COURT OF APPEAL FOR ONTARIO

CITATION: Union Gas Limited v. Ontario Energy Board, 2015 ONCA 453
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Hoy A.C.J.O., and Simmons and Tulloch JJ.A.

BETWEEN

Union Gas Limited

Appellant

and

Ontario Energy Board

Respondent

Patricia D.S. Jackson, Crawford Smith and Alex Smith, for the appellant

Michael Millar, for the respondent

Heard: December 16, 2014

On appeal from the order of the Divisional Court (Justices Colin D.A. McKinnon and Susan G. Himel, Justice Herman J. Wilton-Siegel dissenting) dated December 20, 2013, with reasons reported at 2013 ONSC 7048, 316 O.A.C. 218, affirming the decision of the Ontario Energy Board, dated November 19, 2012.

Simmons J.A.:

A. INTRODUCTION

[1] Union Gas Limited appeals with leave from an order of the Divisional Court dismissing Union's appeal from a decision of the Ontario Energy Board. The

main issue on appeal is whether the Board's decision contravened the principle against retroactive ratemaking.

[2] In April 2012, Union applied to the Board for an order amending the rates it would charge to its customers for natural gas as of October 2012. A primary purpose of the application was to adjust rates as a result of allocating a portion of Union's 2011 utility earnings between Union and its ratepayers under the terms of an Earnings Sharing Mechanism ("ESM") contained in an Incentive Regulation Mechanism Settlement Agreement (the "IRM Agreement").

[3] In 2007, Union entered into the IRM Agreement with parties representing its major stakeholders and constituents (the "interveners") to provide for a five-year period of incentive regulation. By order made in January 2008, the Board approved the IRM Agreement. The IRM Agreement contained the ESM, under which Union agreed to share utility earnings greater than two per cent above its regulated rate of return with ratepayers.

[4] As part of the IRM Agreement, Union agreed to reduce its revenue requirement by $4.3 million. In exchange for this reduction, four deferral accounts previously established by the Board were eliminated.

[5] Deferral accounts allow a regulator to separately accumulate certain amounts (costs or revenues) before deciding by order, at specified intervals, to what extent, if at all, such costs or revenues will be charged to ratepayers as part

of rates. Because it is contemplated from the outset that amounts in deferral accounts will be disposed of in a manner that affects rates, deferral accounts do not offend the principle against retroactive ratemaking.

[6] At least one of the four eliminated deferral accounts tracked upstream transportation optimization revenues. Union generated upstream transportation optimization revenues through transactions with third parties in which Union disposed of upstream transportation services.

[7] In the past, the Board had directed that Union share the upstream transportation optimization revenues in the eliminated deferral accounts with ratepayers based on a 75/25 split in favour of ratepayers.

[8] As a result of the elimination of the four deferral accounts, under the IRM Agreement, Union was able to keep net revenues that would previously have been recorded in those accounts, subject to the ESM.

[9] Union's April 2012 application for a rate order included a request to share with ratepayers $22 million in 2011 revenues Union had earned using TransCanada Pipelines Limited's ("TCPL") Firm Transportation Risk Alleviation Mechanism ("FT-RAM") program under the ESM.

[10] Under the FT-RAM program, utilities earned credits for unused firm[1] transportation services, which the utilities could then use to purchase cheaper interruptible transportation services. Union was able to monetize the credits it earned under the FT-RAM program through various assignment and exchange transactions with third parties.

[11] Union classified its 2011 FT-RAM earnings as upstream transportation optimization revenues – that is, as utility earnings that would previously have been recorded in one of the eliminated deferral accounts. In a procedural order in Union's application, the Board directed that Union's classification of its 2011 FT-RAM revenues be dealt with as a preliminary issue in the proceeding.

[12] In its decision on the preliminary issue, the Board rejected Union's classification of its 2011 FT-RAM revenues as utility earnings and concluded instead that the disputed $22 million should be classified as "gas supply cost reductions". As such, the revenues would ordinarily be passed through to ratepayers, and Union would not be entitled to any portion of them.

[13] The Board found that Union had used the FT-RAM program to generate profits on its upstream transportation portfolio on a planned basis – whereas Union's past upstream transportation optimization activities had occurred on an unplanned basis. Because upstream transportation costs are passed through

[1] Firm transportation refers to the quality of upstream transportation. Firm transportation cannot be interrupted by the transportation supplier, whereas interruptible transportation can be interrupted.

entirely to ratepayers, the Board found that Union's planned profit-making on its upstream transportation portfolio was inconsistent with the IRM Agreement and the regulatory principle imbedded in it that a utility "cannot profit from the procurement of gas supply for its customers."

