REPORT OF THE FRANCHISE FEE REVIEW TEAM

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REPORT OF THE FRANCHISE FEE REVIEW TEAM

EXECUTIVE SUMMARY

- This report was prepared in response to potential pressures for change in Calgary's franchise fee practices. The report reviews Calgary's utility franchise fee practices and a number of perceived issues, including examination of an alternative approach to levying the fees.
- Calgary levies franchise fees on four public utilities within its boundaries: electricity, natural gas, water and sewer. The fees are payments in lieu of local taxes and other municipal fees and charges.
- Franchise fees are a significant source of revenue for The City, totaling $156.9 million in 2003 and accounting for about 12 percent of City operating revenues.
- Franchise fees rank favorably in terms of standard criteria for evaluating the quality of public revenue sources: adequacy, ease of administration and compliance, and fairness. The fees fair poorly in terms of revenue stability, being subject to the vagaries of weather and the volatile energy markets. However, market responsiveness of electricity and natural gas franchise fees is actually advantageous in that it provides a matching offset to changes in significant City energy costs.
- The fees are broadly based, inclusive of all developed properties in the city, including those exempt from property and/or business taxation. As well, the fees support a balance between taxation and other revenues, a City fiscal objective.
- A review of US and Canadian practices indicated that franchising of public utilities is widespread. Typical fees for energy utilities range between five and ten percent of gross revenues or equivalent and for water and sewer utilities eight to ten percent. Calgary, at ten percent for all utilities, is within the range of common practice.
- Conversion of the current total revenue franchise fee base to a distribution charges base was examined. The examination indicated that a revenue neutral conversion could disadvantage either consumers or The City, depending upon the choice of a base year and energy markets conditions in subsequent years. At present, and choosing 2003 as a base year, a simplified example for electricity indicates a potential disadvantage to consumers in the order of 30 percent over 2004 – 2008. In addition, conversion to a new base shifts the fee burden between customer classes since each class uses the utility systems differently. Under a distribution charges base, a calculation based on Enmax's applied applied for distribution access tariff indicates that residential electricity and small commercial customers would pay an increased franchise fee and that large commercial customers would see a reduction. Similar effects are expected for natural gas customers. Finally, a distribution charges approach exposes the franchise fees to increased policy and regulatory risk. Other Alberta municipalities who have converted have experienced ongoing reductions in their franchise fees, primarily due to regulatory actions. There appears to be little advantage, and substantial disadvantage, in conversion to a distribution charges base.
- Not all energy customers pay the same effective franchise fee rate under Calgary's current system, since market energy prices may vary from the regulated rate, upon which the fees are based. However, payment of equal effective rates by all customers is not required under present legislation.
- The electricity regulated rate tariff is due to expire July 1, 2006. After this date, the energy component of the deemed price of electricity will be set as the spot market price, applied on an hourly basis. Residential consumers, who consume much of their electricity in peak hours, will see an increase in franchise fees paid. Large commercial consumers will see a decrease.
- The proposition that converting electricity and natural gas franchise fees to an equivalent property tax would avoid the GST, saving customers 7%, was examined. This proposition is considered impractical and, in any case, the customer would not realize any savings.
- The report considers the application of franchise fees to combined energy production operations, where franchise fees are applied to both inputs to, and outputs of, the process. Since each utilizes

its own separate and distinct right of way and bears its own costs of occupation, there is no reason for these operations to be accorded special consideration in applying franchise fees.

- While there may be considerable public pressure on The City to revisit its franchise fee practices, there are substantial advantages in, and no insurmountable obstacles to, maintaining Calgary's existing approach.

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INTRODUCTION

This project was undertaken in response to potential pressures for change in Calgary's franchise fee practices and related perceived issues.[1] The report reviews Calgary's public utility franchise fee practices from a number of perspectives: rationale, history and recent evolution, and the role of franchise fees within the City's overall revenue structure.

Calgary's franchise fee practices are reviewed for reasonability, within the context of American and Canadian practice. An alternative approach to determining utility franchise fees, widely advocated, and adopted by a number of Alberta municipalities, was examined. This "alternative approach" levies franchise fees on only distribution revenues of the utility, as opposed to a levy on distribution revenues plus deemed commodity value. Other perceived issues examined are differences in effective rates between consumers, the expiry of the electric Regulated Rate Tariff (the deemed value of the commodity) in mid-2006, application of the GST to utility fees and franchise fee treatment of combined energy operations.

The review finds that there are no insurmountable technical obstacles to maintaining Calgary's existing fee structure and no compelling reasons to consider adoption of alternative approaches. There is a need to undertake an analysis of the impacts on electricity consumers and electricity franchise fee revenues arising from legislative change defining the deemed electricity energy price as the spot market price.

THE RATIONALE FOR PUBLIC UTILITY FRANCHISE FEES

Public Utilities (electric, gas, sewer and water) require, as a major input to the distribution of their products, access to rights-of-way. For the most part, such rights-of-way are owned by the local government, as owner of the street network and other public lands. It is reasonable that, if utility companies are going to use public rights-of-way and enjoy vested supply privileges, they should expect to compensate the public. Equally, local government should expect such compensation. Accordingly, various compensatory arrangements between local governments and utilities have developed to deal with the conditions of utilization of public property by utilities. Compensation may be effected by fees, taxation, or both.

From a utility perspective, the use of public lands provides the utility with the use of a significant capital input without the corresponding capital outlay and the risk that this entails. In most cases, the utility is granted an exclusive right to distribute its product, a privilege of significant value, and enjoys the right of access to maintain and expand its system. As well, the utility avoids the significant transaction costs required if rights-of-way were required to be assembled on private lands, with multiple parties involved. From a local government fiscal perspective, occupancy fees are attractive. They satisfy the requirement for prudence in the management of public assets. They contribute to diversification of the municipality's revenue base. The consumer benefits from lower utility costs than would be the case in the absence of access to public lands.

CALGARY'S FRANCHISE FEES

While Calgary has entered into utility franchise agreements since the early 1900's, a franchise fee was instituted in 1939 with Canadian Western Natural Gas (now Atco Gas). Since the early 1970's, Calgary has, as a matter of policy, managed its own electric, water and sewer utilities on the public utility model,

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[1] These fees are often referred to, variously, as Municipal Consent and Access Fees (MCAF) or Local Access Fees (LAF). Franchise Fees, as the generic terminology, is used throughout this paper.
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including application of franchise fees. The electric utility, since 1998, has operated as a separate corporation, Enmax Corporation, and a formal consent and access agreement now applies.

