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British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

Attention: Sara Hardgrave, Acting Commission Secretary

Dear Sirs/Mesdames:

Re: British Columbia Utilities Commission Generic Cost of Capital Proceeding
FortisBC Energy Inc. and FortisBC Inc. Final Submissions

We enclose the Final Submissions of FortisBC Energy Inc. and FortisBC Inc., together with copies of the following four referenced court decisions related to the Fair Return Standard:

- *Northwestern Utilities Ltd. v. Edmonton (City)*, [1929] S.C.R. 186;
- *Ontario (Energy Board) v. Ontario Power Generation Inc.* 2015 SCC 44;
- *British Columbia Electric Railway Co. v. Public Utilities Commission*, [1960] S.C.R. 837; and
- *TransCanada PipeLines Ltd. v National Energy Board*, 2004 FCA 149.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[Original signed by]

Matthew Ghikas
Personal Law Corporation

MTG/lh
Enclosure

BRITISH COLUMBIA UTILITIES COMMISSION

IN THE MATTER OF THE *UTILITIES COMMISSION ACT*,
R.S.B.C. 1996, CHAPTER 473

AND

BRITISH COLUMBIA UTILITIES COMMISSION GENERIC COST OF CAPITAL PROCEEDING

FINAL SUBMISSIONS OF FORTISBC ENERGY INC. AND FORTISBC INC.

DECEMBER 23, 2022

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PART ONE: INTRODUCTION AND OVERVIEW

A. INTRODUCTION

1. The Fair Return Standard is well-established law in Canada. It requires setting an overall return (i.e., the combined capital structure and return on equity ("ROE")) for FortisBC Energy Inc. ("FEI") and FortisBC Inc. ("FBC") that accounts for the comparability of the overall return with the overall returns of other enterprises of similar risk, and allows the utilities to maintain their financial integrity and to attract capital in varied market conditions. The Fair Return Standard recognizes that utilities like FEI and FBC have committed, and must continue committing, capital on a long-term basis to provide safe and reliable utility service and that there is risk inherent in these investments. As Mr. Slater put it:

> We are a very capital intensive business. We need to make significant long-term investments in infrastructure to maintain safe and reliable service for customers, and we need to finance those investments with equity as well as debt. Investors consider both their prospects of earning their expected return, and recovering all of their invested capital. That makes risk – including both financial risk associated with how leveraged our business is, and the underlying risk facing the business – a key consideration for investors and for us.[1]

2. A Fair Return that reflects an equity investor's perceived risk, and supports these utilities' access to debt and equity in varied market conditions, is a legitimate cost of providing utility service. The evidence discussed in these Final Submissions related to business risk, ROE modelling and credit ratings, demonstrates that the cost of capital for FEI and FBC has increased since the BCUC last set the allowed ROE and common equity ratio for these utilities.

3. While FEI's business risk has increased in a number of areas, the Energy Transition is pervasive and a game changer for how FEI is perceived among investors. In the FEI 2016 Cost of Capital proceeding ("2016 Proceeding"), the BCUC confirmed a common equity ratio for FEI that it had previously reduced in 2013 (from 40% to 38.5%) when it had cited a reduction in public

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[1] Exhibit B1-30, FortisBC Opening Statement (Doug Slater).

policy-related risk. Since that time, the Energy Transition has impacted virtually every aspect of FEI's business to the point where it is an existential risk for FEI. In the space of only a few years, FEI has gone from being perceived by Moody's as having "low carbon transition risk" in 2019, to being characterized as having "very negative carbon transition risk" in 2021, to having "Highly Negative" risk in 2022. Portions of the market, including institutional investors that FEI relies upon, are now avoiding or limiting gas utility investment. The new and growing prevalence of Environmental, Social and Governance ("ESG") investment considerations means it is no longer safe to expect that FEI can maintain its credit rating with borderline financial metrics. Increasing FEI's common equity ratio to 45% will improve access to capital on reasonable terms, and narrow the incongruous disparity in common equity ratios relative to North American peers with whom FEI directly competes for capital.

4. The BCUC last assessed FBC's business risk in the 2013 Stage 2 GCOC Proceeding (the "2013 Proceeding"). Overall, FBC's current common equity ratio of 40% remains appropriate. The increases in some of FBC's risk categories since 2013 are not material enough to justify a material increase in FBC's common equity thickness and are otherwise offset by the potential to benefit from the Energy Transition. FBC's financial metrics are marginal—so much so that most of the metrics are already consistent with a non-investment grade credit rating. Mr. Coyne's assessment was that FBC's deemed equity ratio should be maintained at 40% at a minimum, and that an increase could be justified based on a business and financial risk comparison with his proxy groups.

5. Mr. Coyne provided a comprehensive analysis of the appropriate ROE for FEI and FBC, which considered current market conditions and employed standard Discounted Cash Flow ("DCF") modelling and the Capital Asset Pricing Model ("CAPM"). Dr. Lesser's participation in this proceeding has only underscored the reasonableness of Mr. Coyne's analysis. There was a high degree of alignment between Mr. Coyne and Dr. Lesser, including on the multi-stage DCF methodology and results. Dr. Lesser's commentary showed that Mr. Coyne has been conservative in a number of respects, including by not adjusting ROE for FEI and FBC's greater leverage relative to the proxy groups and refraining from adding a size premium to FBC's results. On the points of

disagreement, key among which was one element of the CAPM modelling (the Market Risk Premium), Mr. Coyne provided a compelling rationale for the adoption of his modelling parameters; by contrast, Dr. Lesser's preferred approach to the CAPM produced ROEs so low that even he questioned their validity. Ultimately, Mr. Coyne's overall recommendations are intuitive in light of recent interest rate increases. They also align with the observed relationship between historical allowed returns in North America and government bond yields, and the output of both the former BCUC Automatic Adjustment Mechanism ("AAM") and the AAM in place in Ontario.

6. FortisBC respectfully submits that the BCUC should approve, in accordance with the Fair Return Standard, FEI's proposed common equity ratio of 45% with an ROE of 10.1%, and FBC's proposed common equity ratio of 40% with an ROE of 10.0%.

B. ORGANIZATION OF THESE FINAL SUBMISSIONS

7. These Final Submissions are organized as follows:

- ***Part Two – The Fair Return Standard:*** A fair overall return is one that meets all three Fair Return Standard tests of comparability of returns, financial integrity, and capital attraction in all market conditions.

- ***Part Three – FEI's Business Risk Has Increased Significantly***: FEI's business risk is significantly higher than what it was at the time of the 2016 GCOC Proceeding, and supports a material increase in FEI's common equity ratio and overall allowed return. The impact of the Energy Transition, in particular, is pervasive and recognized by investors.

- ***Part Four – Other Factors Supporting 45% Common Equity Ratio for FEI:*** An increase in FEI's common equity supports its existing credit rating, which is under strain from marginal financial metrics and new emphasis by rating agencies on ESG considerations. FEI's proposed equity thickness is still at the low end of the range of reasonableness when compared to its North American peers, with whom it competes for capital.

- ***Part Five – FBC's Business Risk is Similar to 2013:*** FBC's overall business risk is similar to what was assessed in the 2013 Proceeding. FBC is experiencing increased risk in various areas, such as operating risk, Indigenous rights and engagement, regulatory risk and challenging economic conditions. However, these increases are not material enough to justify an increase in FBC's common equity thickness and are otherwise offset by FBC's potential to benefit from the Energy Transition.

- ***Part Six – Other Factors Demonstrating 40% Equity Remains Reasonable for FBC:*** FBC's current capital structure also remains appropriate in light of FBC's marginal financial metrics, and Mr. Coyne's assessment of FBC's business and financial risk relative to his proxy groups.

- ***Part Seven – The Appropriate ROE for FEI and FBC:*** Mr. Coyne's recommended ROE (based on the proposed common equity ratios) of 10.1% for FEI and 10.0% for FBC is based on robust modelling. The results are intuitive in light of current market conditions, and have been validated for reasonableness in a number of ways.

- ***Part Eight – Other Issues:*** The BCUC should continue to set ROE by periodic hearing, rather than adopt an AAM. The effective date of the BCUC's order should be January 1, 2023.

PART TWO: THE FAIR RETURN STANDARD

8. Part Two addresses the Fair Return Standard, which is the well-established legal test that the BCUC must apply in determining FEI and FBC's allowed capital structure and ROE. The Fair Return Standard is integral to just and reasonable rates, and recognizes the long-term financial health of the utility is beneficial to both the company and customers. FEI and FBC make the following points:

(a) The overall allowed return must meet all three elements of the Fair Return Standard: comparable investment, financial integrity and capital attraction.

(b) The legal requirement to provide a Fair Return that meets the three requirements is absolute, and cannot be compromised to achieve lower rates in the short-run.

(c) Capital structure and the cost of common equity are closely linked in determining the Fair Return for regulated entities, and both must be considered together to determine whether the Fair Return Standard has been met.

(d) The BCUC's application of the Fair Return Standard must account for the financial and business risks that investors will perceive FEI and FBC face in achieving their return on and of their invested capital. The BCUC has generally reflected changes in business risk primarily in capital structure, with ROE being informed by the output of cost of equity models and an assessment of capital market conditions.

(e) Credit ratings, which are directly impacted by the allowed ROE, common equity ratio and (increasingly, for FEI in particular) ESG considerations, are important in the context of the capital attraction and financial integrity elements of the Fair Return Standard.

(f) The ability to adjust depreciation rates does not eliminate investor risk, and accelerating depreciation now would be ill-advised and counterproductive.

A. ALL THREE ELEMENTS OF THE LEGAL STANDARD MUST BE MET

9. The Fair Return Standard, the obligation on rate regulators to provide for a Fair Return on capital invested by utilities, is a long-established legal principle.[2] It is embodied in sections 60 and 59(5) of the *Utilities Commission Act*[3] ("UCA"). The BCUC explicitly recognized the Fair Return Standard in the 2006 GCOC Decision,[4] the 2009 GCOC Decision,[5] the 2013 GCOC Decision,[6] and the 2016 GCOC Decision.[7]

10. In the 2009 GCOC Decision, the BCUC endorsed[8] the National Energy Board ("NEB") articulation of the Fair Return Standard as comprising three elements. The NEB had held in Decision RH-1-2008:

> The Fair Return Standard requires that a fair or reasonable overall return on capital should:
>
> • be comparable to the return available from the application of the invested capital to other enterprises of like risk (comparable investment requirement);
>
> • enable the financial integrity of the regulated enterprise to be maintained (financial integrity requirement); and
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> • permit incremental capital to be attracted to the enterprise on reasonable terms and conditions (capital attraction requirement).

11. The three requirements of the Fair Return Standard are distinct, and each requirement must be satisfied. The BCUC recognized in the 2006 GCOC Decision, for instance,

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2 *Northwestern Utilities Ltd. v. Edmonton (City),* [1929] S.C.R. 186.

3 R.S.B.C. 1996, c. 473.

4 *In the Matter of Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc., Application to Determine the Appropriate Return on Equity and Capital Structure and to Review and Revise the Automatic Adjustment Mechanism* Decision, Order No. G-14-06, March 2, 2006 ("2006 GCOC Decision"), pp. 8 and 48.

5 *In The Matter of Terasen Gas Inc. Terasen Gas (Vancouver Island) Inc. Terasen Gas (Whistler) Inc. and Return On Equity And Capital Structure* Decision, G-158-09, December 16, 2009 ("2009 GCOC Decision"), p. 15.

6 *In the Matter of British Columbia Utilities Commission Generic Cost of Capital Proceeding (Stage 1)*, Order and Decision G-75-13, May 10, 2013 ("2013 GCOC Decision"), pp. 7-9, 11-12.

7 *In the Matter of FortisBC Energy Inc. Application for its Common Equity Component and Return on Equity for 2016*, Order and Decision G-129-16, August 10, 2016, ("2016 GCOC Decision") pp. 3-5.

8 2009 GCOC Decision, p. 15.

that the comparable return requirement is distinct from the capital attraction standard: "One standard does not trump the other, neither is one subsumed by the other."[9]

12. The Fair Return Standard represents an opportunity cost for investors, who, given a choice of investments of similar risk, will choose the investment that offers the highest return for a given level of risk. As the Supreme Court of Canada put it in *Ontario (Energy Board) v. Ontario Power Generation Inc.*: "The required return is one that is equivalent to what they could earn from an investment of comparable risk." [10] Mr. Coyne and Dr. Lesser both characterized the Fair Return Standard in this way. Mr. Coyne stated, for instance:[11]

> The assessment of whether the Fair Return Standard has been met requires an examination of the required returns by investors in like-risked enterprises. Investors must consider whether there might be alternative investment opportunities that would provide a better return for the same risk. This weighing of alternatives and the highly competitive nature of capital markets causes the prices of stocks and bonds to settle on a price that provides investors with a return that is adequate for the risks involved. Thus, for any given level of risk, there is a corresponding level of return that investors expect in order to take on that risk and not invest their money elsewhere. That return is referred to as the "opportunity cost" of capital or "investor required" return. In addition to setting the return at the "opportunity cost" of capital, a fair return must also be sufficient to maintain the financial integrity of the utility which requires a return sufficient to maintain credit metrics such that the utility can maintain a favorable bond rating to minimize debt costs and provide lenders assurance that the company's earnings are adequate to meet its fixed obligations. Finally, the return must be sufficient to attract incremental capital on reasonable terms and conditions, to the benefit of both investors and customers.

13. Dr. Lesser similarly stated:[12]

> The underlying legal standard for determining the cost of capital for a regulated utility is sometimes called the "fair return" or the "capital attraction" standard. Capital attraction is embedded within a fundamental economic concept: *opportunity cost*. When investors make their funds available to a firm – regulated

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9 2006 GCOC Decision, p. 48.

10 2015 SCC 44 ("Ontario Power Generation Decision") at para. 16.

11 Exhibit B-1-8-1, Application, Appendix C, Evidence of Mr. Coyne ("Concentric Report") pp. 10-11.

12 Exhibit A2-3, Dr. Lesser Report, p. 3.

> or not – they are foregoing the option of using those funds for some other purpose, whether current consumption or another investment. They are also putting their funds at risk.
>
> In return for their investment, investors will expect to be compensated for the risk they are taking. This means investors must be offered an expected return that will provide an opportunity for compensation comparable to the expected returns of other investments with similar risk. In regulatory settings, the expected return is considered be a risk-comparable or fair return.
>
> [Emphasis in original.]

14. Accordingly, a Fair Return respects the opportunity cost principle with regard to equity investment and provides a utility the opportunity to earn a return equivalent to that available to utilities with comparable risk.

15. Debt investment is also integral to providing safe and reliable service, such that the capital attraction and financial integrity elements of the Fair Return Standard also require consideration of the utilities' ability to debt finance. The BCUC's determination of ROE and capital structure for FEI in 2009 was predicated on the finding that the decision would improve FEI's credit metrics so as to allow it to maintain its existing A-level rating "with a margin of comfort".[13] As discussed in Parts Four and Six below, FEI's and FBC's financial metrics are marginal for their rating, and FEI's are under pressure as rating agencies begin placing weight on ESG considerations. The utilities' respective proposed ROEs and capital structures account for these concerns.

B. THE FAIR RETURN MUST BE ESTABLISHED INDEPENDENTLY FROM RATE IMPACTS

16. The overall rate of return allowed for FEI and FBC—i.e., the combined impact of ROE and capital structure—must be based on their true cost of capital with reference to the Fair

[13] 2009 GCOC Decision, p. 68: "These improvements in metrics should, in the Commission Panel's opinion, enable TGI both to maintain its A3 rating with a margin of comfort and to attract the capital it requires on reasonable terms and conditions."

Return Standard, without compromising this legitimate cost of service to achieve lower rates in the short-term.

17. There is a statutory obligation on the BCUC, set out in sections 60 and 59(5) of the UCA, to approve rates that afford the utility an opportunity to earn a Fair Return. Binding judicial authorities have referred to this obligation as "absolute".[14] In the Supreme Court of Canada's BC Electric Railway Decision, Locke J. stated:[15]

> The Commission is directed by s. 16(1) (a) to consider all matters which it deems proper as affecting the rate but that consideration is to be given in the light of the fact that the obligation to approve rates which will give a fair and reasonable return is absolute.
>
> [Emphasis added.]

