COURT FILE NO.: 307/08
DATE: 20090427

ONTARIO
SUPERIOR COURT OF JUSTICE

DIVISIONAL COURT

Swinton, Low and Karakatsanis JJ.

B E T W E E N:	
	James Douglas, for the Appellant
TORONTO HYDRO-ELECTRIC SYSTEM LTD. Appellant	
- and -	*Michael Millar,* for the Respondent
ONTARIO ENERGY BOARD Respondent	
- and -	*John De Vellis*, for the Intervenor
SCHOOL ENERGY COALITION Intervenor	
	HEARD at Toronto: March 30, 2009

KARAKATSANIS J.

[1] The appellant, Toronto Hydro-Electric System Ltd. (THESL) appeals s. 3.4 of Ontario Energy Board (OEB) Decision EB-2007-0680 dated May 15, 2008. The OEB allocated the net after-tax gains on the sale of three properties by the appellant to reduce the appellant's revenue requirement for 2008 and thereby reduced electricity distribution rates to ratepayers.

[2] The appellant submits that the OEB exceeded its jurisdiction in this allocation as it had no jurisdiction to appropriate the proceeds of sale to the ratepayers. It further submits that by allocating the entire net after tax gain on the sale of the properties to reduce the appellant's revenue requirement, the OEB granted ratepayers a property interest in the property of the utility, contrary to principles of corporate law and the Supreme Court of Canada's decision in *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, [2006] 1 S.C.R. 140.

[3] The respondent and the intervenor take the position that the OEB was acting within its rate setting authority and expertise and that deference is required. Furthermore they submit that the OEB was entitled to offset the proceeds of sale from the revenue requirements and made no errors of law in so doing.

[4] An appeal to this Court lies only on a question of law or jurisdiction pursuant to s. 33 of the *Ontario Energy Board Act, 1998*, S.O. 1998 c. 15, Sched. B (OEBA).

Background

[5] The appellant is an electricity distributor licensed by the OEB, which regulates the rates THESL can charge for electricity pursuant to the OEBA.

[6] THESL applied for rate approval for the years 2008, 2009, and 2010. THESL's rate application included submissions on its plans for facilities during that period. The facilities plan was to consolidate seven facilities into three to increase long term efficiencies. Three of the facilities would be sold in 2008. A fourth property would be sold after the period covered by the application. Two of the existing properties would be "repurposed to suit THESL's needs" and a third would be newly built.

[7] In the rate application, THESL voluntarily proposed to apply 50% of the net after-tax gains from the sale of the properties to reduce its revenue requirement. In addition, an OEB policy stipulates that in the normal course, ratepayers and shareholders share 50/50 in capital gains or losses below a certain threshold that applied in this case.

[8] THESL's position was that it would re-invest the other 50% of the capital gains share in the capital assets, thus creating efficiencies and avoiding the cost of borrowing those funds.

[9] After referring to the fact that properties to be sold in 2008 have been rendered redundant and have been or will be sold as part of the THESL's Facilities Consolidation and Renewal Plan, the OEB found:

> If it were not for the Plan, the properties would continue to be used and useful. The properties' functions are useful and will be transferred to or replaced by other facilities, at

> a substantial cost to the ratepayer. The total capital cost of the Plan to 2011 is estimated at $105 Million. The estimated capital cost of the Plan up to and including 2009 is $69.5 Million.
>
> To defray these substantial costs to the ratepayer, the Board finds that 100% of the net after tax gains from the sale of ...the properties, that are planned to be sold in 2008 should go to the ratepayer. The Company's revenue requirement for the 2008 test year shall be adjusted downward by $10.3 million to reflect this finding.

Standard of Review

[10] The Appellant characterizes the question on appeal as one of 'true' jurisdiction, and therefore, in accordance with *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190, at paras. 58-59 it must be correct. In the alternative, THESL submits that because the OEB erred in relation to general principles of corporate and property law, its expertise was not engaged and the appropriate standard of review is correctness.

[11] Finally, THESL submits that given that this Court has already determined that the standard of review in relation to similar questions of law by an Energy Board is correctness, it is not necessary to apply a standard of review analysis (*Dunsmuir* at para. 62).

[12] In *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, [2006] 1 S.C.R. 140, at paras. 21 and 32, the Supreme Court of Canada determined that the issue of the Alberta Board's power to allocate proceeds from a sale of utility assets to its ratepayers engages a standard of review of correctness because the issue "goes to jurisdiction". In *Toronto Hydro-Electric System Ltd. v. Ontario Energy Board* (2008), 93 O.R. (3d) 380, leave to appeal granted, the Divisional Court held that the standard of review on a question of law in an appeal from the order of the OEB was correctness; in that case, the OEB directed the manner in which dividends of the utility were to be approved by the Board of Directors as a condition of its rate-setting decision.