Municipal-utility consent and access agreements are pursuant to Section 45 of the Municipal Government Act (MGA). Section 45 provides that a municipality may grant a public utility a right, exclusive or otherwise, to provide service within its boundaries. Further, MGA Section 360 permits a municipal council to enter into a tax agreement with the operator of the public utility. Under such an agreement, the operator makes a payment in lieu of property taxes and all other fees and charges payable to the municipality.[2]

Calgary applies a franchise fee under tax agreements with electricity and natural gas providers and, by City Council policy, to water and sanitary sewer services provided by City business units. The fee is in lieu of property tax payments, where applicable.[3] For all four utility services the franchise fee rate is 10% of total revenue generated within City boundaries.[4] This results in an effective rate of 11.11 % (1/9) of the utilities' own revenue.

Until the advent of deregulation of the electricity and natural gas industries, this approach required only the straightforward application of the fee to the respective utilities' gross revenues. However, under deregulation, the electric and gas utilities were each segregated into unregulated retail and regulated distribution components.

As a result, the Municipal Government Act was amended to allow application of a deemed value to energy transported by the franchise holder (the distribution utility) on behalf of others. At present, the deemed price of electricity transported is the Regulated Rate Tariff and of natural gas the Gas Cost Recovery Rate. Both are determined the Alberta Energy and Utilities Board, as required under the Municipal Government Act.

VIEWS ON TAXATION/FRANCHISING OF UTILITIES

There are two views on utility taxation/franchising. Depending upon the jurisdiction, and its enabling legislation, the levy is either a "fee" or a "tax". For example, under Alberta legislation, a municipality and a utility may negotiate a tax agreement, for a payment in lieu of property tax. However, the Alberta Energy and Utilities Board (EUB) in its Decision 2001-52, approved a Standard Electric Franchise Agreement requested by the Alberta Urban Municipalities Association (AUMA), which incorporated applicable property taxes. The AUMA successfully argued that the franchise fee was not a tax but rather a fee paid for the use of the municipal rights of way, and incidental to property taxation. In its decision, the EUB commented that:

> *In QCTVLtd. v. Edmonton (1983), the Alberta Court of Queen's Bench held that the power of a municipality to charge a special franchise fee was "fairly implied and incidental to" the express power of the municipality to confer a special franchise fee ... the Board is of the view that municipalities may charge franchise fees in addition to imposing linear property taxes...*
>
> *The board finds that franchise fees such as the fees proposed in the Standard Agreement are not taxes. A tax is a levy a person cannot avoid paying, whether or not that person intends to use a*

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[2] The most recent version of the Electric Utilities Act, SA 2003, Chapter E-5.1, S. 138.3, provides that a municipality, as owner of an electric distribution system, may impose a surcharge or tax additional to the approved rates for its utility.
[3] As a municipality cannot waive education property taxes, the City pays these on behalf of the utility. For Atco and Enmax these amounted to $1.5 and $2.9 million, respectively, in 2003.
[4] These rates were instituted in 1974 and have remained unchanged since.

service being provided. In QCTV v. Edmonton, cited above, the court found that a special franchise was not a tax because it was "freely and voluntarily negotiated" between the municipality and the utility.

...

While many jurisdictions treat utility franchise fees as taxes, Alberta legislation and jurisprudence clearly establish utility franchise fees as distinct from taxes.

ROLE OF FRANCHISE FEES IN CALGARY'S FINANCES

Franchise fees have been a significant revenue source for the City of Calgary, as illustrated in Table 1:

Table 1
City Franchise Fee Revenues
($ Millions)

Year	Enmax	Atco`	Water & Sewer	Total
1997	44.2	28.3	20.2	92.7
1998	45.7	25.5	20.8	92.0
1999	47.5	30.2	24.2	101.9
2000	69.0	46.8	28.4	141.1
2001	110.6	59.9	26.5	197.0
2002	72.2	47.7	23.1	142.5
2003	68.5	64.4	24.0	156.9

Source: City of Calgary, Finance and Supply Management

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It is clear that franchise fee revenues in total have increased significantly over the 1999 – 2003 period. This increase can be attributed, in part, to strong economic performance and population growth, with associated general inflation. The bulk of the increase, however, stems from a coincidence of events in both the natural gas and electricity markets, resulting in substantial commodity price increases in both. Electricity deregulation came into effect January, 2001. To date, this has affected both the electricity and gas sectors. For electricity, the price has moved to a higher plateau, partly as a result of the growth in gas-fired generation in the deregulated environment. Under the new market rules, higher cost gas-fired generation plays a significant role in setting the market price.[5] Coincident with this, the gas markets have experienced a tightening of supply, in the face of increasing domestic industrial and export demand, leading to sharp increases in natural gas prices over the past few years. One effect of this has been a "cost-push" in the electricity markets. Prices for both commodities appear to have reached new higher "normal" levels. Medium term price forecasts for electricity and natural gas, however, suggest relatively modest declines from 2004 through to 2008.[6]

All franchise fees, for differing reasons, are subject to downward pressure on consumption of the commodities. For the electric and natural gas utilities, ongoing increases in energy efficiency are resulting in decreased consumption per customer, dampening growth in utility revenues. [7] [8] City policy to achieve universal water metering by 2011 will have a negative influence on water and sewer franchise fees, resulting in ongoing decreases in per capita water consumption over the next few years[9]. To date, decreases in average consumption per utility customer appear to have been offset by overall market growth. Calgary's population and employment growth, while expected to moderate over the medium term, will continue to reflect the ongoing strong performance of the Alberta economy.[10] As well, utilities are regulated monopolies and declines in consumption may reasonably be expected to encourage compensating rate increases. The circumstances suggest that, even in the face of energy and water conservation measures, franchise fees will be a continuing strong contributor to the City's revenue base, currently in the order of 12% of City revenues.

FISCAL DIMENSIONS OF THE FRANCHISE FEES

In general terms a revenue source should rank well in terms of four basic criteria: adequacy of revenues, ease of administration and compliance, revenue stability, and fairness.