18. The "absolute" requirement to provide a fair return necessitates determining FEI's capital structure and ROE with reference to the three criteria without considering potential short-term rate impacts. The BCUC's 2006 GCOC Decision stated: "In coming to a conclusion of a fair return, the Commission does not consider the rate impacts of the revenue required to yield the fair return." [16] Similarly, in the 2009 GCOC Decision, the BCUC stated:[17]

> As for the Intervenors' submissions that this is not the time for a rate increase, and ICG's submission that the Commission must balance the requirements of customers with those of Terasen, the Commission Panel adopts the Commission's statement in the 2006 ROE Decision where it made it clear that its obligation was and is to set rates that are fair and reasonable, and to allow a utility the opportunity to earn a fair rate of return.

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[14] *British Columbia Electric Railway Co. v. Public Utilities Commission*, [1960] S.C.R. 837 ("BC Electric Railway Decision") at 848 and 856-857; *TransCanada Pipelines Ltd. v National Energy Board*, 2004 FCA 149 ("TransCanada Decision") at paras. 35-36 and 43.

[15] BC Electric Railway Decision at p. 848 (see also pp. 856-857).

[16] 2006 GCOC Decision, p. 8.

[17] 2009 GCOC Decision, p. 15.

19. Moreover, the Fair Return Standard is not met by the lowest possible overall return. The BCUC stated in the 2006 GCOC Decision:[18]

> As for the JIESC's lowest cost argument, the Commission Panel shares the view of the NEB, which recognized that "lowest possible" was not the appropriate test when it stated, at page 25 of its RH-2-94 Decision on generic cost of capital:
>
> > "Contrary to what some parties advocated during the hearing, the Board is of the view that it is not appropriate to over-leverage a pipeline in order to identify the minimum acceptable deemed common equity ratio possible."

20. While some interveners might still choose to focus on short-term rate impacts associated with FortisBC's proposals, courts have emphasized that a Fair Return is in the long-term best interest of customers. It enables customers to continue obtaining service from a utility operating on a financially strong and sustainable basis. For instance, the Federal Court of Appeal has stated:[19]

> [6] The cost of capital to a utility is equivalent to the aggregate return on investment investors require in order to keep their capital invested in the utility and to invest new capital in the utility. That return will be made in the form of interest on debt and dividends and capital appreciation on equity. Usually, that return is expressed as the rate of return investors require on their debt or equity investments.
>
> …
>
> [12] Even though cost of capital may be more difficult to estimate than some other costs, it is a real cost that the utility must be able to recover through its revenues. <u>If the Board does not permit the utility to recover its cost of capital, the utility will be unable to raise new capital or engage in refinancing as it will be unable to offer investors the same rate of return as other investment of similar risk. As well, existing shareholders will insist that retained earnings not be reinvested in the utility.</u>
>
> [13] <u>In the long run, unless a regulated enterprise is allowed to earn its cost of capital, both debt and equity, it will be unable to expand its operations or even maintain existing ones. Eventually, it will go out of business. This will harm not</u>

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[18] 2006 GCOC Decision, p. 8.

[19] TransCanada Decision, paras. 6, 12 and 13.

> only its shareholders, but also the customers it will no longer be able to service. The impact on customers and ultimately consumers will be even more significant where there is insufficient competition in the market to provide adequate service.
>
> [Emphasis added.]

21. The Supreme Court of Canada similarly stated in the Ontario Power Generation Decision:[20]

> The required return is one that is equivalent to what they could earn from an investment of comparable risk. Over the long run, unless a regulated utility is allowed to earn its cost of capital, further investment will be discouraged and it will be unable to expand its operations or even maintain existing ones. This will harm not only its shareholders, but also its customers . . . .

22. The conceptual underpinnings of the absolute requirement to approve a Fair Return is that the utilities' cost of capital is a legitimate cost of providing safe and reliable utility service. As the Federal Court put it: "Even though cost of capital may be more difficult to estimate than some other costs, it is a real cost that the utility must be able to recover through its revenues."[21] The BCUC is determining in this proceeding the amount of that cost, for which provision will be made in rates set by the BCUC. Establishing the allowed return for FEI and FBC at a level that fails to reflect their true cost of capital as determined with reference to the three standards of capital attraction, financial integrity, and comparable returns would be no more valid than a determination to disallow rate recovery for a prudently incurred capital or operating cost.

C. CAPITAL STRUCTURE AND ROE ARE INTER-RELATED AND BOTH AFFECT A FAIR RETURN

23. Capital structure and the cost of common equity (ROE) are closely linked, and must be considered together when assessing whether the Fair Return Standard has been met.[22] For instance, other factors being equal, a firm with a lower common equity ratio requires a higher

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[20] At para. 16.

[21] TransCanada Decision, para. 12.

[22] 2016 GCOC Decision, p. 9; 2013 GCOC Decision, p. 12; Exhibit B1-8, Appendix C, Concentric Report, p. 147.

ROE to compensate for the additional financial risk equity investors face from being more highly leveraged.[23] A lower common equity ratio means greater fixed financing obligations through debt and increased earnings volatility, as Mr. Coyne explained: [24]

> The equity in the capital structure, besides providing a return that compensates equity shareholders for their investment, serves to buffer unanticipated earnings swings. If the equity layer becomes too thin, lenders will become concerned that the company may not be able to meet its fixed debt obligations and will require a higher debt yield to compensate for the additional risk. Additionally, as the equity layer is reduced, earnings are also reduced such that an unexpected earnings disruption has greater impact on the thinner equity layer. Shareholders will require a higher return to compensate for this increased risk to their investment return. Accordingly, an appropriate equity ratio benefits both shareholders and customers by reducing overall financing costs.

D. THE FAIR RETURN STANDARD IS INFORMED BY INVESTOR PERCEPTION OF THE UTILITY'S RELATIVE BUSINESS AND FINANCIAL RISK

24. Since the Fair Return Standard involves determining an investor's opportunity cost, the BCUC's analysis must assess how investors will perceive the financial and business risks that FEI and FBC face in achieving their return on and of invested capital. In this regard, FEI and FBC highlight three points.

(a) Consider Change in FEI/FBC's Risk Over Time and Relative to Peer Groups

25. The BCUC's practice, which is consistent with Mr. Coyne's evidence, is to determine the Fair Return in consideration of (a) changes in the utility's risk since the previous

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[23] In the 2009 Decision, the BCUC confirmed its view that "Financial risk is measured through the debt equity ratio of a utility" at p. 18. See also Exhibit B1-8-1, Appendix C, Concentric Report, pp. 73, 119 and 147; Exhibit A2-3, Lesser Report, p. 86. This is discussed further in Part 7, Section E of these Final Submissions.

[24] Exhibit B1-8-1, Appendix C, Concentric Report, p. 117.

BCUC cost of capital proceeding;[25] and (b) the utility's risk relative to a group of proxy companies with similar (albeit not identical) risk profiles.[26]

26. The BCUC last reviewed FEI's business risk in the 2016 Proceeding, and FBC's business risk in the 2013 Proceeding. Comparisons between the circumstances today and what the BCUC had recognized in prior decisions provide a directional indication as to the utility's cost of capital. We address the changes in FEI and FBC's business risk over time in Parts Three and Five, respectively.

27. Proxy groups consisting of relatively comparable companies are used when modelling ROE so as to ensure the ROE is comparable to the return of other enterprises of like risk. (In this case, Mr. Coyne developed proxy groups and Dr. Lesser endorsed them).[27] However, proxy groups are never a perfect match for the subject utility's risk profile, and this comes into play in several ways in this proceeding, including:[28]

(a) Differences in business risk and financial risk between the subject utility (FEI/FBC) and its respective peer groups affect an investor's required return. Mr. Coyne's evidence is that FEI's business risk (after considering mitigation efforts[29]) is comparable to, or higher than, the US Gas proxy group and greater than other large Canadian investor-owned gas utilities. FEI's financial risk is comparable to

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[25] In 2016, the BCUC stated, ". . . consistent with past practice, the Panel has reviewed the evidence and provided its determination on the common equity component with consideration of three factors: (i) changes in FEI's business risk since the last proceeding . . .": 2016 GCOC Decision, p. 9. See also 2013 GCOC Decision, pp. 13, 16.

[26] 2016 GCOC Decision, pp. 8, 52, 53. In this case, Mr. Coyne selected Canadian, US and North American proxy groups with companies comparable to FEI and FBC with respect to business and financial risks. The ROE estimation models produce a range of results for the gas proxy groups. Based on this analysis, Mr. Coyne selected reasonable estimates of FEI and FBC's ROE. The assessment of the appropriateness of FEI and FBC's proposed capital structure is also based on an examination of each company's business and financial risks relative to the respect proxy groups. See Exhibit B1-8-1, Appendix C, Concentric Report, pp. 2-4.

[27] 2016 GCOC Decision, p. 47. Mr. Coyne's proxy groups are discussed in Part Seven, Section B.

[28] 2016 GCOC Decision, p. 8: "The 'comparable investment requirement' of the Fair Return Standard requires the return available from the application of the utility's invested capital to be comparable to the return of other enterprises of like risk. The challenge posed by a comparability test is to find a group of proxy companies that reflect the substantially similar environment facing FEI, including the market, regulatory, financial, environmental and political circumstances affecting current and future economic prospects."

[29] Tr. 5B, p. 910, l. 19 – p. 911, l. 5 (Roy).

that of the Canadian proxy group and substantially higher than the US and North American gas proxy groups. FBC has markedly greater financial risk than the US electric utility proxy group, but has comparable to lower business risk. Dr. Lesser did not assess relative risk. (See Part Four, Section B for FEI and Part Seven, Six, Section D)

(b) ROE models will underestimate the cost of capital for FEI and FBC because these utilities have higher financial risk (i.e., much more debt and less equity in their capital structure, relative to the peer groups used in the modelling).[30] (See Part Seven, Section E)

(c) In the 2016 Decision, the BCUC also accepted a relative risk analysis with other proxy companies as a "check" on its determinations respecting FEI's capital structure.[31] FEI and FBC are far below the North American average. (See Part Four, Section B for FEI and Part Six, Section D for FBC)

(b) Cost of Capital Is Informed by Investor Perception

28. How investors are likely to perceive the markets and risks is important because it is for investors to consider whether there might be alternative investment opportunities that would provide a better risk-adjusted return. Investor focus is prospective and primarily long-term.

29. As Mr. Coyne stated, "the key consideration in determining the cost of equity is to ensure that the methodologies employed reasonably reflect investors' forward-looking views of the financial markets in general, and the subject company (in the context of the proxy group) in particular" [Emphasis added].[32] Mr. Coyne also observed: "It doesn't have to be what actually happens, and this can be -- this is where I think this conversation can get off track, that you're

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[30] Tr. 3, p. 271, l. 22 – p. 272, l. 5 (Coyne); Dr. Lesser agreed that differences in financial risk (i.e. leverage) need to be taken into account: Exhibit A2-3, Lesser Report, p. 86; Tr. 3, p. 270, ll. 5-21 (Lesser).

[31] 2016 GCOC Decision, p. 43-44.

[32] Exhibit B1-8-1, Appendix C, Concentric Report, p. 45.

not trying to determine what's going to happen in the future. What you're trying to determine is what investors expect is going to happen in the future"[33] [Emphasis added]. Dr. Lesser put it this way:

> Perceived risk is not necessarily the same thing as actuarial risk. Investors, for example, may perceive that sunspot activity affects corporate profitability, even though there may be no actuarial evidence of such. However, if perceived risks are commonly believed, then they will nevertheless be relevant to the calculation of expected returns.[34]

30. Consistent with Mr. Coyne's comment that cost of capital is concerned with "investors' forward-looking views",[35] the BCUC has recognized that risk is prospective:[36]

> While investors certainly consider a risk which has recently occurred, they must be equally concerned about the future prospects of an investment. Further, while it is true investors may sell a particular investment; it would be imprudent of an investor to fail to consider the future prosects of an investment and any potential future risks which may occur.
>
> The Panel accepts FEI's argument that risk is prospective. In the Panel's view, the risk of earning ROE does not disappear in any given test year because of a utility's success in achieving it in prior years.

31. The BCUC has previously determined that "only minimal weight can be given to short-term risk as an impediment to earning a fair return".[37] This is consistent with the investment objectives of FortisBC's debt and equity investors. As Ms. Roy noted:

> . . . our risk assessment in done in consideration of the long term. So, I mean, we consider short term as well, of course, but included in that. Because we're considering the long-term lives of our assets because that is, you know, investors

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[33] Tr. 4, p. 686, ll. 12-17 (Coyne); see also Exhibit B1-13, RCIA IR1 23.4.

[34] Exhibit B1-41, Testimony of Dr. Lesser before the Illinois Commerce Commission ("Illinois Testimony"), p. 13; Dr. Lesser confirmed this is still his view: Tr. 4, p. 474, l. 25 – p. 475, l. 11 (Lesser); Mr. Coyne also agreed with this statement at Tr. 5B, p. 914, l. 7 – p. 915 l. 13.

[35] Exhibit B1-8-1, Appendix C, Concentric Report, p. 45.

[36] 2016 GCOC Decision, p. 11. Mr. Coyne also observed that "the evaluation of risk from a cost of capital perspective is forward looking. And the fact that the company has been able to earn its allowed return historically doesn't really address what risk the company faces today in its business on a going forward basis": Tr. 5B, p. 914, ll. 12-17.

[37] 2013 GCOC Decision, p. (iii).

> are investing in our company, so that's what their [sic] worried about is the recovery on and of their capital and you know, we have long-[term] assets.[38]

The vast majority of FortisBC's debt investor pool consists of long-term institutional investors, pension funds, and "buy and hold" investors. As with the equity investors referenced by Ms. Roy, these debt investors take a long-term view of risks like those represented by Energy Transition.[39]

32. As discussed in Part Four, commentary by credit rating agencies, actions of FEI's investors, and market trends shifting away from investment in fossil fuel infrastructure, among other things, all show that investors are taking note of the new long-term risks for gas utilities associated with the Energy Transition. The markets will continue to perceive risk in FEI's pathways to compliance.

(c) BCUC Has Primarily Accounted for Long-term Business Risk in Capital Structure

33. The BCUC has historically reflected investor-perceived changes in a utility's long-term business in its capital structure:

> An assessment of the level of business risk is a key element in reaching a determination on a common equity component for FEI's capital structure. The Commission has typically found the level of business and other risks are an important factor in determining the equity ratio in a utility's capital structure.[40]

Mr. Coyne has taken that approach.[41]

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[38] Tr 5B, p. 911, l. 20 – p. 912 l. 1 (Roy). As described by Mr. Coyne, "Long-term risks represent an actual shift in the business risk profile of the company for which there is no foreseeable mitigation": Exhibit B1-8-1, Appendix C, Concentric Report, p. 73.

[39] Tr. 5A, p. 724, l. 18 – p. 725, l. 7 (Lorimer).

[40] 2016 GCOC Decision, p. 13. See also 2013 GCOC Decision, pp. 24-25.

[41] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 148-150.

E. SOUND CREDIT RATINGS ARE CRITICAL FOR CAPITAL ATTRACTION AND FINANCIAL INTEGRITY ELEMENTS OF THE FAIR RETURN STANDARD

34. As discussed further in Part Four (FEI) and Part Six (FBC), credit ratings—which are directly impacted by ROE, the common equity ratio and (increasingly, particularly for FEI[42]) ESG considerations—are important to maintaining appropriate access to debt financing in varied circumstances. Credit ratings are one indicator of how the market (particularly debt investors) perceives FEI and FBC's financial and business risk. They influence the utility's ability to attract capital.[43] As such, they inform the financial integrity and capital attraction elements of the Fair Return Standard.

35. Thus, after considering business risk, the BCUC's practice is to consider the implications of the common equity ratio for the utility's credit rating. In the 2013 GCOC Decision, for example, the BCUC:

(a) Accepted that continued access to debt capital at an attractive price is important;[44] and

(b) Supported the maintenance of an "A" category credit rating to the extent that it could be maintained without going beyond what is required by the Fair Return Standard.[45]

36. In the 2016 Decision, the BCUC recognized the implications that its cost of capital determination can have on FEI's credit rating:

> The Panel accepts FEI's view that a reduction of its common equity ratio [below 38.5%], especially to the level recommended by Dr. Booth, could result in downward pressure on the credit rating. Moody's past actions, including its reaction [to] the 2013 GCOC Decision, indicate that any negatively viewed regulatory action could impact FEI's credit rating due to its weak metrics especially

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42 See discussion in Parts Four and Six of these Final Submissions.

