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NEWSLETTER

Summer 1997, Issue

IN THIS ISSUE

- Centre for Transportation
- Centre for Regulatory Affairs
- Deregulation and Stranded Investment Seminar
- Global Networking '97

MEMBER NEWS:

- New Board Members
- Board and Member News

INSTITUTE INFORMATION:

- VHI Members
- Publications
- VHI Directors

PUBLICATION INFORMATION

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Invitation to Submit: Submissions for the Newsletter are welcome and can be forwarded to Vivian Pander by mail, fax or e-mail. Please include your phone and fax numbers. Submis-

The Board of Directors of the Institute have appointed two Committees to look into the development of two unique Centres to be located at the University of Calgary - the Centre for Transportation and the Centre for Regulatory Affairs.

CENTRE FOR TRANSPORTATION

Chaired by Darshan Kailly, President and CEO of Canadian Freightways Limited, the Centre for Transportation Committee consists of members from industry and the University of Calgary. The Committee was struck as a result of numerous discussions by the Institute's Board about the lack of transportation education in Canada. At the university level, there exists no sustained, organized program in which a student can focus on the interdisciplinary studies necessary to be trained in transportation matters. The same lack of organized educational opportunities exists, with respect to continuing transportation education programs in Canada, for people in industry who wish to upgrade and broaden their expertise. One result of the lack of Canadian programs is a reliance on U.S. educational programs and expertise. This leads to significantly higher costs for industry, and a lack of Canadian focus or application.

A review was done by the Institute of Transportation Centres located in the U.S. It became clear that there is a strong commitment to transportation education in the U.S., which is generously funded at both the federal and state levels of government. There are numerous well-established Transportation Centres in the U.S. at Northwestern University in Illinois, the University of Texas at Austin, and others throughout the country. In addition, in 1987, the U.S. Department of Transport established and operated Transportation Centers in 10 federal regions with \$148 million in federal funding. The Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991 re-authorized the University Transportation Centers Program (UTCPC) for 6 more years, and then added 3 more Centers under the program. This kind of progressive development of transportation education and research has not

CENTRE FOR REGULATORY AFFAIRS

evolved in Canada.

To determine the needs of industry for transportation education and research, a survey has been developed and is being circulated to Institute members and their customers. If you would like to participate in the survey, please contact our office.

An Institute Board Committee was also set up, under the Chairmanship of Terry Dalgliesh, Senior Vice President-Law for TransAlta Utilities, to consider the development of a Centre for Regulatory Affairs based at the University of Calgary. This Committee also recognized the lack of Canadian educational offerings available in the field of regulatory theory and practice. Major Canadian companies spend millions of dollars on regulatory expertise imported from the U.S. to appear before regulatory boards and commissions in Canada in order to act as expert witnesses for Canadian companies. Although trends are moving towards less government regulation, it will

DEREGULATION AND STRANDED INVESTMENT SEMINAR

still remain a significant influence on the business activities of Canadian industry in the foreseeable future.

Surveys are currently being carried out through an interview process with selected companies to determine their research and training requirements. Once these survey results have been evaluated, the directional focus will be established for the Centre.

The Institute assisted the Department of Economics of the University of Calgary in organizing a seminar on June 13th, on the topic "*Deregulation and Stranded Investment: When, Why and How Should Incumbent Firms Recover Embedded Costs?*" Two speakers were heard: John Lowe, Partner with Bennett Jones Verchere in Calgary, and Timothy Brennan, a Professor of Policy Sciences and Economics from the University of Maryland. The seminar addressed the law and economics of the appropriate public and regulatory policy response when the introduction of competition makes it impossible for utilities to recover past costs incurred to provide service.

John Lowe's speech was called "*Transitioning without Confiscating: Inducing Competition without causing Write-Downs.*" Lowe discussed the legal arguments for the existence of a regulatory bargain - that regulated carriers are assured recovery of prudently invested capital. He argues that it is possible to establish the existence of a regulatory bargain in Canada on two separate grounds. The first is the statutory requirement that rates be *just and reasonable*. Failure to allow regulated companies to recover past investment during a period of regulatory transition would entail rates which were not just and reasonable. The second argument arises from the regulated utilities obligation to serve. As long as the utility had assumed an obligation to serve, investments made to honour that obligation are part of a regulatory bargain.