Adequacy of a revenue source can be rated on its significance and its ability to yield sufficient revenues to keep pace with the economic growth of a jurisdiction. The franchise fees are significant and collectively account for approximately 12% of the City's revenues. With consumption growing in step with growth in the

[5] Energy Demand Consultants, "Alberta Electric Energy Demand & Pool Price Forecast, January Quarterly Update", p.12
[6] Ibid, Appendix, Table 17
[7] Atco Gas, in its 2003-2004 General Rate Application, Section 5.14, noted a potential decline in average annual sales per residential customer attributable to energy conservation of up to 2 gigajoules (1.5%) in 2002. Atco's 2003 and 2004 forecasts reflected 1.9 and 1.5 gigajoule declines, respectively.
[8] In EUB Decision 2004-67, "Epcor Distribution Inc. Distribution Tariff Application, 2004 Final Distribution Tariff", p.6, the Energy and Utilities Board approved a forecast 0.10% increase in average residential (electric) energy use, reduced from an historical average of 0.17% (1990-2002) "...as increases in price and energy conservation are likely to begin to offset the positive effects of income growth in the future." For commercial customers, with consumption driven by economic growth, the Board approved an annual growth rate of 2.30%, noting an historical decrease of 0.74%.
[9] City of Calgary, "Waterways", April, 2004, "CO2 Data Collection Update For The Corporation of The City of Calgary", August, 2003
[10] City of Calgary, "Budget 2004, Vol. 1, Summary"

economy and prices determined largely by Alberta's energy sector, franchise fees satisfy the adequacy criterion.

Administration and compliance costs are minimal. Collection of these fees is straightforward, with utilities calculating the amount and adding it to the customer's bill. Collecting defaults or arrears from individuals is also straightforward, as this is handled by the utility as part of its normal billing and collection process.

For local government, with stable demands for services, a corresponding stability of revenues is desirable. Calgary's franchise fees, being based largely on total (and volatile) energy costs do not fare well in this regard. Table 2 provides a sketch of year to year variability for Calgary's franchise fees.

Table 2
Franchise Fee Revenues
Year over Year Fluctuations
(Percent)

Year/Year	Enmax	Atco	Water&Sewer	Total
1997/98	3.4	(9.8)	2.9	(0.8)
1998/99	3.9	18.4	16.3	11.1
1999/00	38.7	55.0	17.4	38.5
2000/01	67.8	28.0	(6.7)	39.6
2001/02	(35.2)	(20.4)	(12.8)	(27.7)
2002/03	(4.5)	35.0	3.8	9.9

In recent years, franchise fees in total have reflected the increased volatility of the electricity and natural gas markets. Even water and sewer fees are subject to significant fluctuations, although of a lesser order.

This can be of concern to a municipality, although not particularly so if its revenue base is sufficiently diversified, and the more volatile components do not account for a disproportionate share of total revenues. The City of Calgary is in a strong position in this regard with about 54% of total (2003) operating revenue derived from property and business taxation and the remainder derived from a mix of government grants, reserves, investment income, enterprise earnings, licenses and permits, sale of goods and services and utility franchise fees.

Fairness requires that equals be treated equally. This requires that individuals in like circumstances be treated alike and individuals in differing circumstances be treated in accordance with these circumstances. Since a franchise fee is proportional to consumption of the commodity in question (the "circumstances") the equity criterion is satisfied.

In addition to their performance under the basic criteria outlined above, utility franchise fees have two desirable features. First, they are paid by institutions providing public or quasi-public services and therefore exempt from property and/or business taxation. There are a substantial number of these in Calgary (over 7,000 in 2003), notably hospitals and education facilities. Through franchise fees these entities make at least some contribution to the municipality's revenue requirement. Further, many of the services provided, particularly health and post-secondary education, are of a regional nature and it would be unfair for Calgary residents and businesses to subsidize these entirely. Second, electricity and natural gas franchise fees

vary with energy prices, reflecting Alberta's economic performance. This is advantageous to the City. While all City revenue sources ultimately reflect economic performance, the effect on energy franchise fees is the most immediate and congruent with economic conditions in Alberta's resource driven economy.

In particular, the City is a major consumer of energy, and changes in energy prices are quickly reflected in City costs. Under the current total revenue based fee structure, the energy franchise fees have recently shielded the taxpayer from significant energy price fluctuations.

Table 3
Energy Costs for The City of Calgary[a]
($ Millions)

Year	Natural Gas	Electricity	Total
1999	5.3	21.8	27.1
2000	7.4	24.9	32.3
2001	7.4	31.3	38.7
2002	7.7	29.3	37.0
2003	10.6	32.9	43.5

[a] With the introduction of the new PACE accounting system, energy costs are readily available only from 1999.
Source: City of Calgary Finance and Supply Management

From a fiscal perspective, franchise fees accord well with the criteria for a "good" revenue source. They are, individually and collectively, significant with low collection and administration costs. They do not fare as well as a stable revenue source, being subject to energy market fluctuations. Despite this, volatility is manageable and, since franchise fees provide an offset to fluctuations in energy prices, volatility actually offers an advantage. The fees are fair according to generally accepted standards of public finance practice. Benefits to the consumer are proportional to consumption, and equal treatment of equals is assured. Franchise fees also contribute an element of general fairness to the City's revenue base in that franchise fee coverage extends to all residences, businesses and institutions, including those exempt from property and/or business taxation. Finally, franchise fees significantly support a balance between taxation and other revenue sources.

PERCEIVED ISSUES WITH CALGARY'S FRANCHISE FEE PRACTICES

The issues relate to both the fees and the manner in which the fees are levied. The electricity industry and the Provincial Government are increasingly being challenged on the success of deregulation. The promised benefits to the average Albertans are not being realized as the monthly bills are both higher than previously and more difficult to understand. The gas industry has been subjected to sharp escalation in natural gas prices resulting from growth in demand and a tightening of supply North America wide. As the energy utilities' franchise fees are passed on to consumers and are shown as a separate item on the bill, these particular charges are obvious targets for the consumer, industry players and the Provincial Government.

An Overview of Utility Franchising Practices

As with many taxes and fees, there is a perception that the franchise fees are excessive or unwarranted. This proposition can be examined relative to practices in other North American jurisdictions. An exhaustive review of U.S. and Canadian practices is beyond the scope of, and not essential to, this review. It is, however, helpful to enumerate examples from various jurisdictions to illustrate the range and nature of utility franchising and taxation practices.

This illustration is complicated by the advent of electric and gas utility deregulation over the last decade. Not all jurisdictions are at the same stage in the deregulation process nor have all responded in identical ways to the changes in utility taxation/franchising required by deregulation.

The utility franchising practices of a number of US jurisdictions were examined. The results presented, for four of these jurisdictions, reasonably reflect the various US practices.

The City of Baltimore, prior to 1999, levied a gross receipts tax (8%) plus property and other local taxes on electric and gas utilities. The State of Maryland concurrently levied a gross receipts tax (2%); a franchise fee (2%) and a sales/use tax (5%). After deregulation of electricity in 1999, both city and state devolved to a tax per physical unit consumed, with the state retaining its 2 % franchise fee. Both jurisdictions targeted revenue neutrality, with Baltimore's tax rate adjusted annually to ensure this outcome.[11] Baltimore does not levy franchise fees, or equivalent, on its municipally owned water and sewer utilities[12]

A utility serving Spokane, Washington faces a combined state and local tax levy of 10% of gross utility revenue, with the municipality taxing both electricity and natural gas at 6%. City-owned water and sewer utilities are both subject to an imputed tax of 17% of gross revenue.[13] The State of Washington has not yet deregulated its electricity sector.