43 Exhibit B1-8-1, Appendix C, Concentric Report, p. 80.

44 2013 GCOC Decision, p. 50.

45 2013 GCOC Decision, p. 50.

> given the additional pressure higher capital expenditures expected over the next few years.[46]

37. It is fundamentally important to recognize that assessing the impact of a credit rating downgrade goes much, much further than a financial calculus of additional interest charged on future debt. As FortisBC put it: ". . . a downgrade to a lower credit rating is not a simple transition to another lower credit rating state. A credit rating downgrade itself is a profoundly negative economic event and its overall impact would be so pervasive that it is not possible to reliably quantify the true impact to customers" [Emphasis added].[47] Parts Three and Five demonstrate that FEI and FBC's financial metrics are now weak to the point of being generally inconsistent with the current rating. Moreover, Moody's is now highlighting FEI's high exposure to the Energy Transition, and is explicitly basing its assessment on the assumption that this GCOC proceeding will not have a negative financial impact on the utilities.[48]

F. THIS PROCEEDING ADDRESSES RETURN ON CAPITAL, NOT RETURN OF CAPITAL

38. FortisBC was asked why depreciation rates, which provide for return of capital through depreciation expense based on the current estimate of an asset's expected life, do not eliminate the need for a higher return. The answer is that there will always be residual risk that cannot be mitigated. The NEB has correctly identified two material residual risks: (1) the risk that estimates of expected life will prove to be wrong by virtue of, e.g., intervening event or mis-estimation; and, (2) the inability to increase deprecation rates because rates would be uncompetitive:[49]

> There was discussion during the hearing regarding the extent to which regularly adjusting depreciation rates to reflect current best estimates of economic life affects the risk faced by TransCanada. The Board is of the view that there are two distinct aspects to risk as it relates to business risk and depreciation rates. <u>The first is that the current best estimate of economic life, which is reflected in the depreciation rates, may ultimately prove to be wrong.</u> Various business factors,

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46 2016 GCOC Decision, pp. 35-36.

47 Exhibit B1-13, RCIA IR1 17.2.

48 Exhibit B-1, Application, p. 34.

49 Exhibit B1-20, BCUC IR2 62.1 and 62.2, citing NEB Decision RH-2-2004, Phase 22 (April 2005), p. 46.

> including changes to supply or competitive forces, could alter the economic life of the Mainline. This possibility cannot be fully mitigated and therefore should be compensated through cost of capital. The second aspect of depreciation-related risk is that the depreciation rates in use may not actually reflect the estimates of economic life that would be selected if assessed at that point in time. A company can mitigate the risk that the estimates in use are not current by bringing forward an application to reconsider its depreciation rates. The part of this risk that is mitigable should not be compensated through the cost of capital. Should it become apparent that depreciation rates do not adequately reflect current estimates of economic life, it is incumbent on the management of the company to seek to change depreciation rates, not to expect incremental compensation through the cost of capital. Still related to the second aspect, there is a potential that a company's tolls may not incorporate sufficiently high depreciation rates because competitive factors would prevent such rates from being charged. This potential, if significant, is appropriately compensated through the cost of capital. The assessment of cost of capital should assume that the depreciation rates reflect the best assessment of economic life of the pipeline. Consequently, resetting depreciation rates to reflect a new best estimate of economic life does not, by itself, reduce business risk from what it would be absent a change in the best estimate.
>
> [Emphasis added.]

39. FEI and FBC continue to update depreciation rates regularly, as they have always done, and also continue to invest new (undepreciated) capital. There is no reason for the BCUC to treat the residual risk associated with depreciation any differently today than it has in the past. In other words, the currency of FortisBC's depreciation rates is a proverbial red herring in this proceeding.

40. Accelerated depreciation (which BCUC staff also raised[50]), regardless of when it is initiated, is not a silver bullet for FEI to address stranded asset risk associated with the Energy Transition. Implementing accelerated depreciation now as a means of trying to avoid cost of capital increases associated with the Energy Transition, would be ill-advised and counterproductive.

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[50] Exhibit B1-9, BCUC IR1 47.1, 47.2, 47.2.1; Exhibit B1-20, BCUC IR2 62.4.

(a) As the NEB noted above, FEI will always face recovery risk associated with the accuracy of the life estimates.

(b) Customer rates would increase significantly due to the higher depreciation expense. In addition to creating energy affordability and inter-generational equity issues,[51] reduced price competitiveness would tend to increase risk for FEI.[52] As customers leave the system, the rate increases would fall to progressively smaller numbers of customers on the system. It can lead to a demand death spiral.[53] Ms. Roy observed that the ability to recover costs in rates "only exists to the extent we [FEI] exist or to the extent we have customers to recover them from".[54]

(c) In addition to competitiveness considerations, adopting accelerated depreciation now would backfire as a means of attempting to slow cost of capital increases associated with the Energy Transition because it would be signalling to the market that a diversified pathway is not viable.[55]

41. In light of these outcomes, it is not surprising that Mr. Coyne was unaware of any regulators that have decided to accelerate the depreciation of gas assets now as a result of the Energy Transition.[56]

G. CONCLUSION AND REQUESTED FINDING

42. The elements and application of the Fair Return Standard are well-settled, and the BCUC should re-affirm the points discussed in this Part. The remainder of these Final Submissions demonstrate how that the proposed ROE and common equity ratio for FEI/FBC achieve that legal standard.

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51 Tr. 5A p. 753, ll. 23 – p. 754, l. 7 (Coyne).

52 Exhibit B1-9, BCUC IR1 47.2.1.

53 Tr. 5A p. 753, ll. 23 – p. 754, l. 7 (Coyne); Exhibit B1-9, BCUC IR1 47.2.1.

54 Tr. 5B, p. 837, ll. 6-10 (Roy).

55 Exhibit B1-9, BCUC IR1 47.1, 47.2, 47.2.1; Exhibit B1-20, BCUC IR2 62.4.

56 Tr. 5B, p. 951, ll. 7-25 (Coyne).

PART THREE: FEI'S BUSINESS RISK HAS INCREASED SIGNIFICANTLY

43. FEI's evidence regarding its business risks is found in Appendix A of the FortisBC Evidence. Mr. Coyne's evidence (Appendix C of the Evidence) includes his own assessment of FEI's business risk, and a comparative risk analysis of FEI's business and financial risks relative to his proxy groups.[57] The evidence discussed in this Part demonstrates that FEI's business risk is significantly higher than what it was in 2016 Proceeding, and supports a material increase in FEI's common equity ratio.

44. This Part is organized around the following supporting points:

(a) Since the 2016 Proceeding, the Energy Transition has developed to the point where it has become pervasive in FEI's business and has required a significant response for FEI to remain relevant.

(b) On a factor-by-factor analysis, the following risks are all higher today than at the time of the 2016 Proceeding: economic conditions, policy, Indigenous rights and engagement, energy pricing, demand/market conditions, operations and the various applicable regulatory frameworks.

A. THE ENERGY TRANSITION IS PERVASIVE AND HAS PROFOUNDLY CHANGED FEI'S RISK PROFILE SINCE THE 2016 PROCEEDING

45. The evidence, discussed below, demonstrates that the nature and extent of policy developments adverse to natural gas and favouring the adoption of low-carbon energy has fundamentally changed since the 2016 Proceeding. The umbrella term "Energy Transition" invokes the truly transformative nature of the policies now being adopted,[58] and FEI is far more affected by it than many other utilities. The mere fact that the discussion has shifted from FEI's competitiveness to whether and how FEI will simply *preserve a role for itself* in the face of policy changes is telling. As Mr. Slater put it: "But the risk that we won't succeed is real, the need to

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[57] Exhibit B1-8-1, Appendix C, Concentric Report.

[58] Exhibit B1-9, BCUC IR1 4.1.

take dramatic steps just to remain relevant in BC's energy landscape is certainly not something we ever contemplated having to face back in 2016."[59] Investors are alive to the risk that FEI's strategies—what FEI calls "pathways"—entail.[60]

(a) FEI's Current Equity Ratio Reflects an Outdated Perception that Political and Price-Related Risks Have Declined Since 2009

46. The significant increase in risk associated with the Energy Transition is evident from the tenor of prior BCUC decisions, which downplayed the policy risk facing FEI. Only a common equity ratio materially greater than 40% can be reconciled with the logic underpinning the BCUC's previous decisions.

47. In FEI's 2009 cost of capital proceeding, the BCUC had increased FEI's deemed common equity thickness from 35% to 40%. It had done so partially, but significantly, on account of the introduction of climate change legislation by the provincial government that had created new uncertainty since the 2005 proceeding. The Panel found that "the change in government policy will quite probably cause potential customers not to opt for natural gas and persuade potential retrofitters to opt for electricity."[61] Note that the focus had been on the impact these policies could have on the competitiveness of gas ("not to opt"), versus policies that preclude or discourage the use of gas.

48. FEI's next cost of capital proceeding occurred in 2013. The BCUC decreased FEI's allowed equity thickness to 38.5%, stating that the political and energy price risks described in the 2009 Proceeding did not materialize to the extent expected. The BCUC found that "reductions are warranted in long-term risk associated with provincial government climate and energy policies as well as the competitive position of natural gas relative to electricity."[62] At the time, there were no plans to raise the carbon tax beyond the 2013 levels and emission trading became

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[59] Exhibit B1-30, Opening Statement of Doug Slater, p. 2. See also Exhibit B1-11 CEC IR1 3.4.

[60] Exhibit B1-20, BCUC IR2 67.1.1.1.

[61] 2009 GCOC Decision, p. 37.

[62] 2013 GCOC Decision, p. 53. See also pp. 26-27.

a dormant issue, resulting in the BCUC finding a lessening of risk associated with provincial climate and energy policies.[63]

49. In 2016, the BCUC viewed FEI's risk as not materially different from what it had considered in the 2013 Proceeding.[64] The BCUC agreed that steps taken by municipal governments and activities taken at the provincial government level with respect to climate-related initiatives and policies posed real and potential threats to demand for natural gas and FEI's ability to earn a future return on and of its capital. However, given the issues of timing and level of knowledge related to potential impacts, the Panel found it could not do more than acknowledge there was a heightened level of potential threats resulting in a slight to moderate increase to the level of political risk compared to the period around the 2013 GCOC proceeding. Accordingly, the Panel indicated that the change in the political landscape was a risk that would continue to evolve and would need to be monitored in future proceedings.[65]

50. In his Opening Statement, Mr. Slater remarked on the tenor of the evidence and decision in the previous cost of capital proceeding and how it differs from today's reality:

> As part of preparing for this hearing my colleagues and I were looking back at the documents and decisions from FEI's previous Cost of Capital proceedings. What struck us is that nobody in that 2016 proceeding was using terms like "Energy Transition" or Environmental, Social and Governance (ESG) based investing. Indeed, in the 2013 Stage 1 Generic Cost of Capital (GCOC) decision, the BCUC reduced FEI's common equity ratio from 40 percent to 38.5 percent citing "a lessening of risk associated with provincial government climate and energy policies" since the proceeding in 2009, and maintained this reduced equity thickness levels in the 2016 cost of capital proceeding.[66] Of course, since 2016 the pace and scope of the Energy Transition, and its potential impact on FEI, has far surpassed what had been contemplated in any of the 2009, 2013 or 2016 proceedings. The Energy Transition is more sweeping, more stringent and is

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63 2014 GCOC Decision, p. 27.

64 2016 GCOC Decision, pp. 44, 53-54.

65 2016 GCOC Decision, p. 22.

66 See Exhibit B1-8, Application, p. 28 for further discussion.

> happening much faster. And BC is at the forefront of it, as demonstrated by the provincial 2018 CleanBC plan and 2021 CleanBC Roadmap.[67]

51. FEI's current common equity ratio of 38.5% reflects an outdated perception that risk associated with relatively nascent climate change policy apparent in 2009 had since declined. The Energy Transition has far exceeded what was anticipated in 2009, let alone the more optimistic scenario underpinning the 2013 and 2016 Decisions. The policies and laws being put in place now go much farther than the policies of 2009 that could affect the competitiveness of gas. Since 2016, need for climate change action is driving rapidly-evolving climate targets and plans. The pace and volume of new and more stringent anti-gas policies proposed and implemented by various levels of government since the 2016 Proceeding is unprecedented. Mr. Slater observed that the influence of the Energy Transition "on our business is now pervasive. The Energy Transition has become an existential issue for FEI as a gas utility."[68] The objective evidence, outlined below, supports that view.

52. While the BCUC is not bound by its previous decisions, the BCUC should endeavour to maintain logical consistency to avoid arbitrary decision making. A common equity ratio materially greater than 40% upholds that principle, whereas anything less than 40% would be impossible to reconcile with the BCUC's prior decisions.

(b) The Energy Transition Creates New Stranded Asset Risk for FEI

53. The Energy Transition, notably the policy developments discussed in this section, creates stranded asset risk for FEI by introducing the possibility that significant portions of FEI's assets will cease being used and useful before being fully depreciated.[69] As Mr. Coyne stated, the potential for stranded assets associated with the Energy Transition "is a real risk and it's one that wasn't present five years ago".[70]

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67 Exhibit B1-30, Opening Statement of Doug Slater, pp. 1-2.

68 Exhibit B1-30, Opening Statement of Doug Slater, p. 1.

69 Exhibit B1-9, BCUC IR1 4.2.1.

70 Tr. 5A, p. 751, ll. 5-6 (Coyne).

Policy Developments Have Changed in Tone and Pace

54. Since 2016, there have been increased developments on the science of climate change pointing to the need for stringent action as global GHG emissions continue to increase.[71] British Columbians have also experienced more severe climate impacts in the form of wildfires, flooding and extreme heat that they did not experience in 2016.[72] These developments have increased the sense of urgency among policymakers in all levels of government to respond to climate change. This urgency is manifesting in two related ways: (1) all levels of government have implemented more stringent policies and GHG emissions targets since the 2016 Proceeding; and (2) governments are now developing and implementing climate action plans in an effort to begin abating emissions.

55. The figure below, which we prepared based on the evidence and legislation, illustrates the stark contrast between the climate action policy landscape before and after the 2016 Proceeding. The former provincial government in 2015 had a Natural Gas Strategy and an LNG strategy, such that, as Mr. Slater observed, "natural gas had a prominent role in both climate and energy policy of the day at that time."[73] Since then, decarbonization policy and legislation has been introduced by every level of government in rapid succession, quickly changing FEI's goalposts for compliance and system planning and ultimately challenging FEI's current business model. We address the specific policies and legislation in more detail in Section B(d) of this Part.

