available for inspection, free of charge, at the Lobbyists Registration Branch. In addition, for a nominal fee, any person can obtain copies of documents filed with the Registrar and use the computer facilities of the Lobbyists Registration Branch to conduct searches of the computer database. Eventually, the Branch expects to have the database information available as an on-line service which can be accessed by any person who has a computer, modem, and telecommunications software.

Further information on the requirements of the *Lobbyists Registration Act* can be obtained from the Registrar of Lobbyists, Place du Portage II, 4th Floor, 165 Hôtel de Ville, Hull, Québec, K1A 0C9 (819) 953-7145). A guide to the *Act*, Information on the Lobbyists Registration Act and Regulations, is available by calling (819) 953-5055.