Prior to deregulation, Ohio levied a public utility excise tax of 6.75% on pipeline companies and 4.75% on all other utilities, and a state property tax, at four times the state's industrial property tax rate.[14] Upon electricity deregulation in 1999 the utility property tax rate was aligned with the general industrial rate and a unit tax, designed to ensure revenue neutrality, was implemented for both electric and gas utilities. The revenue is distributed to municipalities on a formula basis.[15]

Los Angeles currently employs a "utility user's tax" of 10% on electricity and natural gas for residential users. Industrial users pay 12.5% on electricity and 10% on natural gas. Los Angeles levies 5% of prior year gross operating revenue on its water system.[16] [17]

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[11] City of Baltimore, "Summary of the Adopted Budget, General Fund Revenue Forecast, FY 2002"
[12] Schachtel, Marsha R.B., et al, "Alternative Revenue Sources and Structures for Baltimore City" (Excerpts), Johns Hopkins Institute for Policy Studies, 2002
[13] City of Spokane, "Spokane Municipal Code, Listing 13.01.0316", Effective 1/14/98, and "Utilities Tax Return", 2004
[14] Harrington, Cheryl & Lazar, Jim, "Improving State Electricity Taxation", The Regulatory Assistance Project, Gardiner, Maine, 2002
[15] Ohio Department of Taxation, "Public Utility Excise Tax", Bulletin, 2000, "Public Utility Property Tax", Bulletin, 2000, and "Instructions for Completing Natural Gas Distribution Company Tax Return", 2004
[16] Schachtel, Marsha R.B., et al, "Alternative Revenue Sources and Structures for Baltimore City", Johns Hopkins Institute for Policy Studies", 2002
[17] City of Los Angeles, "Revenue Outlook, Supplement to the 2004-05 Proposed Budget", April, 2004
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Across Canada, there are equally varying compensatory arrangements for access to municipal rights-of-way. In British Columbia, the prevailing franchise fee across the Province and across utilities is 3% of gross revenues. British Columbia is in the process of converting traditional natural gas franchise agreements to "operating agreements". Among other provisions, the regulatory authority has directed one natural gas utility to "...seek a method in future agreements to convert the fee to a charge on Utility Margin, so as to stabilize the costs to utility consumers".[18] Vancouver levies an additional revenue tax on BC Hydro of 1% and 1.25% on Terasen (formerly BC Gas). Both are subject to property tax, with BC Hydro, as a Crown corporation, paying a grant-in-lieu of property tax.[19] Victoria relies on property taxes (Terasen) and grants-in lieu of property tax (BC Hydro). Notably, both Vancouver and Victoria employ a multi-class mill rate system: Victoria with five property classes and Vancouver with six, each with a "utilities" class. In both cases, the tax rate for this class (upon which a grant-in-lieu of taxes would be based) is about double the tax rate for "typical" businesses[20] [21]

In Saskatchewan, the standard for electric utilities is 5% of gross revenues for towns and villages and up to 10% for cities.[22] For natural gas, the fees range from 3% to 5%. The Saskatchewan electricity market is deregulated at the wholesale level and gas markets are fully deregulated. Saskatchewan's practice in natural gas franchise fee determination is similar to Alberta practice as allowed under Section 360 of the Municipal Government Act, in the context of accommodating retailer sales within the mandate of a Crown corporation, Saskenergy. Depending on the circumstances, a deemed value of transported gas may be calculated as either the provincial average gas price for the preceding month or Saskenergy's current charge applicable to full service customers. The first option applies to direct sales customers, those who purchase natural gas from a retailer and are billed directly by same, as in Alberta. The second option applies to customers of retailers on whose behalf Saskenergy provides billing services.[23]

The City of Regina levies a 10% surcharge on the customer's electricity bill and a further 5% of Saskpower revenues earned within the city limits. As Saskpower is a Crown corporation, the latter levy is denoted a payment in lieu of taxes. Natural Gas Service is provided by SaskEnergy and its subsidiary, Transgas. SaskEnergy collects a 5% surcharge on the customer's bill. Transgas collects a 5% surcharge, calculated on distribution charges plus a deemed cost of gas, for gas transported on behalf of a retailer. Water and sewer utilities provide a "utility surplus transfer" of 8.9% of billed revenues for the prior year.[24]

The City of Saskatoon owns its electrical distribution utility and levies a 10% surcharge on the customer's bill. As well, the electric utility pays a grant-in-lieu of property tax to the city. This "grant-in-lieu of taxes" differs from the customary local government usage of "equivalent to property tax" in that it is calculated as 13.64% of gross revenue. Saskatoon also collects a similar grant-in-lieu from its water and sewer utilities, with water at 10.85% and sewer at 5% (both net of revenue designated for capital reserves).

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[18] British Columbia Utilities Commission, "Terasen Gas, Inc., Reasons for Decision, Application for Approval of Operating Agreement and Addendum with the Corporation of the District of Salmon Arm", Vancouver, B.C., September 5, 2003. "Utility Margin" is BCUC's term for distribution charges.
[19] BC Hydro and Power Authority Act, Section 34

[20] City of Vancouver, "Property Tax Rates and Property Tax Levies (2003)"
[21] City of Victoria, "Property Tax Rates 1998-2002", 2002 Annual Report
[22] The Power Corporation Act, Revised Statutes of Saskatchewan, Ch. P-19
[23] The Saskenergy Regulations, Chapter S-35, 1992, as amended.
[24] City of Regina, "2003 Budget Forecast, General Operating Revenues"
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Saskpower also supplies electricity to Saskatoon residents outside the local utility's franchise area[25] and pays a grant-in-lieu to the city of 5% of its gross revenues from this source. SaskEnergy's natural gas franchise fee amounts to 5% of the cost of supply and delivery of natural gas in the City of Saskatoon.[26 27]

Winnipeg levies electricity and gas taxes, each at 2.5% of domestic electricity and natural gas consumption and 5% for commercial consumption, but exempting the commodities' use for space heating.[28] Manitoba Hydro, as a Crown corporation, pays a grant-in-lieu of property taxes for municipal and education purpos es. Winnipeg collects a 10% of gross revenue levy on its water system and a 10% levy on sanitary sewer charges. Both utilities also make a payment in lieu of property taxes.[29 30]

Ontario municipalities may not charge fees for the use of municipal rights-of-way and are restricted to property tax.[31] Toronto's water and sewer utilities, both city departments, are subject to payment in lieu of property tax. [32]