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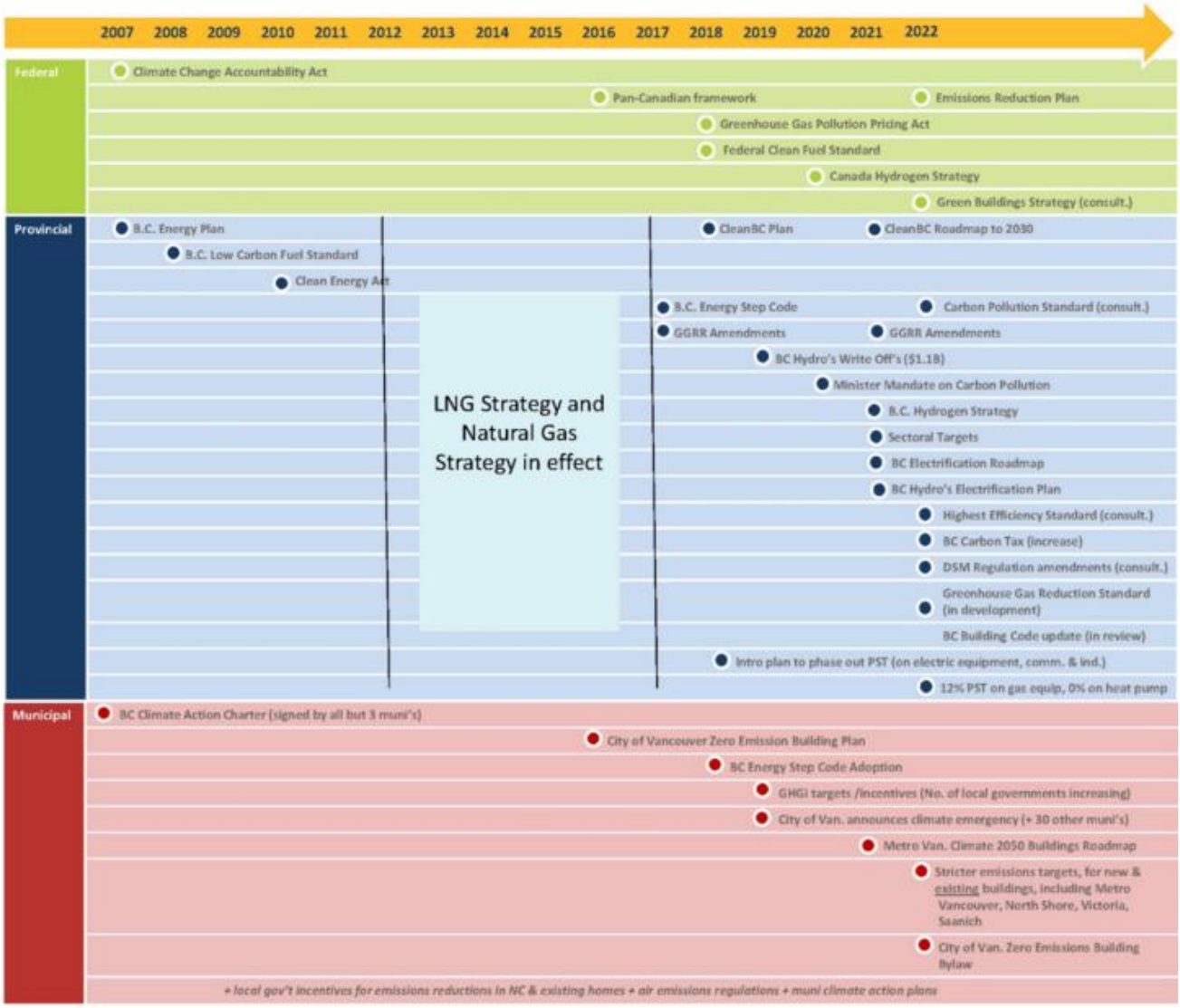
71 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.1.2.

72 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 113; Exhibit B1-10, BCOAPO IR1 5.1.

73 Tr. 5A, p. 762, ll. 5-14 (Slater).

Major Policies Adopted by All Levels of Government

Demonstrate the Acceleration of Climate Action Policy Since 2016



56. Mr. Slater described the policy progression illustrated above in the following terms:

> So, what has happened is we've seen a step change. And I mentioned this morning, I just talked a little bit about the kind of time period with which we had our previous proceeding in 2016, under the B.C. Liberal government of the day, Christie Clark government, and the government had a climate and energy policy that encompassed [a] natural gas strategy and an LNG strategy. And indeed, we have documents on the record today like Direction No. five, that was really

> implementing that strategy. And insofar as it relates to enabling LNG projects. And, you know that was the reality of what we were dealing with then.
>
> What's changed is that since then we've seen that prominent role of gas in climate and energy policy landscape in B.C. become less clear in favour of electrification. We've seen a number of policies like the Clean BC Road Map is the most recent, and probably the most impactful policy that we've ever seen here in British Columbia. That has, you know, a number of different policies and implementation underneath it, which will collectively - - the overall impact is that it discourages the use of gas and will make it much more challenging for us.[74]

57. As Mr. Slater alluded to, the provincial government's CleanBC Roadmap to 2030 ("CleanBC Roadmap")[75] and other climate action plans contemplate GHG reductions and favour an electrification-primary approach as opposed to the decarbonization of the gas system.[76] These plans, and the many steps government is taking to implement them, will negatively impact FEI's customers' rates and throughput.[77]

58. In addition, at the municipal level, FEI is experiencing increased opposition to the role of the gas system, and even Renewable Gas. Many municipalities have issued climate emergency declarations. They have followed-up those declarations with initiatives to curb natural gas attachments and consumption, both directly (through bylaws, regulation or other policy tools, such as carbon intensity targets for new construction) and indirectly (such as by streamlining the permit process for buildings without natural gas connections).[78] Municipal opposition challenges the successful implementation of FEI's Clean Growth Pathway,[79] FEI's strategy to meet provincial greenhouse gas reduction targets.

59. The current policy framework, and the lack of clear direction regarding the future role of FEI's delivery system, is emblematic of a lack of political will at present to advocate for a

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74 Tr. 5B, p. 895, l. 15 – p. 896, l. 12 (Slater).

75 Province of British Columbia, CleanBC Roadmap to 2030 (2021), online.

76 Exhibit B1-10 BCOAPO IR1 5.1.

77 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 4, section 4.2.2.1; Exhibit B1-9, BCUC IR1 4.4.1.1; Tr. 5B, p. 896, ll. 4-19 (Slater).

78 Exhibit B1-9, BCUC IR1 4.1.1.

79 Exhibit B1-20, BCUC IR2 67.1.

role for the gas system, and/or lack of acceptance or understanding among policymakers and the public of the role the gas system can play in decarbonization. Decisions made today have long-term consequences that limit the gas system's ability to transition effectively.[80]

60. These policies and legislative developments, along with energy market and operational barriers to decarbonizing the gas supply (also discussed in Section B below), give rise to stranding risk for FEI. An inability to make necessary investments, and the high cost of compliance with policy or legal requirements, have the potential to lead to a declining customer base, lower system throughput and lower utilization of assets. All of these outcomes, in turn, have a negative impact on customer rates and competitiveness.[81] The snowball effect of this scenario would potentially lead to underutilized assets and the utility not being able to fully depreciate, and thus recover, its invested capital.[82] This is the situation that the NEB recognized in a decision regarding the Canadian Mainline natural gas pipeline, stating: "Various business factors, including changes to supply or competitive forces, could alter the economic life of the Mainline. This possibility cannot be fully mitigated and therefore must be compensated through cost of capital."[83] The same reasoning applies to FEI's assets and capital investments.[84]

61. It is not open to FEI to unilaterally cease investing in the system as stranding risk increases. FEI continues to have the statutory duty to serve its customers.[85] Fulfilling that duty requires continued capital investment in a safe, reliable and resilient system.

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80 Exhibit B1-10, BCOAPO IR1 5.1.

81 Exhibit B1-9, BCUC IR1 4.4.1.1; Exhibit B1-11, CEC IR1 32.1.1.

82 Exhibit B1-9, BCUC IR1 4.2.1.

83 Exhibit B1-20, BCUC IR2 62.1.

84 Exhibit B1-11, CEC IR1 22.4.

85 UCA, s. 38: "A public utility must (a) provide, and (b) maintain its property and equipment in a condition to enable it to provide, a service to the public that the commission considers is in all respects adequate, safe, efficient, just and reasonable."

FEI's Strategy to Remain Relevant Is Promising But Faces Policy and Public Acceptance Challenges

62. Mr. Slater highlighted in his Opening Statement that FEI has strategies that, if successful, would see FEI preserving a role for itself in the Energy Transition. But he also made the point that success is contingent on "the right policy and regulatory support."[86] Mr. Coyne and Dr. Lesser echoed that Energy Transition risk partly depends on the response of policymakers and regulators.[87] However, so far, the provincial government has moved away from previous policies that contemplated a role for natural gas. Most climate action policies from all levels of government now hinder, rather than facilitate, FEI's ability to manage its Energy Transition risk.[88]

63. Ms. Roy, despite expressing pride in FEI's decarbonization efforts, observed that BC's current policy environment presents challenges that are far greater than what existed at the time of the 2016 Proceeding:

> Yeah, I think we've had to be at the forefront. It's not necessarily a choice. I mean, if we could go back to the days when were just worried about our natural gas supply, I'm sure we'd love to be back there. But we're not. We're in a situation where the policy environment has created it such that we have to have these plans in place and we have to move forward with them. And there's no question that they're going to [decrease] the competitiveness of our product, you know, even if we are successful. So, and there's a lot to overcome. But yeah we have – you know, in many ways we are at the forefront. I think we're proud of what we've done. And we're happy, you know, for the support we've had when we've had it, but still, compared to where we were six years ago, we'd rather be back there.[89]

64. Mr. Coyne stated: "It's hard to say that a gas company stands today where it did five years ago before it really dealt with these challenges."[90] Mr. Coyne added that while California, New York and Massachusetts are three jurisdictions progressing down a similar decarbonization path to BC, he stated, ". . . I would say that the rest of the industry has not yet

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86 Exhibit B1-30, Opening Statement of Doug Slater, p. 2. See also Exhibit B1-11 CEC IR1 2.5, 3.4.

87 Exhibit B1-21, Concentric Rebuttal Evidence, p. 3; Lesser Response to BCOAPO IR 14.4 (Lesser).

88 Exhibit B1-20, BCUC IR2 67.1; Exhibit B1-10, BCOAPO IR1 5.1.

89 Tr. 5A, p. 739, ll. 1-18 (Roy).

90 Tr. 5A, p. 722, ll. 21-23 (Coyne).

been faced with the same degree of policy restriction as we see in B.C. They're not as far down that path."[91] We discuss FEI's risk exposure relative to North American peer utilities in Part Six, Section D.

Investors Recognize Stranding Risk Associated With Energy Transition

65. As discussed in greater detail in Part Four of these Final Submissions, there is increasing recognition among investors of the impact of the Energy Transition on the future growth prospects of natural gas utilities generally, and FEI specifically.[92] For instance, Standard & Poor's ("S&P") Global Ratings has noted that, while "[s]tranded costs have not up until now been an issue for gas local distribution companies", concerns about stranded assets have spiked recently: [93]

> While new pipelines have faced fierce opposition from environmental activists and local communities since the initial shale gas development boom and the pace of new projects has declined in recent years, the specter of stranded assets did not really emerge for existing gas pipelines and the gas LDCs until recently when the zero-carbon movement picked up steam.

S&P concluded that "[c]hallenges with respect to addressing stranded costs arising from the latest energy transition are likely to continue and intensify in 2021 and beyond."

66. Investors perceive significant risk to the pathways that FEI is adopting and expect that the risks associated with these initiatives be reflected in the determination of the Fair Return.[94] Moody's, which is fully apprised of FEI's strategies, now characterizes FEI as having "very negative carbon transition risk" (2021)[95] and a "Highly Negative" environmental profile (2022)[96]. (See Part Four, Section A.)

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91 Tr. 5A, p. 732, l. 23 – p. 733, l. 5 (Coyne).

92 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 80-88; Exhibit B1-13, RCIA IR1 3.1.

93 Exhibit B1-8-1, Appendix C, Concentric Report, p. 90; Exhibit B1-9, BCUC IR1 4.2.1.

94 Exhibit B1-11 CEC IR1 2.5; Exhibit B1-9 BCUC IR1 4.1.

95 Exhibit B1-8, Application, p. 34.

96 Exhibit B1-50-1, Response to Undertaking No. 3, p. 7.

B. RISK FACTOR ANALYSIS: EVERY RISK FACTOR IS HIGHER OR SIMILAR

67. This section addresses FEI's business risk evidence by risk category. FEI has used the same categories as in the 2016 Proceeding, with one exception; FEI created a new Indigenous Rights and Engagement risk factor category (instead of being one of the risk factors under Political Risk) in recognition of the increasing significance of these considerations to FEI's overall business risk. These categories conform to the BCUC's definition of risk,[97] since each of the categories can potentially limit FEI's ability to realize its current and future earnings and/or cash flows. FEI's assessment as to how the risk has changed since the 2016 Proceeding for each category is summarized in the table below.

68. The risk factor analysis demonstrates that FEI's overall business risk is **significantly higher** in comparison to the 2016 Proceeding for two reasons. First, most categories present higher risk since the 2016 Proceeding. Second, political and regulatory risk, which are both higher due in large measure to the Energy Transition, are the risk categories where changes presently have the greatest potential to affect FEI's ability to earn its return on, and of, invested capital.

Business Risk Category	Risk Factor	Change in Risk Since 2016
Business Profile		**Similar**
	Type and size of the utility	Similar
	Service area	Similar
	Customer profile	Higher
Economic Conditions		**Higher**
	Overall economic conditions	Higher
Political		**Higher**
	Climate action goals and expectations	Higher
	Energy policies and legislation	Higher
Indigenous Rights and Engagement		**Higher**
	Legislative and policy developments	Higher
	Aboriginal rights and title	Higher

[97] 2013 GCOC Decision, p. 24; 2016 GCOC Decision, p. 9.

Business Risk Category	Risk Factor	Change in Risk Since 2016
	Social license/work interruption	Higher
Energy Price		**Higher**
	Commodity price	Higher
	Commodity price volatility	Higher
	Price competitiveness and carbon tax	Higher
Demand/Market		**Higher**
	Perception of energy	Higher
	New technology and energy forms	Higher
	Net customer additions	Higher
	Changes in building type and capture rates	Similar
	Changes in end-use market share	Higher
	Changes in use per customer	Similar
Energy Supply		**Similar**
	Availability of supply	Similar
	Access to supply	Similar
	Renewable Gas supply	New (Higher)
Operating		**Higher**
	Aging infrastructure and time dependent threats	Similar
	Third party damages	Similar
	Attitudes towards fossil-fuel industry	New (Higher)
	Municipal operating challenges	New (Higher)
	Cybersecurity	New (Higher)
	Unexpected events	Higher
Regulatory		**Higher**
	Regulatory uncertainty and lag	Higher
	Administrative penalties	Similar

(a) FEI Used Its Longstanding Approach to Categorization and Assessment of Risk

69. FEI responded to some information requests that asked whether the use of risk categories resulted in "double counting" of risk. There is no double counting implied. FEI's approach of discussing a single development in the context of multiple risk categories recognizes

certain developments, conditions or events can impact multiple risk categories. For instance, the Energy Transition affects almost every risk category.[98] FEI discusses these root causes where they are relevant in order to deepen an understanding of the business' overall risk profile and highlight the interconnected nature of risk analysis.[99]

(b) Business Profile Risk – Similar Risk

Business Profile		Similar
	Type and size of the utility	Similar
	Service area	Similar
	Customer profile	Higher

70. Business profile risk is determined by analyzing the type and size, service area, and customer profile of a utility, which are its fundamental characteristics. Size is a key determinant of risk, and there is empirical evidence that it affects the cost of capital (see Part Seven, Section F). The evidence demonstrates that, compared to the 2016 Proceeding, the business profile risk is similar overall, although aspects of its customer profile are adding risk.

FEI's Business Profile[100]

	2015	2022
Type of Utility	Local Distribution Company (LDC)	
Energy Product Offering	Natural gas, biomethane, propane	
Service Area	Mainland, Vancouver Island, and Whistler	
Rate Base ($000s)	3,661,370	5,409,207
Sales/Transportation Volumes (TJ)	176,035	234,057
Average Number of Customers	970,389	1,068,458
Customer Profile by Demand		
Residential	42%	41%

98 Tr. 5B, p. 908, ll. 20-26 (Roy).

99 Exhibit B1-9, BCUC IR1 20.3.

100 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 9, as revised in Exhibit B1-8-1-1, Errata on FortisBC's Business Risk Evidence, dated October 20, 2022.

Commercial	32%	29%
Industrial	26%	31%
Customer Profile by Sales Revenue		
Residential	60%	57%
Commercial	33%	30%
Industrial	7%	12%

Type and Size of Utility Are Relatively Unchanged

71. There has been no fundamental change in FEI's size or type since the 2016 Proceeding. FEI's primary business continues to be in serving space and water heating load in the residential and commercial sectors. FEI provides transmission and distribution services to its customers and obtains natural gas supplies on behalf of most residential, commercial and industrial customers. In short, FEI remains a relatively large natural gas distribution utility. Although the risk facing natural gas utilities has increased, the causes of that change are associated with other risk categories.[101]

FEI's Service Area Remains Unchanged

72. FEI's service area remains unchanged from the 2016 Proceeding. The majority of FEI's volume, revenue and customers continue to be located in the Lower Mainland region. The significant concentration of FEI's business in the Lower Mainland, i.e., lack of geographic diversity, has always meant that adverse developments in the Lower Mainland (e.g., earthquakes, floods, supply challenges etc.) have the potential to affect a large portion of FEI's business. FEI's concentration in the Lower Mainland is amplifying the effects of the Energy Transition for FEI; municipalities in these areas have tended to be among the most aggressive proponents of the climate policies discussed in Section B(d) below.[102]

[101] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 9.