[14] The Board concluded that it was entitled to reclassify the FT-RAM revenues because it was part of its mandate to ensure that revenues were being properly characterized under the IRM Agreement and in a manner that resulted in just and reasonable rates.

[15] While acknowledging that gas supply costs (and gas supply cost reductions) are ordinarily passed through entirely to ratepayers, the Board directed that 90 per cent of the $22 million should be credited to ratepayers and that 10 per cent should be credited to Union as an incentive for generating the revenues. In a subsequent rate order, the Board directed that the funds should be recorded in a newly created deferral account.

[16] Union appealed the Board's decision on the preliminary issue to the Divisional Court.

[17] Before the Divisional Court, Union argued that the Board had already approved the gas supply cost reductions to be credited to ratepayers for 2011 through final rate orders made in Quarterly Rate Adjustment Mechanism ("QRAM") proceedings, which disposed of deferral accounts relating to upstream

gas and transportation costs. Accordingly, Union maintained that by reclassifying Union's 2011 FT-RAM revenues as gas supply cost reductions, the Board engaged in impermissible retroactive ratemaking.

[18] In a split decision, the Divisional Court found that the Board's reclassification of the 2011 FT-RAM revenues did not amount to impermissible retroactive ratemaking. The majority concluded that the revenues at issue were not dealt with in the 2011 QRAM proceedings. Moreover, because the revenues were brought forward as part of the ESM proceeding, they were effectively "encumbered", and therefore subject to further disposition by the Board. The majority held that the Board's statutory rate-making authority is broad and "[does not] in any manner constrain the Board from making orders respecting matters which arose in a previous year but had not been specifically dealt with as a discrete item in the rate-setting process."

[19] Union now appeals to this court with leave and argues that the Board acted unreasonably in reclassifying Union's 2011 FT-RAM revenues as gas supply cost reductions for two reasons.

[20] First, it says the reclassification was an unauthorized departure from the terms of the IRM Agreement, which the Board had approved as the mechanism for setting rates during the IRM period. Second, it says the reclassification amounted to impermissible retroactive ratemaking. This is because gas supply

cost deferral accounts had already been disposed of through final orders in the 2011 QRAM proceedings and because there was no separate deferral account for FT-RAM revenues in relation to which the Board could make a further disposition. According to Union, the Board's decision is thus a classic impermissible attempt to remedy past rates the Board later concluded were excessive.

[21] For the reasons that follow, I would dismiss Union's appeal.

B. BACKGROUND

(1) Union

[22] Union is an Ontario corporation that sells, distributes, transmits and stores natural gas. It does not produce natural gas. From its head office in Chatham, Union services approximately 1.4 million residential, commercial and industrial customers across northern, southwestern and eastern Ontario.

(2) The Board and its Authority

[23] The Board is a statutory tribunal governed by the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B. Among other powers, the Board has authority to set rates for the sale, transmission, distribution and storage of gas in the natural gas sector: s. 36(1).[2] The Board carries out its rate-setting function by

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[2] The text of relevant provisions under the Act is included in Appendix "A".

issuing orders: s. 19(2). In making orders, the Board is not bound by the terms of any contract: s. 36(1).

[24] Under s. 36(2) of the Act, the Board may "make orders approving or fixing *just and reasonable rates* for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas" (emphasis added).

[25] Just and reasonable rates permit a utility to recover its prudently incurred costs and earn a fair return on invested capital: see, for example, *Power Workers' Union, Canadian Union of Public Employees, Local 1000 v. Ontario (Energy Board)*, 2013 ONCA 359, 116 O.R. (3d) 793, at paras. 13, 30-32, leave to appeal to S.C.C. granted, [2013] S.C.C.A. No. 339, appeal heard and reserved December 3, 2014; *Northwestern Utilities Ltd. v. Edmonton (City)*, [1929] S.C.R. 186, pp. 192-3.

[26] Under s. 36(3) of the Act, "[i]n approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate."

[27] Deferral accounts are not defined in the Act. However, under ss. 36(4.1) and (4.2), the Board must dispose of the balances in deferral accounts at specified intervals. Deferral accounts relating to the commodity of natural gas are to be reflected in rates within a maximum of three months, and deferral accounts

relating to other items, including transportation costs, are to be reflected in rates within a maximum of 12 months.