[13] Although the appellant has characterized the legal issue as relating to jurisdiction - whether the OEB has an express or implied power to attribute a property interest in the assets of a utility to its ratepayers - I do not accept that characterization. Unlike *ATCO*, which involved the Board's authority to attach conditions to its approval of the sale of a utility's assets, the decision in this case was squarely within the rate setting authority of the OEB. The question of law is whether the OEB may allocate the net after tax gains on the sale of the properties to reduce THESL'S revenue requirements in the course of establishing just and reasonable rates. It goes to the very core of the OEB mandate.

[14] Subsequent to its decision in *ATCO*, the Supreme Court of Canada cautioned in *Dunsmuir* at para. 59, that reviewing judges must not brand as jurisdictional issues that are doubtfully so. The term jurisdiction is intended in the narrow sense of whether or not the tribunal had the authority to make the inquiry. Jurisdictional questions will therefore be limited to this narrow construction. In my view, the OEB is entitled to enter into the inquiry of whether and how to allocate the capital gains upon the sale of the properties sale proceeds when fixing electricity distribution rates. The legal issue in this appeal does not relate to the jurisdiction of the OEB as contemplated in *Dunsmuir*.

[15] As noted in *Dunsmuir* (at paras. 54, 55 and 60), the standard of review for questions of law may depend upon the nature of the question of law. Where the question at issue is one of general law that is both of central importance to the legal system as a whole and outside the adjudicator's specialized area of expertise, a standard of correctness will apply. Deference will usually result where a tribunal is interpreting its own statute or statutes closely connected to its function, with which it will have particular familiarity. Deference may also be warranted where an administrative tribunal has developed particular expertise in the application of a general common law or civil law rule in relation to a specific statutory context.

[16] In *Toronto Hydro*, the Divisional Court found that the standard of review was correctness in an appeal from a decision of the OEB requiring, as a condition of setting distribution rates, that any dividend paid by THESL to the City of Toronto be approved by a majority of THESL's independent directors. The issue in that case was whether the OEB had jurisdiction to impose conditions on the authority of the directors of a regulated business as to the declaration of dividends (para. 32). The Court noted that the legal question involved general principles of corporate law. In that case, the condition placed on a rate-setting order had no impact on the actual distribution rates. By contrast, the decision under appeal is a rate-setting decision, because it directly affects the revenue requirements of the utility.

[17] An OEB decision may well engage or impact principles of corporate law, given that it regulates incorporated distributors, but the nature of the issue must be viewed in light of the regulatory scheme. While the decision in this case may have the effect of curtailing the appellant's ability to otherwise distribute or invest the net after tax gains from the sale of the properties, the substance of the OEB's decision relates to whether and how to apply those gains in its rate setting formula. Unlike the cases relied upon, this issue directly relates to the OEB's determination of rates and goes to the heart of its regulatory authority and expertise. There is no dispute that the OEB has rate-setting powers under the OEBA which are broad enough to encompass the power to determine reduced revenue requirements as a result of the sale of non-surplus assets. Although there is no privative clause, the OEB is a highly specialized expert tribunal with broad authority to regulate the energy sector in Ontario and to balance competing interests. See *Natural Resource Gas Ltd. v. Ontario Energy Board*, [2006] O.J. No. 2961 (C.A.) at para. 18.

[18] In my view, the question of law raised in this appeal relates to a question within the OEB's own jurisdiction under its enabling statute, which attracts deference. The standard of review is reasonableness.

Analysis

[19] The appellant submits that the OEB exceeded its jurisdiction as the OEB has no express or implied power to attribute a property interest in the assets of a utility to its ratepayers. The appellant argues that the OEB erred and acted unreasonably in allocating all the proceeds of a property sale to ratepayers, as it is contrary to corporate law and improperly accords a property interest in the assets of the THESL. Given that THESL is allowed a fair rate of return, it submits that it is unreasonable to allocate all of the proceeds of sale to the rate payers.

[20] The appellant concedes that the OEB has the jurisdiction to consider the financial circumstances of the utility, including its net gains from the sale of properties, in determining a just and reasonable rate. It argues, however, that in this case the OEB failed to consider the benefits of the facilities plan and proceeded under the erroneous impression that the ratepayers would pay for the entire capital costs of the facilities plan and were therefore entitled to all the profits from the sale of the properties. The appellant submits that in according the ratepayers a property interest in the properties, the OEB erred because pursuant to general corporate law principles, the profits (and the risk of loss) belong to THESL, a company incorporated under the Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16.

[21] For the reasons that follow, I find that the OEB had the jurisdiction to allocate the net gains from the sale of properties to the rate-setting formula and that its decision was reasonable.

[22] The OEB regulates the electricity distribution system and is guided by its statutory objectives in s. 1 of the OEBA:

> 1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
>
> 2. To promote economic efficiency and cost effectiveness in the ...distribution of electricity and to facilitate the maintenance of a financially viable industry.