[102] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 9-10.

Customer Profile Changes: Competitive Challenges in FEI's Core Business

73. Changes in FEI's customer profile since the 2016 Proceeding, and changes in expectations around how the profile would evolve, have resulted in higher customer profile risk. FEI's share of residential and commercial space and water heating, which is FEI's largest market for natural gas, is falling; BC Hydro is the primary beneficiary. Low-Carbon Transportation sales, which have for some time been regarded as a potential means of mitigating lost residential and commercial load, have not achieved the levels forecast at the time of the 2016 Proceeding, are volatile and face ongoing obstacles.[103]

74. The greater challenge that FEI now faces in maintaining load and market share in the residential and commercial sectors is attributable to a variety of considerations discussed throughout the remainder of this Section. They include government policies at the local, provincial and federal levels (Section B(d)); new price competitiveness challenges (Section B(f)); and, technological advances, energy efficiency improvements and building codes (Section B(g)).

75. FEI has encountered challenges growing its business in the Industrial and Low Carbon Transportation sectors. This load is also less desirable than residential and commercial load from the perspective of typical utility investors who favour stable earnings and growth:[104]

(a) The energy demand in these sectors tends to be more volatile than residential and commercial use. All else equal, the increased share of this type of load in FEI's load and revenue profiles will therefore lead to higher revenue volatility (and potentially earnings volatility) going forward.[105] The demand for containerized LNG in Asia in recent years illustrates the volatility;[106] LNG load decreased 11% in

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[103] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 2.3.

[104] Tr. 4, p. 503, ll. 8-14 (Lesser).

[105] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 11.

[106] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 14.

2021 compared to 2020 as a result of supply chain issues, far more than the residential and commercial sectors overall.[107]

(b) LNG as an on-road transportation fuel, natural gas vehicles and LNG as a marine fuel all face obstacles:

(i) The prospects of LNG as an on-road transportation fuel have deteriorated since the 2016 Proceeding. Four out of the seven LNG stations built by FEI have been closed due to lack of demand caused by the stalling of development in the production of heavy-duty long haul trucking engines that use LNG.[108]

(ii) The long-term success and continued adoption of natural gas vehicles for the medium- and heavy-duty transportation industries is predicated on FEI's ability to secure Renewable Gas supply for the transportation market, which is itself associated with risk (discussed later in this Section).[109]

(iii) There is currently a risk that FEI's marine bunkering for short sea marine vessels will be capped at the current ten vessels. Ship-to-ship bunkering, which is necessary for larger LNG transfer volumes to fuel trans-Pacific vessels, is dependent on third-parties. The Tilbury Pacific Marine Jetty Project still requires regulatory approvals.[110]

(c) Economic Conditions – Higher Risk

Economic Conditions		Higher
	Overall economic conditions	Higher

[107] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 11.

[108] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 14.

[109] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 12; risk associated with Renewable Gas supply is discussed in Section 8.3 of Appendix A.

[110] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 13-14.

76. Economic conditions can affect the ability of utilities to, among other things: (i) attach new customers or retain existing customers, (ii) maintain throughput levels, (iii) access capital, and (iv) receive cash flow from customers. In the 2016 Proceeding, all parties agreed that economic and capital market conditions remained much as they had been in 2012.[111] Since 2016, economic conditions have deteriorated considerably, affecting FEI's costs, revenues, operations, and ultimately its cost of capital.[112]

COVID-19 Pandemic Fallout and Ukraine War Have Created Economic Risk

77. The 2020 economic shutdown resulted in the worst annual GDP downturn in the last 20 years. BC's economy shrank by 3.8% in 2020, the biggest downturn in the last forty years.[113] In response to the COVID-19 pandemic's suppressive effect on Canada's economy, both provincial and federal governments have engaged in record deficit spending. Central banks were forced to implement unprecedented monetary policies to maintain access to capital markets. These efforts, along with global supply bottlenecks and labour shortages, resulted in increased inflationary pressure not seen in the last 30 years.[114]

78. The Russian invasion of Ukraine on February 24, 2022 has elevated global economic uncertainty, contributing to inflation and the pressure to increase interest rates.[115] Mr. Coyne described the impact of the war on Ukraine on the recovering economy as follows:

> If you go back to December [2021], at that point in time we felt as though we were recovering from our long, almost three-year period under COVID. And markets were beginning to recover. At that point in time we had the first signs of inflation up ticking. But most forecasters, including Central Banks, thought that it was going to be a temporary increase in inflation that was going to subside. But then we had the war in Ukraine later in February of 2022, and that put us in a very different position.

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111 2016 GCOC Decision, p. 8.

112 Exhibit B1-9, BCUC IR1 13.1.1.

113 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 17.

114 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 16; Exhibit B1-9, BCUC IR1 13.1.1.

115 Exhibit B1-20, BCUC IR2 63.2.

> And then at that point in time, we've experienced what is unanticipated, and inflation we haven't seen in the last 40 years in either Canada or the U.S.
>
> So, it really has been very disruptive to both the economy and to capital markets in general.[116]

The war in Ukraine has also contributed to increased price volatility and rising natural gas prices (commodity price risk is addressed later in this section).[117]

79. The supply chain issues, labour shortages and record high inflation rates affect FEI's costs, revenues and operations in a number of ways:[118]

(a) Supply chain issues can make it difficult to procure the necessary goods and materials required to complete projects on time and on budget, and increase delays in capital activities. FEI's ability to forecast revenue from its LNG export business has been affected by congestion and record-high shipping rates caused by supply chain issues.[119]

(b) Labour shortages can have a more pronounced impact on FEI than other companies since, as a natural gas utility, FEI was already facing increased difficulty in recruiting skilled workers.[120]

(c) Record inflation is increasing O&M and capital expenditures, which is generally expected to impact price competitiveness. Inflation can potentially affect the utility's bad debts, as those on fixed-income are increasingly finding it difficult to manage their finances and pay their bills on time.[121]

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[116] Tr. 4, p. 571, l. 15 – p. 572, l. 5 (Coyne).

[117] Exhibit B1-18 CEC IR2 65.1.

[118] Exhibit B1-9 BCUC IR1 13.1.1.

[119] Exhibit B1-9 BCUC IR1 13.1.1, See also Exhibit B1-8-1, Appendix A, Section 2.3 for further discussion of supply chain issues caused by the COVID-19 pandemic and the effect on LNG container exports.

[120] See Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 9.3 for further explanation of FEI's difficulty in recruiting skilled workers.

[121] Exhibit B1-9 BCUC IR1 13.1.1.

80. British Columbia's long-term economic growth contributes to FEI's higher business risk relative to the 2016 Proceeding. The Conference Board of Canada (CBOC) long-term forecast for both GDP and housing starts are lower than what was forecast in the CBOC's 2015 long-term forecast, indicating that in the CBOC's view, BC's long-term outlook is slightly worse than what was assumed in the 2016 Proceeding.[122]

(d) Political – Higher Risk

Political		Higher
	Climate action goals and expectations	Higher
	Energy policies and legislation	Higher

81. Political risk is one of the two most impactful risk categories for FEI (the other being regulatory risk).[123] The evidence demonstrates that FEI's political risk is significantly higher than what was assessed in the 2016 Proceeding—more so than any other risk category—due to the Energy Transition and associated stranding risk discussed in Section A of this Part.[124] We expand below on the lack of acceptance and understanding of FEI's vision for gas infrastructure as an optimal tool to reach decarbonization goals, and the significant policy developments at the provincial and municipal levels that place FEI at the forefront of the Energy Transition.[125]

Lack of Political Will, Understanding and/or Acceptance of Future Role of Delivery System

82. Guidehouse's Pathways to 2050 report[126] outlines how the gas system should have a crucial role in a decarbonized future because of its ability to use renewable and low-

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122 See Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 3 for a discussion of leading economic indicators.

123 For discussion of the distinction between political risk and regulatory risk, please refer to Exhibit B1-9 BCUC IR1 20.2.

124 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 19; Exhibit B1-8, Application, p. 14.

125 Exhibit B1-8, Application, p. 14.

126 Guidehouse, "Pathways for British Columbia to Achieve its GHG Reduction Goals" (August 2020), online at: <https://www.cdn.fortisbc.com/libraries/docs/default-source/about-us-documents/guidehouse-report.pdf>.

carbon fuels to address difficult to decarbonize end-uses like building and industrial heat and commercial transport. FortisBC's Clean Growth Pathway to 2050[127] identifies actions that FortisBC will take to help BC achieve its GHG emissions targets, taking a diversified approach to GHG reduction by using both BC's electricity and gas infrastructure. However, electrification-primary policies are not aligned with FEI's vision. Many policymakers either question the need for the gas system if electrification can be advanced, or consider the gas delivery system to be an impediment to decarbonization.[128]

83. The current policies appear to align with customer sentiment. For instance, in recent customer perception research, nearly half of the respondents now believe it would be relatively easy to meet all of BC's energy needs using renewable electricity. Two-thirds supported or were open to phasing out the use of natural gas for environmental reasons.[129]

84. Mr. Mazza addressed how this reticence to accept the gas system's future role affects FEI's efforts to expand the supply of renewable and low-carbon gas, a Pillar of FortisBC's Clean Growth Pathway:

> We're out acquiring significant, significant volumes of renewable gas right now. Billions of dollars of renewable gas. We need to be cognizant of some of the policy issues, the ability to actually use the renewable gas in municipalities after acquiring all this renewable gas. That's a risk.[130]

Growing Emphasis on Electrification and Disincenting Gas Consumption

85. The Table below provides a snapshot of various policies being implemented by the provincial government and municipalities across BC since the 2016 Proceeding. The recently-

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[127] FortisBC, "Clean Growth Pathway to 2050" (February 2022), online at: <https://www.cdn.fortisbc.com/libraries/docs/default-source/about-us-documents/clean-growth-pathway-brochure.pdf>.

[128] Exhibit B1-10, BCOAPO IR1 5.1.

[129] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, Figure A7-1, p. 79.

[130] Tr. 5A, p. 756, l. 26 – p. 757, l. 5 (Mazza). Mr. Mazza clarified in response to a question from Ms. Dang that "billions of dollars" referred to the commitments FEI has made in long-term renewable natural gas contracts: Tr. 5A, p. 764, ll. 3-22.

issued provincial CleanBC Roadmap to 2030 ("Roadmap"), which won an award at the United Nations COP26 climate conference,[131] includes ambitious measures that represent a marked departure from the policies that preceded the Roadmap. The Roadmap, and other provincial policies, implementation plans and measures summarized in the Table, can reasonably be expected to have a significant impact on FEI's ability to retain or add customers and load.[132] As is also evident from the Table, a growing number of municipalities are using various approaches to reach their ambitious GHG reduction targets, supported by increased autonomy and regulatory authority.[133] The BCUC should find that, collectively, these government policies and measures place FEI at the forefront of the Energy Transition.

Examples of Government Action Since 2016 that Is Detrimental to FEI's Business

Policy	Effect
Provincial	
CleanBC Roadmap to 2030[134]	On October 25, 2021, the Province released the award-winning CleanBC Roadmap as part of its commitment to achieve BC's legislated GHG reduction target of 40% below 2007 levels by 2030. It indicates the government's intention to increase the carbon tax to $170 per tonne by 2030, implement a GHG cap for natural gas utilities, and implement a requirement that all heating equipment must be greater than 100% efficiency (which conventional gas heating equipment cannot meet).[135] Measures in the Roadmap are implemented through a number of policies described in this Table.

131 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 24.

132 Exhibit B1-8, Application, p. 3; Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 24.

133 Exhibit B1-10 BCOAPO IR1 5.1; Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.3; Exhibit B1-11, CEC IR1 35.1 and 35.2.

134 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.

135 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.2.1; Exhibit B1-11, CEC IR1 32.1.1.

Sectoral Targets[136]	In March 2021, the Province set sectoral GHG emissions targets that represent the required emission reduction from 2007 levels by 2030 for the following sectors: • Transportation – 27 to 32%; • Industry – 38 to 43%; • Oil and Gas – 33 to 38%; and • Buildings and Communities – 59 to 64%. FEI delivers the majority of its energy to the Industry and Buildings and Communities Sectors which are also the sectors with the most ambitious targets.
GHG Reduction Standard (GHGRS)[137]	The GHGRS will establish a cap on GHG emissions for natural gas utilities that will require FEI to reduce GHG emissions from energy delivered to the buildings and industrial sectors. The cap will be set at 6.11 Mt of CO2e per year by 2030. Details on the GHGRS remain under development and compliance pathways to achieve the cap have not yet been developed. The GHGRS also sets sectoral targets, e.g., an emissions reduction of 61% in the buildings sector, which is an aggressive target that will require a rapid transition in the buildings sector at great cost and risk to FEI.
BC Carbon Tax[138]	The Roadmap requires the carbon price of $45 will either match or exceed the federal carbon price, which is expected to rise to $170 per tonne by 2030, with annual increases of $15 starting in 2023. These increases go much farther than what had been anticipated at the time of the 2016 Proceeding and erode FEI's price competitiveness with electricity.
BC Building Code - Carbon Pollution Standards[139]	The Roadmap establishes new carbon pollution standards within the BC Building Code to meet a new target of transitioning to zero-carbon new construction by 2030 through the addition of GHGi targets for new buildings. This will reduce conventional natural gas use in new buildings.
Efficiency Standards for New Space and Water Heating[140]	The Roadmap establishes a requirement that all new space and water heating sold and installed in BC will need to be at least 100% efficient by 2030 (the Highest Efficiency Standard). Since this requirement cannot be

136 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.2; Exhibit B1-10, BCOAPO IR1 5.2.1.

137 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.2.

138 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.1.

139 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.4; Roadmap, p. 40.

140 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.4; Roadmap, pp. 40-41.

	met with conventional gas equipment, FEI is significantly exposed to loss of market share in both new buildings and existing customers.
Phase-Out of Gas-Fired Equipment Incentives[141]	The Roadmap establishes a requirement to amend DSM Regulations to phase out energy efficiency incentives for conventional gas appliances and equipment and introduce more incentives to promote fuel switching from gas to electric heat pumps.
BC Low Carbon Fuel Standard (LCFS)[142]	The BC LCFS requires fuel suppliers to decrease the average carbon intensity of the fuels they supply. The Roadmap raised the carbon intensity reduction target to 30% for gasoline and diesel. The increased stringency will increase risk for FEI's CNG vehicles as the volume of credits they generate may be reduced or eliminated, making CNG vehicles financially less attractive.
Building Electrification Roadmap (BERM)[143]	The BERM was sponsored by the Province, BC Hydro and the City of Vancouver and is a central strategy to decarbonize the building sector by electrification. The BERM provides recommendations around increasing the costs of natural gas, replacing gas appliances with electric ones, and investing heavily in electric heat pumps.
BC Hydro's Electrification Plan[144]	BC Hydro's Electrification Plan includes about $190 million for new incentives, energy studies and other programs to encourage customers to make the switch to electricity. This includes incentives of $60 million for industry, $30 million for transportation and $26 million for homes and buildings, including $13 million in "top-up" offers for residential heat pumps (up to $3,000 per household) and new incentives for low-income and commercial customers.
BC Hydro Write-Offs[145]	The Province's 2019 decision to write-off $1.1 billion of BC Hydro's costs and have them absorbed by taxpayers artificially supressed BC Hydro's rates and reduced FEI's price competitiveness.

[141] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.4; Exhibit B1-11, CEC IR1 32.1.1; Roadmap, p. 41.

[142] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.2.1.5.

[143] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.2.2.1.

[144] Exhibit B1-8-1, Application, FEI Business Risk Assessment, section 4.2.2.2.2; Exhibit B1-10, BCOAPO IR1 5.3.