(3) The Board's Practice in Setting Union's Rates

[28] Historically, the Board set Union's natural gas rates following an annual cost of service hearing at which the Board established Union's revenue requirement, consisting of a forecast of Union's costs, including a return on equity, over a future year or test period. As part of the rate-setting process, typically the Board established various deferral accounts to allow it to defer consideration of revenues and expenses that could not be forecast with certainty.

[29] Between 2008 and 2012, Union's natural gas rates were set through a Board-approved Incentive Regulation Mechanism – the IRM Agreement.

[30] During incentive regulation, a utility's base rates are set initially through a cost of service proceeding and then adjusted annually using a pre-approved pricing mechanism intended to encourage productivity or efficiency improvements. If a utility is able to increase revenues or reduce costs during incentive regulation, it is permitted to retain its "over-earnings" in excess of its regulated return on equity – but subject to the terms of any earnings sharing mechanism under which the utility has agreed to share its earnings with its ratepayers.

[31] I will return later to the terms of the IRM Agreement.

(4) Upstream Transportation Optimization

[32] To ensure a consistent supply of gas to its customers, Union holds a portfolio of upstream transportation contracts that provide gas transportation on a firm basis from supply basins across North America to Union's storage, transmission and distribution system in Ontario.

[33] Because it is difficult to predict with accuracy how much firm transportation capacity is required in any given year, as part of maintaining a conservative gas supply plan that will ensure a consistent supply of natural gas, a utility may, from time-to-time, have excess firm transportation capacity.

[34] Traditionally, the Board has passed through the cost of upstream transportation entirely to ratepayers through the use of deferral accounts. However, where a utility was able to generate revenue by disposing of unused transportation capacity through transactions with third parties, the Board has generally permitted the utility to retain some portion of the revenues generated from these transactions to encourage the utility to dispose of the unused capacity. The transactions themselves are generally referred to as "optimization activities" or "transactional services".

[35] Prior to the IRM Agreement, revenue earned from upstream transportation optimization activities was recorded in various deferral accounts. In the past, the Board had ordered that these accounts be cleared at least annually on the basis

that ratepayers receive 75 per cent of the revenues through a rate reduction and Union retain the remaining 25 per cent of revenues.

(5) The IRM Agreement

[36] As indicated above, for the period 2008 to 2012, Union entered into the IRM Agreement with the interveners. In January 2008, the Board approved the IRM Agreement as an acceptable incentive regulation program.

[37] The following aspects of the IRM Agreement are significant for the purposes of this appeal:

- The IRM Agreement identified so-called "Y factors", which are costs incurred by Union that would be passed through entirely to customers during the term of the IRM Agreement. Items treated as "Y factors" in the IRM Agreement included upstream gas and transportation costs.
- The IRM Agreement eliminated four deferral accounts, which had been previously maintained. In return for closing these accounts, Union increased the optimization margin built into rates from $2.6 million to $6.9 million. Put another way, Union agreed to fund a $4.3 million annual decrease in rates and assumed the risk of earning sufficient optimization revenue to offset that decrease.

- The IRM Agreement included the ESM, which initially provided that utility earnings greater than two per cent above Union's regulated rate of return would be shared 50/50 with ratepayers.
- The IRM Agreement permitted the parties to re-open it if Union's earnings exceeded its regulated return on equity by more than three per cent.

[38] When Union's earnings for 2008 did exceed three per cent, the parties to the IRM Agreement entered into a further Settlement Agreement amending the terms of the IRM Agreement (the "Amending Agreement"). Among other things, the Amending Agreement provided that earnings over three per cent of Union's regulated rate of return were to be shared 90/10 in favour of ratepayers. The Board approved this amendment by order.

(6) QRAM Proceedings

[39] As indicated above, depending on the type of deferral account, the Act requires that they be cleared at least quarterly or annually. Given the frequency with which deferral accounts must be cleared, the Board developed QRAM proceedings. They provide an abbreviated and mechanistic hearing process used to clear some, but not all, deferral accounts.

[40] In 2011, Union brought five deferral accounts forward for disposition every quarter through QRAM proceeding. Some of these accounts included gas

transportation related costs. Union did not bring the disputed $22 million in FT-RAM revenues forward for disposition in any of the 2011 QRAM proceedings.

(7) Union's April 2012 Application

[41] The application giving rise to this appeal was brought in April 2012. As indicated above, Union filed an application at that time seeking an order amending or varying the rates charged to customers as of October 2012. A key purpose of the application was to dispose of 2011 utility earnings in accordance with the ESM.