In a series of landmark decisions issued on May 1, 1997, the Canadian telecommunications regulator, the Canadian Radio-television and Telecommunications Commission (CRTC), ruled on how the regulatory bargain will be accommodated under price cap regulation and the rules for local competition. Lowe took issue with arguments made in the CRTC decision underpinning why stranded investments should not be recovered. He then explained that the CRTC decision implicitly recognized the existence of the bargain, and outlined the mechanism under which the telecommunications carriers had the opportunity to recover their depreciation reserve. Although his expertise is primarily in the telecommunications field, Lowe pointed out that lessons learned in this sector can be applied to the gas and electric industries as well.

Tim Brennan's speech topic was "*Stranded Costs, Takings, and the*

Law and Economics of Implicit Contracts." He spoke about stranded costs (unrecoverable, undepreciated expenses), characterizing these costs as "*the 800 pound gorilla*" representing up to \$200 billion in investments in the U.S. alone.

Brennan established that the issue of recovery is not just a question of fairness. His presentation considered the economic rationale of a regulatory bargain. Brennan then observed that it is not obvious why there should be a competitive contingency in the contract between the regulator and the utility firm.

He argued that sunk cost recovery is similar to a contract denying customers the right to switch to a competitive supplier. Observing that suppliers and customers often sign exclusive contracts which limit the exposure to competition of suppliers, Brennan asked if the standard justifications for signing an exclusive contract exists between the regulator and the firm.

Brennan then went to to examine what such a contingency provision would look like if it was explicitly included in a contract between regulator and firm. An efficient contract would consider which party could adapt to or insure against the risk of competitive entry, and it would consider which party could mitigate the damage from the contingency. For instance, if utilities were in a weak position to adapt to potential competition, or if

GLOBAL NETWORKING '97

a regulator was known to be too quick to allow competition, then firms would be allowed cost recovery. Brennan concludes that on the basis of these considerations, it is not clear, without considerably more analysis on a case by case basis, whether sunk costs should be recoverable.

Brennan's final point was that because regulation is a political phenomena, the advantages of competition and deregulation are more likely to be realized if they are not opposed by the regulated firms. To the extent that compensation stifles their incentive to oppose deregulation, cost recovery should be allowed.

Many thanks to our sponsor for the event, TELUS, and one other anonymous sponsor. Also, thanks to Dr. Jeff Church, Professor, Department of Economics at the University of Calgary for his invaluable organizational assistance.

Institute staff attended the Global Networking '97 Conference, June 15-18, 1997 in Calgary. The event was principally sponsored by TELUS Corporation and was the first joint communications conference of the International Telecommunications Society (ITS) and the International Council for Computer Communication (ICCC). ITS is an association of professionals in the information sector with an interest in the growing field of telecommunications planning, policy formulation and economic and market decision analysis. The ICCC, a non-profit corporation, was founded in 1972 as a multi-disciplinary, multi-national

NEW BOARD MEMBERS

body. The group has addressed issues that have evolved from an initial emphasis on technical issues to a broader emphasis including new applications and social, economic and policy concerns.

The program was a challenge for conference organizers to appeal to this diverse group of interests. Chaired, by Bohdan Romaniuk, President of TELUS Advertising Services, the Conference featured topics of a wide range such as International Communications, Competition in Telecommunications, Network Trends, Converging Technologies and the Future of Regulation. Three years ago in Sydney, Australia, TELUS submitted a bid to put the conference on with ITS. TELUS saw the opportunity to showcase the province's very sophisticated high-tech manufacturing companies and cutting-edge regulatory policy development capabilities. The conference was very successful, and gave participants a glimpse into the future of communications which should prove to be fascinating!