[145] Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.2.3.

Preferential Tax Treatment for Electricity	The Province is phasing out Provincial Sales Tax (PST) on electricity for commercial and industrial customers, further reducing FEI's price competitiveness.[146] The Province is increasing PST on gas appliances from 7% to 12% and exempting electric heat pumps from PST.[147]
Local Government	
BC Climate Action Charter[148]	All but three municipalities in BC have now signed the BC Climate Action Charter, a voluntary agreement between the BC government and the Union of BC Municipalities where each local government signatory commits to take action on climate change.
Climate Emergency Declarations[149]	Since 2016, about 30 municipalities including City of Vancouver, City of Victoria, District of North Vancouver and others have declared climate emergencies, along with policies to achieve ambitious GHG reduction targets. These policies include effective bans on conventional natural gas equipment by requiring efficiency levels higher than 100%, adoption of BC Energy Step Code levels for new buildings, and requiring connections to District Energy Systems and other measures such as financial and non-financial incentives for all electric options for space and water heating applications.
BC Energy Step Code[150]	A provincial building code that provides tools for municipalities to adopt a higher level of energy efficiency in new construction that goes above and beyond the requirements of the BC Building Code. While it is a provincial code, local governments are the de facto regulators.[151]
Municipal Greenhouse Gas Intensity (GHGi) Targets[152]	A number of local governments have adopted the BC Energy Step Code and have implemented their own GHGi targets for new construction, the

146 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, p. 30.

147 Exhibit B1-9, BCUC IR1 4.1.1; Exhibit B1-10, BCOAPO IR1 7.8.1.

148 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, pp. 30-31; Exhibit B1-10, BCOAPO IR1 5.5, 5.6.

149 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.3.

150 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.3.2.1; Exhibit B1-9, BCUC IR1 12.2.

151 Exhibit B1-9, BCUC IR1 12.2.

152 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.3.2.1; Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, section 4.2.3.1: GHGi is the total annual GHG emissions from all the energy use for

	combination of which results in an effective ban on natural gas connections. The implementation of GHGi levels, and the range of targets that have been set (from 6 KgCo2e/m2 to 1 kgCO2e/m2) vary substantially across FEI's service territory which creates challenges for FEI in developing a consistent strategy to meet these varying targets.
Incentives for GHG Emissions Reduction in New Construction[153]	Local governments use various incentives for builders to reduce emissions in new construction. For instance, developments that utilize low carbon energy sources may be rewarded with significant density bonuses, and permitting policies for electric-only options may be streamlined. Since developers are making the energy system decisions in new developments, this impedes the ability of the occupants to choose gas as their energy source and restricts FEI from connecting new customers.
Incentives for GHG Emissions Reduction in Existing Homes[154]	Municipalities are streamlining the permitting process for electric-only option retrofits and for rental and non-market housing that switch to electricity.
Municipal Climate Action Plans	For example, Vancouver's Climate Emergency Action Plan states that starting in 2025, carbon intensity limits will incrementally decrease to zero over time before 2050 for large commercial and retail buildings. Prescriptive requirements or carbon limits for other building types will be required in 2030.[155]
Air Emissions Regulations[156]	Some local governments are starting to target or expand their regulation of air emissions. For instance, Metro Vancouver has introduced new air quality requirements and fees. Under the new fee structure, fees related to methane emissions begin in 2022 at $180 per tonne and increase to $1,120 per tonne by 2025. These fees apply to FEI's air discharge permits for the Tilbury LNG facility, compressor stations and biogas upgrader facilities.
Other Bylaws Implementing Measures to Restrict the Use of Natural Gas	Many municipalities are now developing and implementing their own measures that restrict the use of natural gas. For instance:

the operation of a building, per square metre per year. It is calculated by multiplying the total amount of a building's energy use in one year by the associated emission factor for that energy source, and dividing it by the building's gross floor area.

153 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.3.2.2.

154 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 40-41.

155 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.3.3.

156 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 4.2.3.4.

	• The City of Vancouver's Zero Emissions Vancouver Building Bylaw[157] requires zero emissions heating and hot water equipment in new one to three storey residential buildings from January 1, 2022. • The Metro Vancouver Regional District Climate 2050 Buildings Roadmap[158] calls for acceleration of electrification and restriction of fossil fuel supply infrastructure expansion in meeting its target of all buildings being zero emissions by 2050. • The City of Burnaby is making the transition from gas furnaces to heat pumps a requirement for heating and hot water system upgrades by 2025.[159]

Provincial Support of Renewable Gases Is Outweighed by Detrimental Policies

86. Hearing participants pointed to the provisions of the GGRR that are supportive of Low-Carbon Transportation and RNG supply. In reality, the benefit from those GGRR provisions is vastly outweighed by the tide of pro-electrification policies.

87. First, the GGRR provisions supporting FEI's investments and incentives for the transportation sector expired on March 31, 2022. The timing and details of any renewal are uncertain.[160]

88. Second, the renewable and low-carbon gas supply provisions are limited by price, volume and type of gas.

89. Third, they also do not address barriers to demand.[161] As Mr. Slater noted, policies described in the Table above will impede FEI's ability to sell those renewable gases in the future: "So when you do get . . . higher cost lower carbon solutions like RNG, are you going to be able to deliver that to customers in a municipality that's got an effective ban or is not allowing connection to the gas system?"[162] Since 2017, the GGRR itself has included provisions that enable

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157 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, p. 37.

158 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, p. 31.

159 Exhibit B1-1-8, Appendix A, FEI Business Risk Assessment, p. 41.

160 Exhibit B1-9, BCUC IR1 14.1.

161 Exhibit B1-9, BCUC IR1 14.1; Exhibit B1-11, CEC IR 39.7; Tr. 5A, p. 766, l. 16 – p. 767, l. 22 (Slater & Roy).

162 Tr. 5A, p. 736, ll. 6-12; see: Exhibit B1-9, BCUC IR1 14.1 for further discussion.

and encourage electrification through prescribed undertakings, increasing competition for FEI's renewable and low-carbon gas solutions.[163] The RNG also "comes at a higher cost and so maintaining competitiveness is a key issue", [164] an issue we address below in the context of the Energy Price risk factor.

(e) Indigenous Rights and Engagement – Higher (New)

Indigenous Rights and Engagement		Higher
	Legislative and policy developments	Higher
	Aboriginal rights and title	Higher
	Social license/work interruption	Higher

90. As Mr. Slater noted, "the vast majority of the province is unceded and does not have treaties and so we have about 204, 205 different nations in British Columbia and they're all unique, diverse and [have] individual, complex governance systems."[165] While these realities haven't changed much since the 2016 proceeding, the legal, policy and social climate informing relationships with Indigenous communities has changed materially. There is compelling evidence that the potential for Indigenous rights and title issues to impact FEI's business, and hence the investment risk that FEI faces, has increased since the 2016 Proceeding. We focus below on the new risks associated with recent legislation addressing the UN Declaration on the Rights of Indigenous Peoples ("Declaration"),[166] the BCUC's Indigenous Utility Inquiry Report, ground-breaking case law, litigation risk, and social licence and protests.

FEI Is In a Different Position Today than 2016 and Investors Have Noticed

91. In prior proceedings, FEI had grouped risk related to relationships with Indigenous groups with other political risk factors. FEI's concerns had centred on incremental developments

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[163] GGRR, s. 4 (electrification) and s. 5 (EV charging stations).

[164] Tr. 5A, p. 735, ll. 12-13 (Slater).

[165] Tr. 5B, p. 923, l. 25 – p. 924, l. 3 (Slater). See also Exhibit B1-8, Appendix A, p. 44; Exhibit B1-11, CEC IR1, 42.1.

[166] United Nations Declaration on the Rights of Indigenous Peoples (2007), online.

in Aboriginal law jurisprudence. FEI had assessed the uncertainty in the case law, together with differing views on the scope of adequate consultation and accommodation, as creating increased operational and regulatory complexity, as well as an increased risk of litigation. In the 2016 Decision, the BCUC expressed confidence that FEI would continue to successfully manage its relations in an effective and efficient manner, such that any change in the threat to FEI's operations would not have a material effect on the utility's ability to earn a return on and of its capital.[167]

92. That assessment is outdated in light of fundamental developments since the 2016 Proceeding, discussed in this section, affecting how companies and the Crown interact with Indigenous groups in BC.

93. Moreover, regardless of the level of confidence the BCUC might have in FEI's management abilities, investor perception matters and it is clear that the capital markets perceive this change as well. For instance, Moody's recently recognized in an in-depth research report that, while corporations can apply actions and programs to mitigate Indigenous rights and engagement concerns, their best efforts may still be insufficient.[168] Moody's identified that possible repercussions from a lack of social license from relevant Indigenous communities may include: a delay in a project construction or even its cancellation; a loss of permit, right of way or operating license; blockades; litigation and boycotts. All these events could lead to lost revenue, increased costs or a balance sheet write-off, which are credit negatives for the applicable corporation. According to Moody's, Indigenous communities objecting to a specific project or activity is an event risk that cannot be determined in advance with certainty, another credit negative for corporations planning to develop projects or activities.[169]

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[167] 2016 GCOC Decision, p. 23.

[168] Exhibit B1-8, Application, section 6.3.1.4.

[169] Exhibit B1-8, Application, section 6.3.1.4.

New UNDRIP-Related Legislation Has Broad Implications for FEI's Business

94. The provincial *Declaration on the Rights of Indigenous Peoples Act*[170] ("DRIPA") and the federal *United Nations Declaration on the Rights of Indigenous Peoples Act*[171] ("UNDRIP Act") represent very significant developments since the 2016 Proceeding. The BCUC should find that the legislation has added uncertainty, complexity, risk and cost for FEI in developing and maintaining relationships with Indigenous groups, advancing new projects and ongoing operations and maintenance of FEI's existing infrastructure.

95. DRIPA and the UNDRIP Act provide for BC and Canada's laws (respectively) to be brought into alignment with the Declaration and the development of action plans to meet the objectives of the Declaration.[172] Free, Prior and Informed Consent (FPIC) is a central principle of the Declaration. However, the definition of FPIC is unsettled, and many Indigenous groups believe it means projects require their consent to proceed.[173] The conflicting perspectives on FPIC's meaning have created new uncertainty for FEI and FBC. FEI/FBC is addressing this uncertainty by seeking to obtain consent from Indigenous groups, but authorizations may be challenged where decisions are made without the consent of Indigenous groups. More in-depth engagement, and greater involvement of Indigenous groups in decision-making, comes with its own risks: cost escalation, project delays and uncertain timelines.[174]

96. In BC, legislation related to project permitting is being adopted to align with the Declaration. Importantly, the new *Environmental Assessment Act*[175] ("EAA"), which was brought into force in December 2019, introduces changes to the environmental assessment process in BC to incorporate the concept of FPIC and significantly broadens consultation obligations. Under the new EAA, the Environmental Assessment Office must seek to achieve consensus with the

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170 S.B.C. 2019, c. 44.

171 S.C. 2021, c. 14.

172 E.g., DRIPA, ss. 3 and 4.

173 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 46.

174 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 46.

175 S.B.C. 2018, c. 51.

participating Indigenous Nations at various stages of the environmental assessment process.[176] As this process is still new, there is little guidance from the Environmental Assessment Office as to how this change to the engagement process under the new EAA will affect Environmental Assessment applications. However, the Tilbury Phase 2 LNG Expansion Project is in the new Environmental Assessment process (concurrently with the federal impact assessment process). In that process, FEI is engaging with 42 Indigenous groups, which is a significant increase from the number of nations which would have been consulted under the former EAA.[177] To put that number in perspective: The Tilbury Phase 2 LNG Expansion Project is a non-linear project on a brownfield industrial site.

97. These provisions in the EAA not only increase the cost of Indigenous engagement within the environmental assessment process, but also increase the risk of process and project delays and of legal challenges related to consensus-seeking and consent.[178] FEI has important projects that are either currently in EAA processes or will likely be subject to the EAA processes in the coming years.

Indigenous Utility Inquiry Report Introduced New Risks for Incumbent Utilities

98. The implementation of the BCUC's Indigenous Utility Inquiry Report[179] recommendations would: (i) reduce rate base and earnings, (ii) lead to higher rates, and reduced competitiveness, caused by loss of demand from existing customers located in Indigenous utilities' service areas, and (iii) increase the risk associated with CPCN applications. The BCUC recommended that Indigenous Utilities should be able to opt-out of the BCUC regulatory framework in their service areas and self-regulate the provision of public utility services.[180] The report states that an existing franchise should not prevent an Indigenous utility from operating

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176 EAA, see for example ss. 16, 19, 27, 28, 29, 31 and 32.

177 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 46-47.

178 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 47.

179 BCUC, Indigenous Utilities Regulation Inquiry Final Report (April 30, 2020), online.

180 Service area would be confined to reserve lands or lands covered by specific modern treaties, or self-governing agreements (Inquiry Report, sections 4.5, 4.6 and 4.7).

on reserve or treaty land. In certain cases where the Indigenous utility will likely materially impair the franchise of the incumbent utility, "a limited carve-out of the incumbent utility's service area is required".[181] The BCUC further recommended that the UCA be amended to require the BCUC to consider the Declaration and the economic development needs of a First Nation applying for a CPCN to operate an Indigenous utility on Traditional Territory.[182] BC's DRIPA draft action plan included as an action the engagement of First Nations to identify and support clean energy opportunities related to the Inquiry Report (action 4.24), which suggests that BC may take some action with respect to the BCUC's recommendations prior to 2026.

Two Recent Court Decisions Expose FEI to New Types of Risks

99. Project proponents have, for many years, faced the potential for judicial reviews of permits and authorizations for projects based on claims of inadequate consultation or other Indigenous rights litigation. There have been recent manifestations of this risk for companies with linear infrastructure, such as the Trans Mountain pipeline litigation. Notably, the multiple challenges Trans Mountain faced in that case underscored that even securing the support of most of the affected Indigenous groups along a project corridor does not insulate the proponent from delays and project risk from consultation and accommodation-based court challenges.[183]

100. While consultation and accommodation issues were on the BCUC's radar at the time of the 2016 Proceeding, two recent cases in particular—*Yahey v. British Columbia*[184] ("*Yahey*") and *Thomas and Saik'uz First Nation v. Rio Tinto Alcan Inc.*[185] ("*Saik'uz*")—mark significant legal developments that introduce new types of risk exposure for FEI.

101. In *Yahey*, the court found cumulative impacts from industrial development in the Treaty 8 region of BC infringed Blueberry River First Nations' treaty rights. BC was ordered to

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181 Inquiry Report, section 4.9.3, p. 65.

182 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 49.

183 *Tsleil-Waututh Nation v. Canada (Attorney General)*, 2018 FCA 153*; Coldwater First Nation v. Canada (Attorney General)*, 2020 FCA 34.

184 2021 BCSC 1287.

185 2022 BCSC 15.

establish mechanisms to assess and manage the cumulative impacts of industrial development. BC and Blueberry River First Nations are in the process of negotiating such mechanisms. FEI operates in Treaty 8 region. Significant delays for authorization applications in the Treaty 8 region are expected until the new mechanism to assess and manage cumulative effects is developed and the inevitable backlog of applications is cleared. Further, although the nature of the mechanism is unknown at this point, it reasonable to expect that the mechanism will increase risks for FEI's operations and related applications within Treaty 8. The potential exists for BC to implement such a mechanism outside of Treaty 8 lands. This, the decision and the current negotiations have also created considerable uncertainty in BC's investment climate.[186]

102. In *Saik'uz*, the court acknowledged for the firs time that Indigenous groups have the ability to pursue private law claims such as nuisance or trespass against third parties, including project proponents, based on impacts to Indigenous rights and title. Although there are defenses project proponents like FEI can rely on, this case expands the circumstances in which Indigenous groups may bring claims against third parties.[187]

Protests and Direct Action Have Become More Commonplace

103. There has been an increase over the past few years in blockades and project-related demonstrations. Blockades and demonstrations can prevent access to project construction sites, assets and operations, delay construction of projects. They may require a proponent to seek an injunction to prohibit interference with a project, assets or operations.[188]

104. The Coastal GasLink natural gas pipeline project is a good example of this phenomenon. The proponent had support from elected leadership from all of the Indigenous nations along the pipeline route but faced blockades organized by a faction of the hereditary

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[186] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 50.