[23] The OEB has broad powers to set rates. The OEBA provides at s. 78(3) that "the Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity...." The OEB has broad powers to hear and determine all questions of law and fact, and the discretionary power to make any orders it sees fit (ss. 19(1), (6) and 23(1)). Rate-setting, and the determination of what is just and reasonable as between the utilities and the ratepayers, is at the heart of the OEB's jurisdiction.

[24] The appellant argues that *ATCO* stands for the proposition that a regulator cannot allocate all the proceeds of sale of a utility's property to the ratepayers because this, as noted, is contrary to the principle that customers do not have a property interest in the assets of a utility. In *ATCO*, the decision was made under the regulator's power to approve a sale, not under its rate-making power. However, the Supreme Court of Canada noted at para. 81, that the Board had the ability to modify and fix just and reasonable rates and to give due consideration to any new economic data anticipated as a result of the sale of property.

[25] In fixing rates, the OEB considers a distributor's revenue requirement for the period. The revenue requirement is the amount of money the utility must receive from its customers to cover its costs, operating expenses, taxes, interest paid on debts, and a reasonable rate of return on invested capital. The OEB sets the amount permitted to be treated as debt load for the purposes of determining the revenue requirement and therefore the equity and debt relationship. If property is sold, the amount required to provide a return on investment as part of the revenue requirements is reduced. If the capital gains on proceeds of sale are deducted from the utility's revenue requirement, it further tends to result in lowering the amount ratepayers would be charged. Conversely, if the utility borrows, its revenue requirements include the cost of borrowing. If the utility makes a capital investment, its revenue requirements include a rate of return on the invested capital. An increase in the revenue requirements tends to result in increasing the rates.

[26] Consideration of the financial circumstances of the utility, including its revenue (capital gains) from the sale of assets, is within the jurisdiction of the OEB.

[27] I do not agree with the appellant's submission that the OEB failed to consider the implications of the facilities plan. The lengthy decision deals only with the disputed areas. The decision was rendered following extensive evidence in a lengthy proceeding. The OEB clearly considered the impact of the facilities plan and some of the findings are reflected in its reasons. It found significant future capital costs of the facilities plan. It found that the properties sold or to be sold would have continued to be used and useful but for the facilities plan and that the properties' functions were not surplus, and would be transferred to or replaced by other facilities at substantial cost to the ratepayer.

[28] While the appellant suggests the OEB was under the erroneous impression that the ratepayers would be responsible for the entire future capital costs of the facilities plan, rather than an increased cost arising from that capital investment, it is not reasonable to conclude that the OEB was under such a misapprehension. While the decision could have expressed the relationship between the capital costs and the resulting cost to the ratepayers more clearly, the implications of capital investment and cost of borrowing on the revenue requirements are integral to the OEB rate setting exercise. The capital investment in the facilities plan (including any capital gains re-invested by the utility into future facilities) would impact on ratepayers as an ongoing return on equity routinely built into the rates. Any loans required to implement the

facilities plan would impact on ratepayers as the cost of borrowing would be routinely built into the rates.

[29] The appellants were seeking a significant increase in the rates. The OEB expressed concern about the increase of operating and capital expenditures and the impact on ratepayers. The OEB decision, quoted above, referred to the need to replace the properties with other facilities, at a substantial cost to the ratepayer and concluded:

> To defray these substantial costs to the ratepayer, the Board finds that 100% of the net after tax gains from the sale of the properties should go to the ratepayer. The Company's revenue requirement for the 2008 test year shall be adjusted downward by $10.3 million to reflect these findings.

[30] The language that "the gains…should go to the ratepayer" is unfortunate. However, read in the context of the rate setting process as a whole, and the allocation of revenue to the formula used by the OEB in the decision, it is clear that the OEB was not granting the ratepayers a property interest in the capital gains from the sale of the properties but was allocating a revenue offset – in a similar treatment to revenue from other sources - to adjust the revenue requirements of THESL for the 2008 year.

[31] The OEB also considered the need to replace the functions of that property and the costs to the ratepayer of doing so. It contrasted this case with another in which Union Gas Ltd. wished to sell cushion gas. In that case, the OEB considered *ATCO* and allocated 100% of the gains to the utility, because the cushion gas was truly surplus, in that the utility was not going to replace it. (Decision EB-2005-0211, June 27, 2007.)

[32] The OEB was required to balance the sometimes competing interests between the ratepayers and the appellant in determining just and reasonable rates. The decision is clearly reasonable as it falls within a range of outcomes and is defensible with respect to both the facts and the law. Given the nature of the statutory regime, the power given to the OEB when exercising its core function of setting rates, and its rate setting expertise, deference should be accorded to the decision-making process and the resulting outcome.

[33] For the foregoing reasons the appeal is dismissed. No costs were sought and none are awarded.

Karakatsanis J.

Swinton J.

Low J.

Released:

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Appellant

- and -

ONTARIO ENERGY BOARD

Respondent

- and -

SCHOOL ENERGY COALITION

Intervenor

REASONS FOR JUDGMENT

Swinton, Low and Karakatsanis JJ.

Released: April 27, 2009