[42] In its application, Union included as utility earnings total optimization revenues for 2011 of $31.7 million, $22 million of which was attributable to FT-RAM optimization.

(8) Union's 2013 Cost of Service Proceeding

[43] On November 10, 2011, Union filed an application with the Board for an order approving or fixing its rates effective January 1, 2013. The appropriate treatment of FT-RAM revenues was an issue in that proceeding. The cost of service decision is relevant because the Board incorporated the evidentiary record from the 2013 cost of service proceeding as part of the record on the preliminary issue.

C. DECISIONS BELOW

(1) The Board's decision on the Preliminary Issue

[44] Prior to dealing with Union's application, the Board determined that it would address Union's treatment of upstream transportation optimization revenues in 2011 as a preliminary issue.

[45] The Board described the preliminary issue as follows: "Has Union treated the upstream transportation optimization revenues appropriately in 2011 in the context of Union's existing IRM framework?"

[46] In its decision on the preliminary issue, the Board accepted the argument of several interveners that TCPL's FT-RAM program allowed Union to create revenue opportunities by planning to replace higher cost firm upstream transportation services paid for by ratepayers with lower cost upstream transportation arrangements:

> The Board agrees with the submissions of parties that *the utilization of TCPL's FT-RAM program by Union allows Union to manage its upstream transportation arrangements on a planned basis* by leaving pipe empty and flowing gas on a different and cheaper path. The Board finds that *the effect of this activity is that higher upstream transportation costs that are paid for by Union's customers, have been substituted with lower cost upstream transportation arrangements*. [Emphasis added.]

[47] As noted by the Divisional Court, the Board used even stronger language in its companion decision on the related 2012 cost of service proceeding in describing Union's actions. For example, the Board said:

> The Board finds that the record in this proceeding is clear that firm assets are being made available for transactional services on a planned basis, with releases occurring prior to the commencement of the heating season and with capacity being assigned for up to a full year. …
>
> … the record in this proceeding suggests that Union's optimization activities have, in their own right, become a driver of the gas supply plan and are no longer solely a consequence of it.
>
> *The Board finds that Union's ability to "manufacture" optimization opportunities undermines the credibility of Union's gas supply planning process, the planning methodology, and the resulting gas supply plan.*
>
> As submitted by various parties to this proceeding and Board staff, *Union has had an incentive to contract excessive upstream gas transportation services to the detriment of the ratepayer. Union has not filed convincing evidence that the amount and type of upstream gas transportation contracts procured on behalf of ratepayers reflects the objective application of its gas supply planning principles.* [Emphasis added.]

[48] In the light of its finding that Union had acted on a planned basis, the Board concluded that treating FT-RAM revenues as utility earnings was "inconsistent" with the IRM Agreement – and contrary to the regulatory principle inherent in it – that the cost of upstream transportation is a pass-through item from which Union is not entitled to profit:

> The Board finds that Union has used TCPL's FT-RAM program to create a profit from the upstream transportation portfolio and has treated this profit as utility earnings, subject only to the provisions of the earnings sharing mechanism.
>
> *The Board finds that this treatment is inconsistent with the Settlement Agreement on the IRM Framework and contrary to long standing regulatory principle inherent in the IRM Framework that the cost of gas and upstream transportation are to be treated as pass-through items, and therefore that Union cannot profit from the procurement of gas supply for its customers*. [Emphasis added.]

[49] Instead, the Board determined that the monies generated from FT-RAM activities should be treated as gas supply costs savings:

> As such, the Board finds that Union's upstream transportation FT-RAM optimization revenues are gas cost reductions, and are properly considered Y factor items in accordance with Union's IRM Framework.

[50] However, although gas supply cost reductions would normally be passed through completely to ratepayers, the Board noted that "absent an incentive, [Union] may not have undertaken these [optimization] activities."

[51] Accordingly, the Board directed that ratepayers would be entitled to 90 per cent of the $22 million net revenue amount related to Union's 2011 FT-RAM activities in the form of an offset to gas supply costs and that Union would be entitled to receive a 10 per cent incentive for having generated the net revenues.

[52] In the course of its reasons, the Board rejected Union's arguments that reclassifying the FT-RAM revenues would undo the IRM Agreement and amount to retroactive ratemaking.

[53] The Board noted that it was reclassifying revenues based on evidence filed in Union's 2013 cost of service proceeding, which the Board incorporated by reference. The Board stated that the reclassification of revenues "[was] consistent with the IRM Framework".