[187] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 50.

[188] Exhibit B-8-1, Appendix A, FEI Business Risk Assessment, section 5.4.

leadership of one of the Indigenous groups. The protests and blockades expanded, and resulted in protests and blockades across the country.[189]

105. Due to both the nature of FEI's business (i.e., linear gas infrastructure) and the large number of Indigenous groups who have overlapping territories across FEI's service area, FEI faces risk of a similar nature to Coastal GasLink. Trying to achieve support and consent from dozens of Indigenous groups over a wide geographic area is challenging, and factions within one Indigenous group can present significant obstacles to successful project development.[190]

The Risk Can Be Mitigated, but Not Eliminated by Effective Engagement

106. FEI's practice of early and ongoing engagement reduces, but cannot eliminate, project and operating risk. There are factors that are beyond FEI's direct control. Effective consultation and accommodation involves the Crown, and the Crown's relationship with particular Indigenous groups will also influence the tenor of engagement.[191] There may be a difference of opinion on the depth of engagement FEI and the Crown is required to undertake in order to meet the duty to consult.[192] Some Indigenous groups or individuals may have an inflexible position on development, as has been the case with Coastal Gaslink.

(f) Energy Price – Higher Risk

Energy Price		**Higher**
	Commodity price	Higher
	Commodity price volatility	Higher
	Price competitiveness and carbon tax	Higher

[189] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 51-52.

[190] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 44, 51-52.

[191] Exhibit B1-9, BCUC IR1 23.5. See also Exhibit B1-9, BCUC IR1 23.6.

[192] Exhibit B1-9 BCUC IR1 23.6. See also Exhibit B1-8, Application, section 6.3.1.4, Moody's June 2020 Report regarding Indigenous rights.

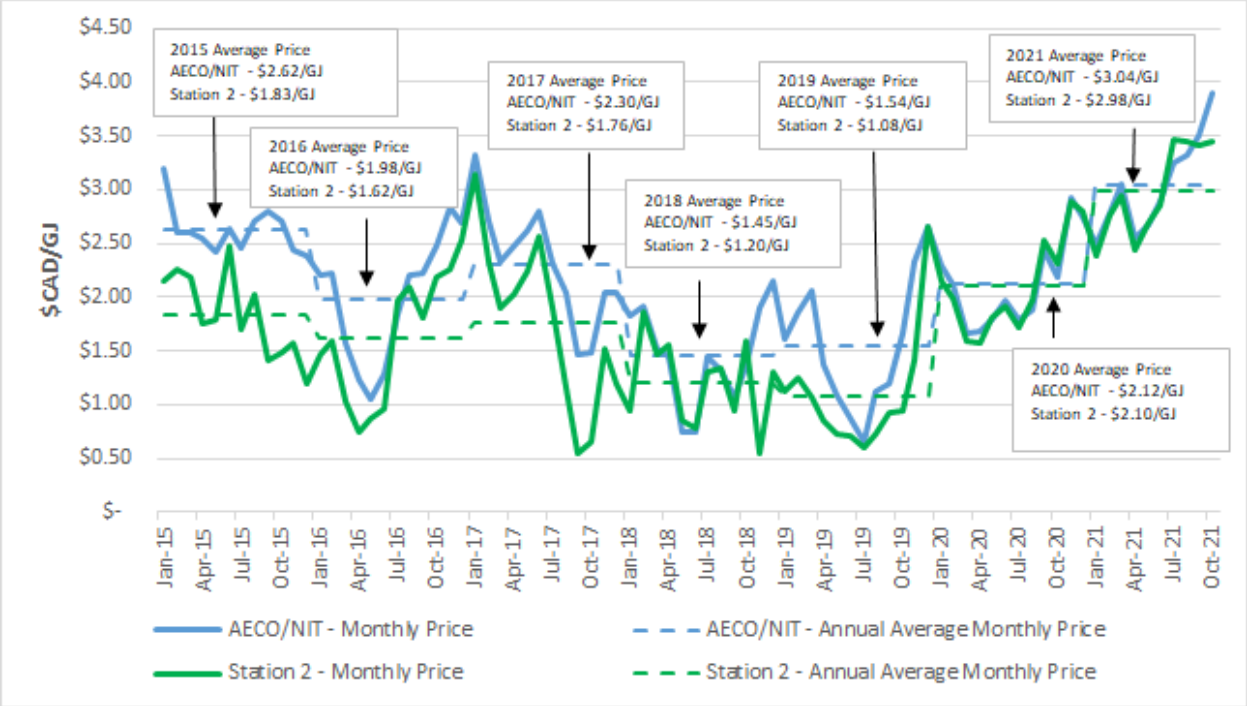
107. Energy prices impact a utility's business risk because price is among the factors that can influence consumer energy choices. The evidence demonstrates that FEI's overall energy price risk is higher now compared to the 2016 Proceeding primarily due to the following four factors, discussed below: (1) natural gas commodity prices are higher; (2) FEI is blending more higher-cost Renewable Gas as a pathway to compliance with GHG targets; (3) natural gas prices are more volatile; and (4) subsidies and tax incentives / disincentives are making electric appliances cheaper than gas appliances.

Factor 1: Natural Gas Commodity Prices are Higher

108. FEI purchases a mix of AECO/NIT price based monthly supply in Alberta and at Station 2, and daily priced supply at both AECO/NIT and Station 2 to meet its customer requirements. Actual 2021 market prices at AECO/NIT and Station 2 have, on average, increased 16% and 63% respectively since the 2016 Proceeding, as illustrated below. [193]

[193] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 57.

AECO/NIT and Station 2 Natural Gas Monthly and Annual Average Prices[194]



109. FEI explained that supply and demand factors have been driving up natural gas commodity prices since the 2016 Proceeding. Production levels in the Western Canadian Sedimentary Basin have been flat. Demand has steadily increased due to North American LNG exports, petrochemical development, and new electricity load powered by natural gas (as coal-fired plants retire).[195]

110. The demand pressures associated with LNG exports and new natural gas electricity generation, which are associated with the Energy Transition, can be expected to continue. FEI noted that LNG Canada coming online in 2026, and Woodfibre LNG to follow, will likely add pressure on prices.[196]

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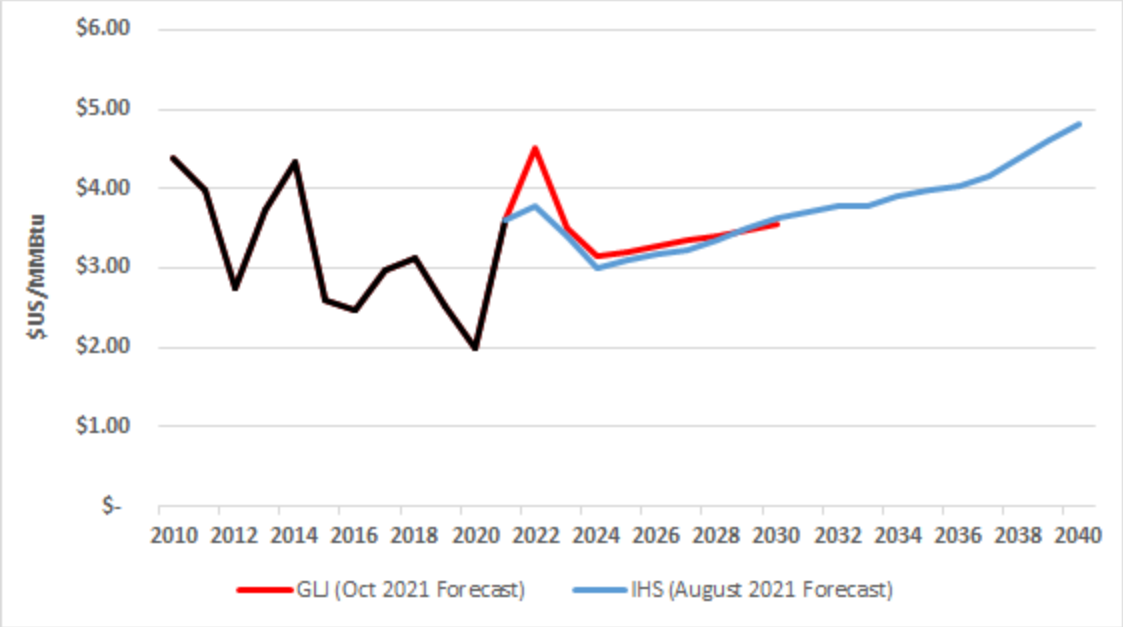
194 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, Figure A6-3.

195 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 6.1.1.

196 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 57.

111. The following figure similarly shows that current Henry Hub natural gas prices are higher than the actual 2015 prices. The figure also compares long-term price forecasts from different information sources that would reflect the expectations of the impact of long-term natural gas supply and demand fundamentals. The long term forecasts indicate that by 2030, gas prices could be above $3.50 US/MMBtu and continue to increase above $4.00 US/MMBtu out to 2040.

Long-Term Henry Hub Natural Gas Price Forecasts (nominal dollars)[197]



Factor 2: FEI Is Adding More Higher Cost Renewable Gas Supply to Its Portfolio

112. FEI is acquiring more Renewable Gas than projected at the time of the 2016 Proceeding.[198] The increasing share of higher-cost[199] Renewable Gas in FEI's gas supply portfolio,

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197 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 58, Figure A6-4.

198 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 73.

199 Exhibit B1-11, CEC IR1 3.5.

while providing a path for compliance with emission reduction requirements, does erode FEI's price competitiveness. Mr. Mazza explained:

> From a cost perspective, I mean, we were the first utility in North America to have a renewable gas program which was positive. And we've been slowly increasing the supply of natural gas over the years, renewable natural gas. But to highlight a couple points, one is the cost of renewable natural gas is about five times more than natural gas. So there's that competitiveness issue that we start to get concerned about over time. Even though it is a compliance pathway that we are very, very keen on.[200]

113. FEI expects that by 2032, approximately 11% of the gaseous energy delivered to customers will be renewable gas, resulting in an incremental annual cost of approximately $330 for a residential customer consuming 83 GJs per year.[201] Increasing the volume of renewable gas within FEI's supply mix, combined with renewable gas's higher unit cost, will result in an approximate 260% increase in FEI's total cost per GJ by 2032:[202]

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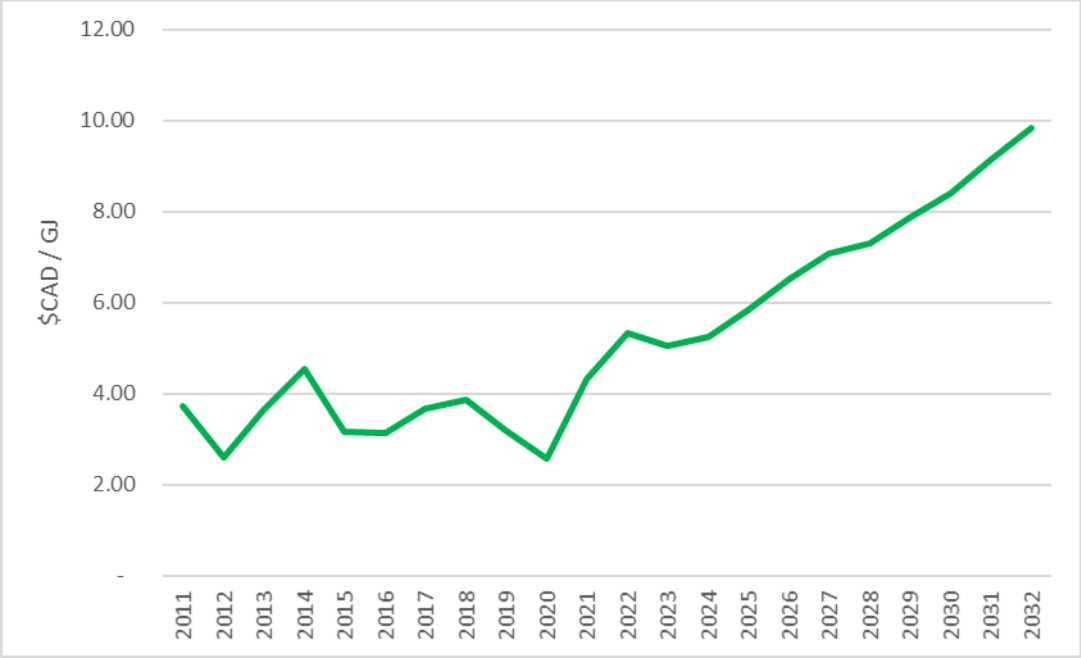
[200] Tr. 5A, p. 737, ll. 4-13 (Mazza).

[201] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 6.3.3.

[202] Exhibit B1-10, BCOAPO IR1 7.7.2.

Weighted Average Cost of Gas (Renewable and Natural)[203]



114. The Province has yet to decide whether carbon tax will be applied to renewable gas, but if so then it will add to FEI's cost competitiveness challenges.[204]

Factor 3: Price Volatility Impedes Attracting and Retaining Customers

115. Commodity price volatility is an impediment to attracting and retaining natural gas customers. It can negatively influence consumers' view of natural gas,[205] especially when contrasted with the relative stability of prices for electricity.

116. The natural gas market is more volatile than it was at the time of the 2016 Proceeding. Compared to 2015, the 95% confidence range for recent forward market gas prices has widened, reflecting the potential price volatility and continuing uncertainty as to where

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[203] Exhibit B1-10 BCOAPO IR1 7.7.2, Revised Figure A6-17.

[204] Exhibit B1-10 BCOAPO IR1 7.7.

[205] Exhibit B1-8, Appendix A, FEI Business Risk Assessment, p. 59.

market prices could ultimately settle in the future.[206] Market prices are expected to remain volatile as a result of extreme weather events, changes in natural gas demand for power markets in the region and anticipated growth in demand to supply the LNG export market.[207] Regional infrastructure is now fully contracted, such that there is now greater potential for price spikes to last longer.[208]

117. FEI's deferral accounts insulate customers who take commodity service from FEI from daily volatility, but volatility still results in quarterly commodity rate changes. Natural gas commodity rates are more volatile than electricity rates in BC.[209] Ms. Roy also observed that the volatility in the commodity rates has lately tended to be in one direction—up,[210] meaning that customers are lately being notified of another unwelcome FEI rate increase every three months.

Factor 4: The Total Cost Differential With Electricity Has Narrowed

118. Price competitiveness of natural gas versus electricity is an important risk factor, as a potential natural gas customer is likely to consider the relative cost of space and water heating. Customers may consider the operating costs, or the total costs (combined operating and capital cost of equipment). Developers are particularly interested in the up-front capital cost of appliances, as they do not pay the ongoing cost. As such, three key elements impact FEI's price competitiveness compared to electricity: (a) the cost of energy; (b) carbon tax; and (c) up-front equipment and maintenance costs. Since the 2016 Proceeding, FEI's price competitiveness has declined with respect to all three factors.

(a) <u>Energy cost advantage has declined:</u> Compared to 2015, natural gas' cost advantage over electricity has declined from 58% and 65% (2015 and 2016, respectively) to 43% (2022). The sharp decrease in the energy cost differential

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206 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 6.2.1.

207 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 15.

208 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 64.

209 Exhibit B-8-1, Appendix A, FEI Business Risk Assessment, p. 59.

210 Tr. 5B, p. 927, ll. 12-16 (Roy).

between natural gas and electricity can be attributed to higher natural gas commodity cost as well as FEI delivery rate and carbon tax increases. FEI expects this trend to continue in the coming years,[211] eroding natural gas' current price advantage.[212] Blending higher percentages of Renewable Gas will further close the gap, as discussed above.

(b) Carbon tax has increased significantly, and more increases have been announced: At the time of the 2016 Proceeding, there hadn't been a carbon tax change for almost four years ($1.49 per GJ set in 2012) and no further carbon tax changes had been announced. As of April 2022, BC's Carbon Tax is set at $2.5588 per GJ—72% higher than the carbon tax rate in 2015. The carbon tax will rise by approximately $0.75 per GJ each year until 2030. Once the announced carbon tax increase for 2030 is in place, the carbon tax rate will have increased by more than 5.5 times, to $8.40 per GJ. The continued increase of the share of this non-controllable item in customer bills hinders FEI's ability to manage the rate impact on its customers and reduces FEI's competitiveness.[213]

(c) Gas appliances are less competitive now: Upfront capital costs, efficiency rates and maintenance costs affect the total cost of an energy appliance over its measure life.[214] The price competitiveness of natural gas space heating appliances versus both electric baseboards and electric heat pumps has also declined materially since the 2016 Proceeding.