Newfoundland and Labrador levy a provincial "business tax" on utilities of 2.5% of gross revenue. A municipality is allowed to levy a further 2.5%, in addition to property taxes and municipal fees and charges.[33 34]

Most Alberta municipalities collect franchise fees, from one or both natural gas and electric utilities.[35] The general practice in Alberta, until quite recently, has been to compute the franchise fee as a percentage of the gross revenues of the utility, currently based on a deemed value of the commodity, in lieu of taxes payable to the municipality. The Province levies an education property tax, which is paid by the municipality on behalf of the utility. For example, in 1985, the rate in Calgary, Edmonton and Lethbridge was 10%, Grande Prairie 8%; Red Deer 7.75%; Camrose and Wetaskiwin 7.5%; Spruce Grove and St. Albert 5%. The majority of Alberta municipalities continue this practice, with most of them falling within the 5-7 percent range. However, some municipalities have chosen in recent years to base their electricity and natural gas franchise fees on distribution charges only, including Edmonton, Lethbridge and Red Deer.

The City of Edmonton recently further revised its distribution charges fee for electricity. It is now based on a flat fee of $26,658,000 collected at a rate per kilowatt hour and escalated annually at the rate of consumer price inflation plus 1.5 percent. The utility is liable for all city taxes and fees.[36] The natural gas franchise fee, also recently renegotiated and approved by the Alberta Energy and Utilities Board, is calculated as 33.4 percent of natural gas distribution costs, in lieu of property taxes and fees[37]. Edmonton's water utility is subject to a franchise fee of 7.6 percent of gross revenues plus property and business

[25] The local utility's franchise area is that area within the 1958 boundaries of the municipality
[26] City of Saskatoon, "2003 Operating Budget, Vote 03 – Grants in Lieu of Taxes"
[27] City of Saskatoon, "Cross Charges Levied on Civic Utilities and Boards", 1992
[28] "Commodities' use for space heating" is defined as consumption over and above the average consumption for June, July and August for natural gas and for electric heating 80% of the total bill
[29] Manitoba Hydro Act, Section 43
[30] City of Winnipeg, "Preliminary 2004-2006 Operating Budget"
[31] Ontario Energy Board, "Model Natural Gas Franchise Proceeding, Decision", April 11, 2001, citing Ontario Regulation 61/01, 2001
[32] City of Toronto, Water & Wastewater Services, "Annual Report, 2002"
[33] Newfoundland and Labrador, Taxation of Utilities and Cable Television Companies Act, 2004, City of St. John's Budget, 2004
[34] City of Saint John's, "2003 Fiscal and Service Strategy"
[35] In a recent decision (Decision 2004-072), the EUB noted 126 franchise agreements with Atco Gas. Atco Electric reports 85 electricity franchises ("Electric Service Tariff, 23/07/02"). Altagas and FortisAlberta account for additional franchises.
[36] Franchise Agreement Between The City of Edmonton and Epcor Distribution, January 1, 2004
[37] Alberta Energy and Utilities Board, "Decision 2004-72, City of Edmonton, Natural Gas Franchise Agreement with ATCO Gas and Pipelines Ltd.", August 31, 2004

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taxes[38]. Its sanitary sewer utility is subject to a levy of 8% of gross revenues and a similar levy on gross revenues of the land drainage utility is contemplated, to be implemented by 2014.[39]

The City of Lethbridge collects a levy of 31% on electricity distribution costs and a similar levy of 32.3% on natural gas.[40] Lethbridge also levies a fee of 8% of gross revenues on its water utility as a "contribution to relief of taxation".[41]

These examples of US and Canadian practices in utility franchising illustrate the general characteristics of utility franchise fee/taxation practices. Utilities are generally taxed at higher levels than non-utility firms. This is effected through utility-specific taxes and/or occupancy fees. Historically, the predominant theme has been a tax/fee on gross revenues of the utility in combination, or not, with property taxes. Deregulation has occasioned two approaches to dealing with the question of separation of the regulated distribution and the unregulated retail functions. US approaches have involved the direct application of sales or use taxes to the consumer, or the levying of a unit tax on the commodity. In Canada, the levy of the equivalent of a unit tax is practiced in Alberta and Saskatchewan, with the option of levying franchise charges only on distribution revenues preferred in British Columbia and allowed in Alberta. In both Canada and the US, property taxes may be levied at higher rates for utilities, as opposed to non-utility industries. Combinations of provincial/state and local taxes are not uncommon, although Canadian provinces in general do not levy utility-specific taxes. Utility franchising, in its various forms, is a widespread and generally accepted practice. Although the fee/tax differential may vary across jurisdictions, the intent is clear that utilities, because of their extensive use of public lands and special privileges, should pay appropriate compensation.

Changes occasioned by deregulation complicate comparisons between jurisdictions. A fee based on gross utility revenue (or its equivalent) appears to be quite different from a fee based only on distribution revenues. For example, Lethbridge now applies a 31% rate on electricity distribution revenues, where formerly this city levied a 10% rate on gross revenues. In fact, both rates, at least at the outset, yield equivalent revenues, given revenue neutrality.

Edmonton's electricity franchise agreement does not apply a rate directly, relying on a base year flat fee with escalator provisions. It is believed that the flat fee is derived from the utility's distribution charges, but the agreement is not explicit on this point.

Nominal rates may be applied differently. For example, Calgary's nominal rate of 10% equates to an effective rate of 11.1%. This arises because the total charge to the consumer is regarded as the sum of the franchise fee and the utility's charges. Other jurisdictions may take this approach, or may apply the nominal rate directly to the utility charges.

Interjurisdictional comparisons are further complicated by property taxation or absence thereof. Most Canadian jurisdictions levy property tax in addition to franchise charges. In one case, Vancouver, the property tax is levied at twice the rate for a "typical" business. Saskatoon, in addition to an electricity franchise fee of 10% of gross revenue, also calculates additional levies on its municipally-owned electric distribution and sewer and water utilities as percentages of gross revenue, denoting these as "payments in lieu of tax." Regina levies a similar fee on its municipal water system. Calgary and most other Alberta municipalities, as mentioned previously, forego municipal property and other taxes and pay the Provincial

[38] City of Edmonton, Council Agenda Item G.1.a, "Transfer of the City's Water Utility Assets to EPCOR Utilities Inc.", 1998 and Agenda Item E.1.m, "EPCOR Water Services Inc. Franchise Agreement", 2003
[39] City of Edmonton, "Utility Fiscal Policy", April 29, 2003
[40] City of Lethbridge, "Electric Wire Services", Budget Office
[41] City of Lethbridge, "Summary of Fiscal Principles, Practices and Policies", 2004

education tax on behalf of the electric and natural gas utilities. This practice lowers the effective rates for these utilities. Conversely, jurisdictions levying property taxes have a higher effective rate.