[54] Moreover, the Board found that it had "an ongoing responsibility to determine whether activities undertaken during the IRM term [were] being characterized in accordance with the IRM Framework and have been characterized in a manner which results in just and reasonable rates."

[55] Accordingly, "the annual disposition of deferral accounts, earnings sharing, and other accounts that are part of Union's IRM Framework is not merely a mechanical exercise." Instead, "it is a process that is informed by evidence relating to the balances in those accounts and whether those balances reflect the appropriate application of the IRM Framework and the regulatory principles inherent in it."

[56] The Board also rejected Union's arguments that its FT-RAM activities were no different than optimization activities or transactional services in which Union had engaged in the past and that treating its FT-RAM activities as gas supply

cost reductions would be inconsistent with the descriptions and historical use of deferral accounts.

[57] The Board found that evidence in prior proceedings led to the conclusion that upstream optimization opportunities were generally only available on an *unplanned* basis. Further, Union had not pointed to any evidence filed prior to the concurrent cost of service proceeding that fully explained how the FT-RAM revenues were being generated.

[58] In this regard, the Board noted that an “information asymmetry … exists” between Union and its ratepayers and that Union had an obligation to make “a much higher level of disclosure than was produced in prior proceedings” concerning “departures or potential departures … from regulatory principle inherent in the IRM Framework”.

[59] Despite its findings concerning the 2011 FT-RAM revenues, the Board rejected submissions from some of the interveners that it should address FT-RAM revenues earned prior to 2011.

[60] The Board directed Union to advise it of the gas supply related deferral account(s) in which the reduction to ratepayers would be recorded and to file a draft accounting order for the account(s).

[61] The Board subsequently issued a decision and rate order on February 28, 2013, under which the revenues from the 2011 FT-RAM optimization activities were to be recorded in a newly created deferral account.

(2) The Divisional Court's Decision

[62] Union appealed the Board's decision on the preliminary issue to the Divisional Court. Before the Divisional Court, Union argued that all 2011 gas supply related costs had been dealt with through final orders in 2011 QRAM proceedings. Accordingly, by reclassifying the utility revenues as gas supply cost reductions to be passed through to ratepayers, the Board varied what were final rate orders and engaged in impermissible retroactive ratemaking.

[63] The majority dismissed the appeal, holding that the Board's findings were clear that the disputed $22 million had not been dealt with as part of the 2011 QRAM proceedings and that Union had not met its disclosure obligations concerning the FT-RAM revenue. Because the "true scope and nature of the FT-RAM program" was only revealed during the 2012 rate hearing, that revenue could only be properly classified following the 2012 hearing. It followed that the $22 million was "encumbered" because "Union, in accordance with the statutory framework and Board policy, was bringing forward its 2011 accounts for review and approval."

[64] During the course of their reasons, the majority stated, "the provisions of section 36 of the Act are liberal in construction and do not in any manner constrain the Board from making orders respecting matters which arose in a previous year but had not been specifically dealt with as a discrete item in the ratesetting process".

[65] In the dissenting judge's view, the elimination of the deferral accounts when the IRM Agreement was entered into led to the conclusion "that the intended Y factor under the [IRM Agreement] was gross transportation costs".

[66] In other words, because the upstream transportation optimization deferral accounts were eliminated, the Y factor described as upstream transportation costs in the IRM Agreement referred to the costs associated with Union's firm transportation contracts "without regard for any netting or pass-through of profits or losses on the sale of any such contracts."

[67] Accordingly, under the terms of the IRM Agreement, the FT-RAM revenues were to be treated as utility revenues subject to the ESM because there was "no other account or provision that would mandate different treatment" for them.

[68] The dissenting judge also rejected the Board's conclusion that a meaningful distinction could be made under the terms of IRM Agreement between FT-RAM revenues and other transactional services revenues. In his view, the Board's conclusion that a distinction existed between planned and

unplanned upstream transportation optimization activities was not justified. He concluded, "[T]he concept of 'transactional services revenues' does not, by itself, provide a basis for the re-classification of FT-RAM related revenues as gas supply costs."

[69] Having concluded that the Y factor described in the IRM Agreement referred to gross transportation costs – and therefore that FT-RAM revenues were subject to the ESM – the dissenting judge turned to the question of the Board's authority to reclassify such revenues as gas supply cost reductions. He rejected the Board's submission on appeal that the amounts brought forward by Union were "encumbered" and questioned how, in the absence of an applicable deferral account, that condition could arise.