We would like to welcome the following appointments to our Board:

Harry Hobbs

Harry Hobbs is the Vice President, Transportation and Corporate Secretary for Foothills Pipe Lines Ltd., a major Canadian interprovincial natural gas pipeline company. Mr. Hobbs is the corporate officer responsible for customer service, transportation services, economic planning, rates, regulatory, government affairs, public affairs, environmental and socio-economic matters, in addition to his responsibilities as Corporate Secretary. Mr. Hobbs also serves on the Board of Directors of a number of the Foothills group of companies. Mr. Hobbs has been involved in the energy industry since 1978 and has held several positions in Foothills. He is active in industry-wide activities, including current positions as a Director of the Canadian Gas Association, and Vice-Chair of the Canadian Energy Pipeline Association, Regulatory and Public Policy Committee. He is also active in community affairs and devotes a substantial amount of time to volunteer efforts. Mr. Hobbs is a graduate of the University of Alberta.

Dr. Robert L. Mansell

Dr. Mansell received his Ph.D. from the University of Alberta in 1975 with a specialization in Regional/Resource Economics and Econometrics. He has more than 10 books/monographs in print on topics such as regulatory issues, project evaluation and MAE, an econometric model of the Alberta economy. His publications also include more than 35 book chapters and articles in journals and conference proceedings on the topics of cost benefit analysis, computer modeling, energy policy, and

resource and regional economics. He is qualified as an expert witness before the National Energy Board, Ontario Energy Board, Alberta Energy and Utilities Board, B.C. Utilities Commission, Alberta Land Compensation Board and various other regulatory tribunals. Dr. Mansell is currently Professor and Head of the Department of Economics at the University of Calgary. Courses he teaches include Macroeconomics, Regional Economics, Industrial Development and Regulatory

NEW MEMBERS

Economics. As principal of Wright Mansell Research Ltd., he has completed over 100 consulting studies since 1974.

R. J. (Rob) Ritchie

Rob Ritchie joined Canadian Pacific Limited in 1970 as a research analyst, after earning his MBA from the University of

BOARD AND MEMBER NEWS

Western Ontario, London, Ontario. He also obtained his B.Sc. from McGill University, Montreal, in 1967. In 1972, he became a marketing representative for CP Rail in Vancouver. With that, he began a career path that led to senior marketing positions in the company. By 1979, he was General Manager, Marketing and Sales, Pacific Region, covering the area from western Saskatchewan to the Pacific Coast. Two years later, he was named Assistant Vice-President, Marketing for the system. He was appointed Vice-President, Marketing and Sales based in Montreal in June 1984. In March, 1987, he was appointed Executive Vice-President, CP Rail, responsible for the activities of Intermodal Freight Systems in Toronto. In 1990, Mr. Ritchie became President, CP Rail System, located in Montreal. He held that position until he was promoted to President and Chief Executive Officer in March 1995. His many associations include: Chairman of the Railway Association of Canada, a member of The Canadian Chamber of Commerce Committee on Canada-United States Relations, and a Governor of McGill University.

We are pleased to announce the following new members to the Van Horne Institute:

- Delta Airlines
- MetroNet
- SNC-Lavalin Inc.
- Stentor Telecom Policy Inc.

Congratulations to Board member, **Mr. Paul Tellier**, President of Canadian National Railway, who has been named "Railroader of the Year" by the U.S. publication, *Railway Age*. The award cites Mr. Tellier for extraordinary leadership in guiding CN into the private sector and positioning the company for renewal and growth.

VHI MEMBERS

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 Sultran Ltd.
 TELUS Corporation
 The University of Calgary
 TransAlta Utilities Corporation
 TransCanada PipeLines Limited
 Trimac Corporation
 United Airlines

PUBLICATIONS

The Institute will publish monographs of interest, to Members and the broad community, with the goal of bringing forward existing unpublished research into the public domain. Publications must be written in industry terminology, meet Editorial Board Standards and be subject to appropriate peer review. Editorial Board members represent a cross-section of transportation and utilities research areas, comprising a mix of academics, government and industry representation with national and international

ABOUT THE VAN HORNE INSTITUTE

The Van Horne Institute has been established to address important **transportation** and related **regulatory** issues confronting industry and government, in North America and internationally, through research and education.

The Institute was incorporated federally in 1991 as a not-for-profit organization, and was granted affiliation with The University of Calgary in January 1992.

KEY CONTACTS:

PETER C. WALLIS, *President & CEO*

VIVIAN PANDER, *Programs Coordinator and Manager Administration*

CARLA FREDE, *Executive Assistant*

For more information on membership,

VHI DIRECTORS

George Addy, TELUS Corporation
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