While the differences in practice between jurisdictions render precise comparisons and rankings unattainable, it appears that preferred franchise rates for electric and natural gas utilities range from 5 -10 percent of gross revenue, or equivalent, plus property taxes. Many sewer and water utilities, all municipally owned, are subject to some form of "revenue taxation". Alternatively, municipally owned sewer and water utilities may be subject to an imputed property tax, as in Toronto. Generally, those municipalities who levy fees on their sewer and water utilities seem to prefer a rate of 8-10 percent of gross revenue[42], including Calgary at 10 percent. Calgary is within the range of common practice, for all utilities.

Converting to a Distribution Charges Base for Franchise Fees

Calgary's franchise fees are based, in part, upon deemed commodity value and the amount collected varies with commodity prices, with these set by natural gas and electricity markets for the major contributors, the energy utilities. Energy markets, in recent years, have tended to be quite volatile and City franchise fees have mirrored this volatility. More importantly, the fees amplify the effect of commodity price movements for individual consumers. Many utility customers do not believe The City should be benefiting from price spikes, especially when consumers may already be experiencing budgeting difficulties because of the higher commodity prices. The alternative advocated is to base franchise fees only on the utilities' distribution charges, usually with property taxes.

The distribution charges approach, under revenue neutral conditions, has some intuitively appealing characteristics. The consumer's payment is based on the cost of transporting the commodity and likely a share of the utility's property tax bill, both independent of commodity prices. Consumers, as a group, are paying about the same amount as before and neither transportation costs or property taxes exhibit short term volatility. From the municipality's point of view, the revenue source is stable and growth-responsive. Under revenue neutrality, the municipality should be indifferent as to how the fee is calculated. These are substantially the arguments advanced by some critics, who also argue that since the franchise fee relates to the use of municipal rights-of-way for the distribution of a commodity it should be based only on distribution revenues. These premises appear to underlie moves in Alberta to distribution charges franchise fees, commonly with property taxes, with conversion subject to revenue neutrality.

There are three issues to be considered in a decision to convert from one fee system to another: choice of a starting point, inter temporal effects and impacts on individual consumer groups. The first two issues stem from the condition of revenue neutrality on conversion. Some perspective on these is provided by considering the implications of revenue neutrality in light of historical and forecast price movements and trends. The impacts on consumer groups of converting the franchise fee base to a "distribution only" mode are examined by calculating franchise fee burdens by customer class under both approaches.

Recent historical and medium term forecast prices for electricity and natural gas are presented in Table 4.

Table 4
Average Annual Electricity and Natural Gas Prices

[42] Some municipalities also "franchise" their solid waste services, for example Spokane and Lethbridge. Saskatoon "franchises" its transit system.

Year	Electricity Cents/kWh	Percent Change	Natural Gas Dollars/GJ	Percent Change
1999	4.3		2.75	
2000	13.3	209.3	5.45	98.2
2001	7.2	(45.9)	5.17	(5.1)
2002	4.4	(38.9)	3.88	(25.0)
2003	6.3	43.2	6.36	63.9
2004	5.4		6.00	
2005	5.1		5.20	
2006	5.5		5.00	
2007	4.9		4.70	
2008	4.2		4.80	

Source: EDC Associates Ltd., Alberta Electric Energy Demand & Pool Price Forecast, 2004-2018, January 31, 2004-11-23

These markets have been subject to significant annual fluctuations over the last few years. The electricity market is particularly notable for an extreme price spike in 2000 with a carryover of higher prices to 2001. While electricity markets will continue to exhibit volatility, in part due to volatility in the natural gas market, such extreme price behaviour is not expected in the future. Simply put, the 2000 experience was an anomaly attributable to deregulation of the electricity markets in that year, exacerbated by coincident upward price movement in the natural gas markets. Even so, both markets exhibited significant price movements in 2002 and 2003, positive and negative.

There is some difficulty in choosing a "fair" starting point, in that neither consumers nor the municipality should be disadvantaged at the outset by the revenue neutrality condition. By extension, this disadvantagement could easily persist over time. The degree of difficulty is apparent from the data of Tables 1 and 4.

The revenue to be derived from distribution charges required to achieve neutrality is dependent upon the year or years in question chosen as a base. Not only are the commodity markets volatile in the short term, they adjust to new "normal" price levels over the medium term. This is evidenced by the post 1999 natural gas markets and the post deregulation electricity markets. The risk here is symmetrical for the municipality and the consumer. If overall revenue neutrality is based on a period of prices which subsequently drop, consumers are unnecessarily penalized and the municipality benefits unduly. If the converse market situation occurs, the roles are reversed. Casual examination of the historical and forecast data of Table 4 suggests that either scenario is plausible on a year-to-year basis.

An indication of the potential harm, in this case to consumers, can be illustrated by an example based on the data in Table 4. If an electricity agreement based on distribution charges had been concluded on the basis of revenue neutrality, on a 2003 base, consumers would have been disadvantaged at the outset by about 14 percent, on the basis of commodity price effects alone. Over 2004-2008, consumers would have experienced a cumulative disadvantage arising from price effects of some 33 percent.[43]

[43] The results are illustrative only, since forecasts of the deemed commodity value are not available. Instead, the example employs market price movements as a proxy for deemed value movements and resultant changes in the franchise fee. Further, the calculation implicitly assumes that distribution rates remain constant over the forecast period.

The City of Lethbridge converted its natural gas franchise to a distribution charges base in 1999. From the data of Table 3, it appears that the municipality has foregone significant revenues over the past few years. The City of Edmonton converted its natural gas franchise fee in 1995, a period of low gas prices, resulting in a similar disadvantage to this municipality.

The above illustrate the generic problem with any conversions of tax/fee systems on the basis of revenue neutrality. The more volatile the initial base, the less likely equitable revenue neutrality can be achieved. To the extent that this pertains, either stakeholder may be immediately disadvantaged and likely over some period of time. Some jurisdictions, notably Baltimore, Edmonton and those jurisdictions utilizing the AUMA Standard Electric Franchise Agreement have attempted to address this possibility by providing for periodic adjustments of their franchise fees. However, it is not clear as to what a reasonable basis for adjustment might be, given a conscious choice of a different revenue base.

Conversion to a different revenue base results in different determinants of a consumer's fee burden and the total burden of the fee will be differentially shifted among consumer groups. In the case of converting to a distribution charges base a customer's relative burden is determined by the ratio of distribution charges per unit of the commodity. A higher proportion of distribution costs results in an increased fee burden upon conversion.