[70] The dissenting judge concluded that neither the IRM Agreement nor the Act authorized the Board to reclassify Union's FT-RAM revenues. Rather, the Board's reclassification of Union's 2011 FT-RAM related earnings for the purposes of the ESM constituted retroactive ratemaking, and was, "by definition, unreasonable".

D. ANALYSIS

(1) Standard of Review

[71] Under s. 33(2) of the Act, an appeal lies to the Divisional Court from an order of the Board "only upon a question of law or jurisdiction".

[72] The parties agree that decisions of the Board are reviewable on appeal to the Divisional Court on a standard of reasonableness. I agree. (See, for example, *Power Workers'*).

(2) Discussion

[73] Union submits that the Board's decision to reclassify the FT-RAM revenues as gas supply cost reductions is unreasonable because it is an unauthorized departure from the terms of the IRM Agreement, which the Board had approved as the mechanism for setting just and reasonable rates during the incentive regulation period, and because it constitutes impermissible retroactive ratemaking.

[74] Union points out that, under the terms of the IRM Agreement, it reduced its revenue requirement in exchange for the elimination of the upstream transportation optimization deferral accounts. Union contends that its FT-RAM optimization activities were no different than other optimization activities in which it had previously engaged and that it is undisputed that, absent the IRM Agreement, such revenues would have fallen within the one of the eliminated upstream transportation optimization deferral accounts. By reclassifying FT-RAM revenues as gas supply cost reductions, the Board effectively unwound the IRM Agreement. Moreover, the reclassification is inconsistent with the Board's past treatment of such revenues.

[75] In any event, all permissible 2011 rate adjustments based on gas supply cost reductions had already been made through final orders in the QRAM proceedings. In the absence of a deferral account that segregated specified amounts for future disposition, reclassifying the FT-RAM revenues from utility earnings to gas supply cost reductions was nothing more than an impermissible attempt to adjust rates that had been previously set based on unanticipated circumstances – namely, the unanticipated amount of revenue Union was able to generate by using the FT-RAM program. By definition, the Board's decision constitutes impermissible retroactive ratemaking.

[76] I would not accept these submissions.

[77] As a starting point, contrary to Union's position, the Board made an explicit finding that monies generated by Union's 2011 FT-RAM activities would not have fallen into one of the deferral accounts eliminated under the IRM Agreement. In the Board's view, this was because Union was using the program to create optimization opportunities on a planned basis, whereas the deferral accounts recorded optimization activities carried out on an unplanned basis:

> The Board notes that *Union has classified the revenues generated from its upstream transportation FT-RAM optimization activities as transactional service revenues because it believes that these activities are no different than its traditional transactional service activities.* However, *the Board finds that a review of the evidence* filed by Union in previous proceedings to answer the

> question: "what are transactional services" *does not lead to this conclusion*.
>
> …
>
> The Board finds that *Union's evidence* in the RP-2003-0063 / EB-2003-0087 proceeding, when taken as whole, *does not support the conclusion that the planned optimization of gas supply related assets would be considered a transactional service. The evidence* in the above noted proceeding *explicitly speaks to the fact that with a balanced gas supply portfolio there will be few, if any, firm assets available to support transactional services on a future planned basis. In the Board's view, this statement speaks to the fact that the portion of utility gas supply assets that is available to support transactional service activities is only the portion of those assets that is temporarily surplus to the gas supply plan as a result of factors beyond Union's control. Therefore, a clear distinction can be made between Union's transactional services (including exchanges) and Union's FT-RAM related activities*. [Emphasis added.]

[78] In my view, the Board's findings that monies generated by Union's 2011 FT-RAM activities were generated on a planned basis, and were thus distinguishable from upstream transportation optimization revenues that would have fallen within the eliminated deferral accounts, are findings of fact that were not subject to review on appeal to the Divisional Court.

[79] In the result, rather than being a departure from the IRM Agreement that had the effect of unwinding the IRM Agreement, the Board's decision was nothing more than a review of the nature of the revenues brought forward for sharing under the ESM and a determination that some of such revenues did not

qualify for that treatment. Accordingly, in my view, the Board's decision cannot be seen as unreasonable on the basis that it was a departure from the IRM Agreement. Nor was its conclusion that the FT-RAM revenues did not qualify for sharing under the ESM unreasonable.

[80] Moreover, I am not convinced that the fact that the FT-RAM revenues were not segregated in a special deferral account relating specifically to gas supply cost reductions means that the Board engaged in impermissible retroactive ratemaking by reclassifying them as gas supply cost reductions. Rather, I conclude that the FT-RAM revenues brought forward by Union for disposition as part of the ESM proceeding were effectively "encumbered" and subject to further disposition by the Board.

[81] This issue requires a discussion of the principle against retroactive ratemaking.

[82] It is well established that an economic regulatory tribunal, such as the Board, operating under a positive approval scheme of ratemaking must exercise its rate-making authority on a prospective basis. Generally speaking, absent express statutory authorization, such a regulator may not exercise its rate-making authority retroactively or retrospectively.

[83] As noted by the Divisional Court majority, the classic explanation for the general presumption against the retroactive operation of statutes is set out in *Young v. Adams*, [1898] A.C. 469, at p. 476:

> [I]t manifestly shocks one's sense of justice that an act legal at the time of doing it should be made unlawful by some new enactment.

[84] In *Bell Canada v. Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722, ("*Bell Canada 1989*"), at p. 1749, Gonthier J. writing for the court, characterized retroactive ratemaking as ratemaking the purpose of which "is to remedy the imposition of rates approved in the past and found in the final analysis to be excessive."

[85] At p. 1759 of the same case, Gonthier J. explained that "the power to review its own previous final decision on the fairness and reasonableness of rates would threaten the stability of the regulated entity's financial situation."

[86] From the ratepayers' perspective, retroactive ratemaking may create unfairness because it "redistributes the cost of utility service by asking today's customers to pay for the expenses incurred by yesterday's customers": *Atco Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2014 ABCA 28, 566 A.R. 323, at para. 51.

[87] Nonetheless, courts have recognized qualifications on the principle against retroactive ratemaking.

[88] In *Bell Canada 1989*, at pp. 1752-1761, the Supreme Court concluded that the power to make interim orders necessarily implies the power to modify, by final order, the rates created under an interim order.

[89] In *Bell Canada v. Bell Alliant Regional Communications*, 2009 SCC 40, [2009] 2 S.C.R. 764, ("*Bell Alliant*"), the Supreme Court noted, at para. 54, that deferral accounts are "accepted regulatory tools" that "'enabl[e] a regulator to defer consideration of a particular item of expense or revenue that is incapable of being forecast with certainty for the test year'".

[90] Although *Bell Alliant* involved the disposition of funds in a deferral account, at paras. 61 and 63, Abella J. also used the term "encumbered" to explain why the disposition of funds in a deferral account for one-time credits to ratepayers did not constitute impermissible retroactive ratemaking. A key feature of her reasoning was that it was known from the beginning that funds accumulated in the deferral accounts at issue were subject to further disposition by the regulator in the form of credits to ratepayers. She said:

> [61] In my view, because this case concerns encumbered revenues in deferral accounts … we are not dealing with the variation of final rates. As Sharlow J.A. pointed out, [the principle from] *Bell Canada 1989* [that retroactive or retrospective ratesetting is impermissible] is inapplicable because *it was known from the outset in the case before us that Bell Canada would be obliged to use the balance of its deferral account in accordance with the CRTC's subsequent direction*.

…

> [63] In my view, the credits ordered out of the deferral accounts in the case before us are neither retroactive nor retrospective. They do not vary the original rate as approved, which included the deferral accounts, nor do they seek to remedy a deficiency in the rate order through later measures, since *these credits or reductions were contemplated as a possible disposition of the deferral account balances from the beginning. These funds can properly be characterized as encumbered revenues, because the rates always remained subject to the deferral accounts mechanism established in the Price Caps Decision*. The use of deferral accounts therefore precludes a finding of retroactivity or retrospectivity. Furthermore, using deferral accounts to account for the difference between forecast and actual costs and revenues has traditionally been held not to constitute retroactive rate-setting [Citations omitted and emphasis added.]

[91] More recently in *Atco Gas,* the Alberta Court of Appeal explained that "[s]lavish adherence to the use of interim rates and deferral accounts should not prohibit adjustments" in a proper case: at para. 62. Moreover, "[s]imply because a ratemaking decision has an impact on a past rate does not mean it is an impermissible retroactive decision": at para. 56. Rather, "[t]he critical factor for determining whether the regulator is engaging in retroactive ratemaking is the parties' knowledge [that the rates were subject to change]": at para. 56.

[92] In that case, the regulator directed Atco to remove certain surplus assets from its rate base and revenue requirement, and backdated the effective date of the removal to an earlier date. The earlier date was the day after the Alberta

Court of Appeal issued a decision indicating that Atco did not require the regulator's consent to remove the asset from its rate base. Removal of the assets from the rate base and revenue requirement caused a decrease in rates, and since the regulator backdated the effective date of the removal, rates were decreased after the fact.