Table 5 provides an illustrative example of shifts between rate classes under a revenue neutral conversion to a distribution charges base.

Table 5
Impacts by Rate Class
Conversion to a Distribution Charges Based Franchise Fee

Class	Distribution Revenue ($ 000's)	Total Sales (MWh)	Distribution Revenue/ Total Sales ($/MWh)	Value Based Franchise Fee[a] ($ 000's)	Distribution Based Franchise Fee[b] ($ 000's)	Relative Change in Franchise Fee Paid (Percent)
Residential	76,523	2,379,494	32.16	22,771	27,242	19.6
Small Commercial	11,659	445,810	26.15	3,969	4,151	4.6
Medium Commercial	32,838	1,319,678	24.88	11,563	11,690	1.1
Large Commercial (Secondary)	41,221	2,004,216	20.57	16,600	14,674	(11.6)
Street Lighting	1,710	84,132	20.32	695	608	(12.5)
Large Commercial (Primary)	35,145	1,899,355	18.50	15,297	12,511	(18.2)
Totals	199,097	8,132,683		70,895	70,876	

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[a] Calculated as the sum of 11.1 percent of Distribution Revenue plus $6.00 per MWh multiplied by Total Sales.

[b] Calculated as 35.6 percent of Distribution Revenue.

Table 5 is constructed from information in Enmax's 2004 distribution tariff application and 2004 regulated rate tariff application.[44] A franchise fee based on distribution charges of 35.6% is required to achieve revenue neutrality between the two franchise fee approaches.

While the data are "applied for" values, final approval by the regulator is not expected to materially affect the relative results. Accordingly, Table 5 provides a realistic indication of the magnitude and direction of shifts in the fee burden upon conversion. Under this scenario, the residential consumer would see nearly a 20 percent increase in the franchise fee, with lesser increases for small and medium residential consumers. The beneficiaries of the new system would be the large commercial customers, with 12 to 18 percent fee reductions. Similar patterns would be expected for natural gas consumers.[45]

A further concern with a distribution only fee is that it is relatively more open to policy risk than a total value based approach. As an example, the recently announced Provincial policy on funding transmission could alter fee yields for electricity. The former policy had regulated transmission costs split equally between consumers and producers. The consumer's portion was reflected through the Distribution Access Tariff with the producers' costs ultimately passed on to the consumer through the delivered commodity price. The new policy reallocates producer's costs to be the responsibility of the consumer and translates to an increase in regulated distribution charges. In principle, this should not change the final cost to the consumer, owing to an expected offsetting reduction in the commodity price and should have no impact on The City's current franchise fee revenues. In practice, the expectation of a flow through of producers' cost reductions is grounded in the existence of effective competition in electricity markets and not all sectors of the economy enjoy competitive electricity supplies. To the degree competition is lacking in a particular sector, both The City's current system and a distribution charges approach will disadvantage electricity consumers in that sector, although less so under the current system.

Regulatory risk is always a concern, more so with a franchise fee based on distribution charges. While a total value based fee is also subject to the same regulatory risk on the distribution component, the overall impact is relatively less since a distribution charge reduction is spread over the total value base. In the recently approved sale of Atco Gas' customer base to Direct Energy Ltd., rate unbundling resulted in a "pipe rate" decrease of 4.82 percent, translating directly to a corresponding decrease in distribution based franchise fees.[46] Between 1996 and 2003, Edmonton's gas franchise fee revenue declined from $24.9 million to $20.7 million, as a result of ongoing distribution rate reductions.[47] [48] While distribution charges are

[44] Enmax Power Corporation, "2004 Distribution Tariff Application No.1306819, Schedules 12.1 and 12.26"

[45] A City of Edmonton administrative report (Bylaw 13600, Attachment 3) suggests natural gas distribution costs/sales ratios of $2.16/gigajoule for residential consumers, declining to $1.08 and $1.04 per gigajoule for medium and large commercial consumers, respectively.

[46] Atco Gas, "2003 Rate Unbundling Application, Information Response No. 1 to Alberta Urban Municipalities Association and The City of Edmonton"

[47] City of Edmonton, Bylaw 13600 – A Bylaw to Approve the Renewal and Amendment of the Franchise Agreement with Northwestern Utilities Limited, Attachment 3

[48] Atco Gas North, "History of Rate Adjustments for Residential Customers", June, 2004

ultimately driven by inflationary pressures, with the expectation of ongoing increases over the longer term, regulatory actions can reduce or even reverse these in the short to medium term, exposing municipalities relying on a distribution charges base to corresponding franchise fee revenue reductions.

Divergence Between Deemed Rates and Actual Rates

Not all customers pay the same effective rate. In both electricity and gas markets, there are regulated and deregulated segments, with "deregulated" customers paying contract rates which may vary significantly from regulated rates. The electricity franchise fee is based on the Regulated Rate Tariff (RRT), and the natural gas franchise fee is based on the regulated Gas Cost Recovery Rate (GCRR), regardless of what the customer is actually paying. A customer purchasing the commodity at more than the regulated rate would have a lower effective rate; conversely, a customer purchasing at less than the regulated rate would have a higher effective rate.

The application of a deemed value to the transported commodity is defined in legislation.[49] Briefly, the legislation allows for "... the deemed value per unit quantity ..." without reference to customer class.[50] It is not required that the deemed rate be determined by the actual energy price, only that it be fairly determined.[51] Exposure to possible discrepancies between nominal and effective rates is limited to the commodity portion of the bill, to a degree mitigating the effective rate discrepancy. Moreover, the deemed rate reflects general market conditions.

Basing Deemed Electricity Rates on Spot Market Prices

Some larger electricity customers have advanced the position that the practice of using the residential RRT as the deemed rate penalizes them on two counts. Their view is that an appropriate deemed rate would be based on Power Pool hourly prices, so as to better reflect their prices paid and load profiles. Effectively, they are asking that the franchise fee be calculated on a flow through basis, as discussed below.

The electricity Regulated Rate Tariff is due to expire July 1, 2006.[52] After that date, the energy component of the deemed price for electricity will be set by legislation as the Power Pool Price and this price fluctuates hourly. While hourly electricity prices can fluctuate drastically, for billing and fee calculation a monthly average is required, which would substantially smooth out hourly price movements. The approach does not pose serious problems from a computational point of view, with the calculation performed on a daily after the fact basis. The methodology was employed by ATCO Electric for its regulated rate customers, and is carried on by its successor, Direct Energy.

Basing the deemed value on flow through pricing has differing implications for the various electricity customer groups, owing to the matching of the hourly price with an individual's consumption profile. An electricity consumer with a relatively flat load profile would see a lower average deemed price as compared to a customer whose greater proportionate consumption occurs during system peak hours, when prices are highest. For example, on-peak Power Pool prices, in 2003, averaged 7.73 cents per kilowatt hour and off-peak 4.35 cents per kilowatt hour.[53] Relatively, the first customer's franchise fee payment would decrease

[49] Municipal Government Act, Section 360(1)
[50] ENMAX Power Corporation, "2004 Distribution Tariff Proceeding, Reply Argument 12.2.1"
[51] The "fairness" requirement is implied by the requirement for regulatory approval of franchise agreements
[52] Alberta Regulation 168/2003, Electric Utilities Act, Regulated Default Supply Regulation

[53] EDC Associates, Ltd., op. cit.

and the latter customer's payment would increase. Typically, those consumers with stable load profiles are large commercial and institutional establishments; those with peak-concentrated usage are small commercial and residential entities. To a degree, flow through pricing will address the concern of large electricity consumers that using the RRT as the deemed price does not incorporate load profile effects into the franchise fee calculation. While this would work to the advantage of the larger consumers, the impacts of flow through pricing on the small consumer and franchise fee revenues are likely negative.

Avoidance of the Federal Goods and Services Tax

As the fee is based on the use of a municipal asset, the Federal Government has deemed the fee to be GST-eligible. Opponents of the GST argue that the franchise fee should be replaced by an equivalent (in the sense of revenue neutral) property tax, in order to save consumers seven percent. However, an equivalent property tax is not permitted under Alberta legislation. This would require a special mill rate category for utilities, in addition to the one non-residential category prescribed by the Municipal Government Act. As well, even if this could be achieved by legislative change, the property tax would be a recoverable cost to the utility, distribution rates would be increased to cover this cost and the commodity value would still be GST-eligible. The validity of this proposition is questionable.

Treatment of Combined Energy Operations

In some instances, natural gas is used to generate electricity or to produce steam (combined energy operations). This can occur with a gas fired power plant, co-generation, or a district energy system. Since electricity and natural gas are subject to their own franchises, a franchise fee is paid on the inputs to the process and on the outputs. The consumer pays both. This situation leads to the proposition that combined energy operations should be subject to reduced franchise fees since they are held to be "paying the fee twice". However, each commodity uses a separate and distinctive right of way and a "doubling up" of the franchise fees is not occurring since each input or output is charged on its individual merit and each fee is a legitimate production cost of the end product.

OBSERVATIONS AND CONCLUSIONS

Utility franchise fees are an important component of the City's revenue portfolio, at 12 percent of total City revenues. In terms of criteria for ranking a revenue source in terms of its fiscal desirability, the fees rank highly on three of four criteria: adequacy, ease of compliance and administration and fairness. The major sources, electricity and natural gas, based on volatile energy markets, rank poorly against the stability criterion. Volatility, however, is actually advantageous to the City, and indirectly to the local taxpayer, in that it provides a corresponding offset to City energy costs.

From an overall fiscal policy perspective, franchise fees contribute significantly to a balance between tax revenues and other revenues, a desirable outcome. The fees are broadly based, inclusive of all developed properties in the city. As such, properties exempt from property and/or business taxation still pay the franchise fees, providing some contribution to The City's revenue requirement.

Franchising of utilities is widely practiced in both Canada and the United States. In Alberta, more than 200 utility franchises are in effect, covering most municipalities. A parallel situation pertains in British Columbia and Saskatchewan. Franchise fee practice varies across jurisdictions, although there is apparent consensus that utilities' fees/taxes should reflect the value of their franchises. There is less consensus on

the magnitude of this value, although major cities generally command a higher tariff. This should not be surprising, since the larger markets are disproportionately more valuable to a utility. In Alberta, larger centres generally collect fees of up to 10 percent of gross revenues, or equivalent.

A number of Alberta municipalities have opted to base their franchise fees on distribution costs, as a replacement for the total value approach. In the near term, either system can produce about the same results, given revenue neutrality. Unfortunately, equitable revenue neutrality is extremely difficult to achieve. Revenue neutrality, for a fee derived from volatile markets, is almost certain to disadvantage either the consumer or the municipality immediately and likely over some period of time. Conversion to a different revenue base results in significant shifts in the fee burden between customer groups. Larger customers pay proportionately less in fees post conversion and smaller customers more.

Volatility in electricity and natural gas markets appears to be the primary motivation for converting to a distribution charges model. While a total revenue based fee increases with market prices, it also allows the consumer the benefit of market price reductions. In contrast, a distribution charges based fee normally only increases over time, although regulatory actions can erode the base in the short to medium term.

Compared within the framework of standard criteria for revenue source evaluation, both the distribution charges and the total revenue approach satisfy the requirement for adequacy in that both are significant and responsive to conditions in the economy. However, Edmonton's experience demonstrates that regulatory actions can negate any economic responsiveness of a fee based only on distribution charges. Owing to its deemed commodity price component, the total revenue approach is more responsive and is superior in an adequacy sense. The two are equivalent in terms of ease of compliance and administrative costs. A distribution charges fee is superior from a stability standpoint. For the municipality, foregoing a market responsive revenue source, and the consumer, likely facing only an ever increasing fee, this may be a mixed blessing. In terms of fairness, the two approaches are roughly equivalent.

A distribution charges fee, being determined by only the regulated component of the product value, is more exposed to regulatory or policy risk. Policy changes in the past have resulted in shifts of costs between the commodity and the distribution segments. This risk is symmetrical for all stakeholders.

The only clear advantage in changing from a total revenue model to a distribution charges model is stability of franchise revenues. Achievement of this objective is not considered to merit changes in present Calgary practice, in light of the potential risks and disadvantages to both the municipality and consumers.

On balance, franchise fees are a widely accepted feature of the local fiscal landscape. Calgary's fees and range of application are comparable to those in many similar jurisdictions, particularly in Alberta. The determination of the fee, using a combination of distribution charges and a commodity unit rate, is superior to alternatives in view of near and potentially longer term problems and risks.

Upon termination of regulated rates in mid-2006, a conversion to deemed price determination using Power Pool (spot market electricity) price will be required to maintain the total value based system. While computation of the new deemed value of transported electricity is straightforward, there could be significant differential effects on consumer groups and fee revenues. An impact analysis of this change should be undertaken well before the conversion date.

Certainly, deregulation of the electricity sector and increasing prices for both electricity and natural gas, coupled with price volatility in both markets, are attracting consumer attention. While there may be considerable public pressure on The City to revisit its franchise fee practices, there are substantial advantages in, and no insurmountable obstacles to, maintaining Calgary's existing franchise fee systems.

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