[93] On appeal to the Alberta Court of Appeal, Atco argued that the regulator could only change the rates by using an interim order or deferral account. The Alberta Court of Appeal rejected that argument. The court found, at para. 53, that "the utility must also be taken to know that the rates will be subject to change as a result of the non-inclusion of those assets in the rate base."

[94] In this case, Union does not dispute that, under the terms of the IRM Agreement, following its year-end, it was obliged to bring forward for the Board's review and approval amounts it classified as utility earnings that were subject to sharing under the ESM. Union also knew, from the outset of the IRM Agreement, that the Board's ESM determination would impact rates. The ESM determination under the IRM Agreement was thus inherently retrospective – and Union always knew that.

[95] Further, on the Board's findings, the manner in which Union generated its 2011 FT-RAM revenues and its classification of those revenues as utility earnings was inconsistent with the IRM Agreement and violated the regulatory

principle inherent in the IRM Agreement that the cost of upstream transportation is a pass-through item and that a utility "cannot profit from the procurement of gas supply for its customers."

[96] Although Union argued that its 2011 FT-RAM activities were no different than its previous upstream optimization activities, the Board made a specific finding that "a clear distinction can be made between Union's [unplanned] transactional services … and Union's [planned] FT-RAM activities."

[97] Significantly, prior to the 2012 hearings, the fact that the 2011 FT-RAM revenues were generated on a planned basis – and thus in a fashion inconsistent with regulatory principle and the IRM Agreement – was uniquely within Union's knowledge.

[98] In this regard, the Board found that Union had an obligation to "be mindful of the information asymmetry that exists between it and [its] ratepayers" and "to disclose departures or potential departures that it intends to make from regulatory principle inherent in the IRM Framework."

[99] In circumstances where Union knew that it was generating its 2011 FT-RAM revenues on a planned basis, Union must be fixed with knowledge, as of the date it generated those revenues, that the Board would be obliged to characterize them as a Y factor, or pass-through item, under the IRM Agreement.

[100] Although the Board had permitted profit-taking on optimization activities in the past, on the Board's findings, the prior optimization activities involved disposing of unplanned surpluses of firm transportation. The 2011 FT-RAM activities were qualitatively different because they involved disposing of planned surpluses of firm transportation. Prior to the 2012 hearings, Union was the only party in a position to know that – and must also be taken to have known that – its actions were inconsistent with the regulatory principle inherent in the IRM Agreement.

[101] In these circumstances, where the ESM determination was inherently retrospective, and where Union failed to disclose in advance the true nature of its intended 2011 FT-RAM activities, it was not unreasonable for the Board to treat Union's 2011 FT-RAM revenues as encumbered and therefore subject to further disposition by the Board in the form of a credit to ratepayers.

[102] Union argues that the Board never made an express finding that Union was acquiring excess firm transportation during 2011. While the Board may not have said so expressly, on a fair reading of their decision on the preliminary issue in combination with their decision on the 2012 cost of service proceeding, in my view, that message is very clear.

[103] Having regard to all the circumstances, I am not persuaded that the majority of the Divisional Court erred in characterizing the 2011 FT-RAM

revenues that Union brought forward in its 2012 application as encumbered or that the Board's decision to reclassify those revenues as gas supply cost reductions was unreasonable.

E. DISPOSITION

[104] Based on the foregoing reasons, the appeal is dismissed.

[105] Neither party requested costs and none are awarded.

Released:

"AH"
"JUN 22 2015"

"Janet Simmons J.A."
"I agree Alexandra Hoy A.C.J.O."
"I agree M. Tulloch J.A."

Appendix "A"

Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B.

19. (2) The Board shall make any determination in a proceeding by order.

33. (1) An appeal lies to the Divisional Court from,

(a) an order of the Board …

(2) An appeal may be made only upon a question of law or jurisdiction and must be commenced not later than 30 days after the making of the order or rule or the issuance of the code.

36. (1) No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract.

…(2) The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas.

(3) In approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate.

…

(4.1) If a gas distributor has a deferral or variance account that relates to the commodity of gas, the Board shall, at least once every three months, make an order under this section that determines whether and how amounts recorded in the account shall be reflected in rates.

(4.2) If a gas distributor has a deferral or variance account that does not relate to the commodity of gas, the Board shall, at least once every 12 months, or such shorter period as is prescribed by the regulations, make an order under this section that determines whether and how amounts recorded in the account shall be reflected in rates.