(i) *Versus baseboards and hot water tanks*: A gas furnace is significantly more costly than electric baseboard heating, with the difference estimated at $22.40 per GJ over the measure life—a greater differential compared to

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211 Exhibit B1-8, Appendix A, FEI Business Risk Assessment, section 6.3.1.

212 Exhibit B1-10, BCOAPO IR1 8.2.

213 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 6.3.2; Exhibit B1-8-1, Appendix C, Concentric Report, p. 75; Exhibit B1-9, BCUC IR1 35.2.2: DRBS Report for FEI (January 5, 2022) at p. 832/5621.

214 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 73-74.

the 2016 Proceeding. This increased price advantage in favour of electricity is even more persuasive when considering smaller multi-family dwellings, such as townhouses and apartment units, that are more likely to have electric baseboards as their main space heating. Due to a reduced differential between gas and electric rates, the relative competitiveness of natural gas hot water tanks has also decreased since the 2016 Proceeding.[215]

(ii) *Versus heat pumps:* The market penetration of heat pumps was so low at the time of the 2016 Proceeding that FEI and the BCUC did not even analyze the relative competitiveness of a gas furnace as compared to a heat pump.[216] The new risk posed by the integration of electric heat pumps into the energy appliance market is significant, not only because of the new interest in cooling as summers get hotter, but also because the subsidies and tax incentives in place have effectively changed the price advantage in favour of heat pumps. Provincial and BC Hydro rebates reduce the capital costs for replacing a natural gas furnace with an electric heat pump to $3,000 *less* than it would cost to replace with a new gas furnace, *even before considering municipal rebates*. The cost after rebates of electric heat pumps installed in new construction will be equal to, or less than, the upfront cost for a natural gas furnace. The BC government has further tipped the scales in favour of heat pumps through tax policy; as we discussed in the context of political risk, it has increased the PST rate applicable to the purchase of fossil fuel combustion systems from 7% to 12% and has eliminated PST from the purchase of electric heat pumps.[217]

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[215] Exhibit B1-8, Appendix A, FEI Business Risk Assessment, section 6.3.4.

[216] Exhibit B1-8, Appendix A, FEI Business Risk Assessment, section 6.3.4.

[217] Exhibit B1-10, BCOAPO IR1 7.8.1.

(g) Demand/Market – Higher Risk

Demand/Market		Higher
	Perception of energy	Higher
	New technology and energy forms	Higher
	Net customer additions	Higher
	Changes in building type and capture rates	Similar
	Changes in end-use market share	Higher
	Changes in use per customer	Similar

119. Demand and market changes pose challenges to FEI's ability to attract and retain customers, and maintain market share and throughput levels. FEI continues to be affected by market trends that were observed in the 2016 Proceeding, such as the market shift in new home development from single family to multi-family dwellings (which tend to use less gas).[218] The evidence identifies three reasons, discussed below, why FEI's risk associated with demand and market shift away from natural gas is now greater than what was assessed in the 2016 Proceeding: (1) BC residents' perception of natural gas has worsened; (2) new technologies and building techniques, supported by policies discussed previously, are negatively affecting gas demand; and (3) FEI is experiencing a downward trend in net customer additions.

Factor 1: Public Perception of Natural Gas Has Worsened

120. Until recently, public perception studies had indicated that perceived reliability and safety of the energy source were the primary influencers of customers' energy choices. However, surveys and studies[219] conducted since the 2016 Proceeding reveal that the environment, along with affordability, are now the main factors that influence existing customers' energy choices. Nearly half of the respondents believe that it would be relatively easy

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[218] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, pp. 87-88; Exhibit B1-9, BCUC IR1 12.2; Exhibit B1-10, BCOAPO IR1 8.5.1.

[219] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, Figure A7-1: Summary of Customer Perception Research.

to meet all of BC's energy needs using renewable electricity, with two-thirds supporting or being open to phasing-out the use of natural gas for environmental reasons.[220] These customer attitudes all create challenges for FEI in retaining and attracting load.

Factor 2: Climate-Centric Technologies and Building Techniques Are Negatively Affecting Demand

121. Since the 2016 Proceeding it has become increasingly common for climate-centric technologies and building techniques to be employed. This is impacting FEI's customer retention and additions, its demand profile and throughput.[221]

122. High efficiency heat pumps are a notable example of a new technology having a significant impact on FEI's demand and market share. FEI estimates that somewhere between 5% and 10% of all residential customers will be faced with replacing their heating equipment in any given year, which is when FEI is most vulnerable to potentially losing the heating load.[222] Prior to the 2016 Proceeding, when a gas furnace came to the end of its useful life and must be replaced, it was traditionally replaced with a newer and more efficient gas furnace.[223] As indicated previously, penetration of heat pumps was very low at that the time of the 2016 Proceeding.[224] Today, when customers are faced with the need to replace aging gas equipment, more homeowners are considering switching their heating load to a heat pump (whether due to, e.g., preference for added cooling function, environmental perception, incentives or municipal requirements).[225] The percentage of households using electric heat pumps increased to 10% in 2019, with sales of heat pumps increasing 19%, 47% and 52% year-over-year from 2017 through

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220 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 7.1.

221 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 7.2.

222 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 81; Exhibit B1-9, BCUC IR1 12.2; Exhibit B1-10, BCOAPO IR1 7.8.1.

223 Exhibit B1-9, BCUC IR1 12.2.

224 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 6.3.4.

225 Exhibit B1-9, BCUC IR1 12.2.

2019. The growing prevalence of heat pumps is contributing to a downward trajectory in capture rate, which has declined 7% in the last three years alone: [226]

FEI's Overall Capture Rate Trend

	2015	2016	2017	2018	2019	2020
Market Capture	81%	83%	85%	82%	81%	78%

123. New building techniques are improving energy efficiency, and thus reducing demand.[227]

Factor 3: FEI is Experiencing a Downward Trend in Net Customer Additions

124. FEI's ability to manage long-term business risk is partly dependent on its ability to grow its customer base to offset the rate impact on customers due to cost increases and decline in gas consumption. The evidence demonstrates that FEI's ability to add customers is more challenged today than at the time of the 2016 Proceeding.

125. First, Mr. Slater noted that about 37% of FEI's net customer attachments over the past five years occurred in municipalities that have recently implemented measures to restrict the use of natural gas.[228]

126. Second, FEI is already experiencing the shift towards electric options in its net customer additions, particularly in the residential sector where existing customers' homes may be torn down and rebuilt with electric-only options to meet more stringent municipal building requirements. In the last three years the pace of residential customers leaving FEI's system is greater than the pace of new customers being added.[229] Net additions peaked in 2018, and since

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[226] Exhibit B1-9, BCUC IR1 12.2; Exhibit B1-8-1, Appendix A, Section 7.5.

[227] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 82.

[228] Exhibit B1-30, Opening Statement of Doug Slater, p. 2; Tr. 5B, p. 896, ll. 20-26 (Slater).

[229] Exhibit B1-8, Appendix A, FEI Business Risk Assessment, p. 83.

then have decreased. FEI expects the downward trend in net customer additions to continue in the following years.[230] Mr. Mazza stated:

> And we're really, really seeing the impact. I mean, in the last couple years its been huge. Our customer attachments, as Mr. Slater mentioned, were over 21,000. Our net attachments in 2018, in the evidence we showed that it dropped down to 10,000, just over 10,000 in 2021. Our year-end forecast this year is 7,000. So, that's one-third of the attachments since 2018. And that's through a construction boom. So, we're seeing it.[231]

127. Third, BC has a teardown rate nearly double the national average, at approximately 2% in 2020. At this teardown rate, within 50 years all of the building stock that exists today would be replaced. Close to 35% of FEI's residential customers live in dwellings that are built prior to 1975 (compared with 37.5% in 2012). If the turnover rate holds true, FEI can reasonably project that more than one third of dwellings that are currently connected to FEI's natural gas system may be demolished and replaced with new ones by 2025.[232] It will be very difficult for FEI to retain customers faced with choosing between gas and electric options for their rebuilt homes, considering the government policies that have been introduced at provincial and local levels since the 2016 Proceeding to incentivize electrification and prevent gas connections.[233]

(h) Energy Supply – Similar Risk

Energy Supply		**Similar**
	Availability of supply	Similar
	Access to supply	Similar
	Renewable Gas supply	New (Higher)

[230] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 83.

[231] Tr. 5B, p. 897, ll. 4-12 (Mazza); see also: Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, Table A7-1, p. 83.

[232] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 7.3.1.

[233] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 85.

128. The evidence demonstrates that FEI's overall energy supply risk remains similar to the 2016 Proceeding. There is an abundance of natural gas and FEI continues to rely on a single system for a significant portion of its gas requirements. We have focused below on the increased energy supply risk associated with the growth of FEI's Renewable Gas supply,[234] arising from issues with suppliers, competition for Renewable Gas supply, and barriers to gas system readiness and acceptance of non-local supply.[235]

RNG Facilities Risk Lower-than-Expected Supply Volumes

129. RNG facilities currently face unique operational issues that affect supply: the equipment used to create RNG can fail more often than conventional technologies; some RNG production facilities experience feedstock supply issues where they have difficulty securing manure or green waste supplies, reducing RNG output; and as the RNG industry is at a nascent stage in development, supplier inexperience creates risk relating to the inability to execute on project developments and fulfill contractual obligations.[236] As a result of such issues, FEI has already faced lower-than-expected supply volumes, increased operating costs, and increased purchase prices.[237] In addition to FEI potentially falling short of its energy delivery requirements, RNG shortfalls jeopardize FEI's ability to achieve its own GHG reduction commitments and remain in compliance with a pending emissions cap.[238]

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[234] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 105: FEI's Renewable Gas portfolio is forecasted to grow from approximately 0.7 PJs in 2021 to 41 PJs in 2032.

[235] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 8.3.

[236] Exhibit B1-8,-1 Appendix A, FEI Business Risk Assessment, section 8.3.2; Tr. 5A, p. 737, l. 20 – p. 738, l. 6 (Mazza).

[237] For instance, over a typical one-year period, FEI lost 22% of its total actual supply from six FEI projects due to operational failures: Exhibit B1-11, CEC IR1 10.1.

[238] Exhibit B1-11, CEC IR1 10.3; for more details on how FEI intends to mitigate these supply risks, refer to: FEI Stage 2 Comprehensive Review and Application for Approval of a Revised Renewable Gas Program, p. 81.

More Competition for RNG Supply

130. An increasing number of entities in other jurisdictions are now competing directly with FEI for Renewable Gas supply.[239] The implications of greater competition include higher prices, reduced volume, or reduced opportunity for renewals.[240]

Technical, Regulatory Barriers to Alternative Forms of Renewable Gas

131. There are technical, regulatory and policy barriers to integrating alternate forms of Renewable Gas, such as hydrogen, synthesis gas or lignin, into the gas system.[241] For instance:

(a) More analysis is required to determine the system extensions and upgrades required to connect producers of Renewable Gas;[242]

(b) FEI must assess the blending of hydrogen into the natural gas supply and how the natural gas system can accommodate distributed gas production at a scale large enough to meet FEI's Renewable Gas objectives.[243]

(c) FEI must also engage regulators, such as NRCan Codes and Standards, to modify and develop safety and technical standards and set longer-term objectives to transition the regional natural gas network to adopt hydrogen, synthesis gas and lignin.

(d) Future government policy that may impact the recognition of non-local sources of FEI's Renewable Gas supply.

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239 See Exhibit B1-9 BCUC IR1 17.1 & 17.1.1; Exhibit B1-20, BCUC IR2 76.3.

240 Exhibit B1-9 BCUC IR1 17.3.

241 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 8.3.4.

242 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 8.3.4.

243 Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 8.3.4; Exhibit B1-9, BCUC IR1 18.1 for a discussion of the barriers to hydrogen deployment.

(i) Operating – Higher Risk

Operating		Higher
	Aging infrastructure and time dependent threats	Similar
	Third party damages	Similar
	Attitudes towards fossil-fuel industry	New (Higher)
	Municipal operating challenges	New (Higher)
	Cybersecurity	New (Higher)
	Unexpected events	Higher

132. The evidence demonstrates that, compared to the 2016 Proceeding, FEI's overall operating risk has increased. FEI's risk from aging infrastructure, time-dependent threats and third party damages remains largely unchanged since the 2016 Proceeding.[244] However, there has been (1) increased awareness around the potential for unexpected events and the importance of resiliency; (2) growing negative sentiment towards companies within the fossil-fuel industry; and (3) municipal challenges to its right to construct and operate that were not previously experienced as frequently or at the level FEI experiences today.[245]

Infrastructure Operators Have Been Experiencing High Impact Events

133. Mr. Mazza and Ms. Roy observed that, from a utility management standpoint, events previously considered exceptional are "becoming more expected".[246] Since the 2016 Proceeding, there have been a number of high-impact events affecting utilities like FEI, including the COVID-19 pandemic, the Westcoast Energy T-South pipeline rupture, the Fort McMurray wildfire, and the 2021 flooding in Fraser Valley, Merritt and Princeton. There have also been near

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[244] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, sections 9.1 and 9.2; Exhibit B1-9, BCUC IR1 19.1 and 19.2.

[245] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 16.

[246] Tr. 5B, p. 928, ll. 4-8.

misses, like the recent uncovering of a portion of Westcoast Energy's 30-inch line caused by an overflowing river.[247] As described by Mr. Mazza:

> In fact, we outlined last year the number of - - we had a couple of huge windstorms that were - - I think the highest we've [FBC] had in 25 years in terms of outages and we also had the third highest in 25 years in the same year. We also had the impacts on the Enbridge line. We had a mudslide there, a washout which impacted our supply.
>
> With the wildfires, we had floods in a number of our communities. One of our communities actually had issues both with their electric supply and their gas supply in the Princeton and Tulameen area. Flooding in the Fraser Valley. So these are all . . . becoming a lot more difficult to manage for us and becoming obviously a huge priority for us and there's a higher risk.[248]

134. While these types of operating risks have always been present, extreme weather events are becoming more frequent.[249] Irrespective of the extent of any empirical change in the frequency or potential severity of such events thus far, investor perception—which the experts agree impact cost of capital regardless of actuarial risk—will be influenced by growing industry recognition of the importance of resiliency.[250] Credit agencies are also taking note:

(a) S&P recently recognized "Physical impacts of climate change" as a material environmental risk to gas utilities:

> **Physical impacts of climate change:** Climate change and extreme weather events have material effects on electric grids and water and gas utilities. For example, acute risks such as flooding and storms can cause operational disruption, damage to assets (including reduced asset lifetimes), reduced capacity in the case of water networks, and increased capital and maintenance costs.[251]

(b) Moody's published new environmental classification that focuses on physical climate risks:

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[247] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 113.

[248] Tr. 5B, p. 928, l. 15 – p. 929, l. 3.

[249] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 9.6; Exhibit B1-19, BCOAPO IR2 71.1.

[250] Exhibit B1-8, Application, p. 16.

[251] Exhibit B1-9, BCUC IR1 35.2.2, Attachment 25.2.2, p. 1.

> A key modification is a category focused on physical climate risks, which considers the effects of climate change. Extreme weather events have increased in severity and frequency and are expected to intensify in the future, causing significant economic losses, hazards for the local population and environmental damage.[252]

(c) DRBS considers climate and weather risks applicable to its rating processes for utilities:

> . . . extreme weather events have become more and more frequent, and are testing the resiliency of the grids as well as the adequacy of the regulatory framework in place for utilities to recover costs. Utilities that fail to maintain operations during extreme weather events have seen reputational loss, faced extra scrutiny from regulations, and increased expenditures to harden the grid.[253]

Negative Attitudes Towards the Fossil-Fuel Industry Create New Operational Challenges

135. The negative public sentiment towards natural gas pipelines, discussed above, can hinder FEI's ability to recruit skilled workers, complete already approved projects on time and budget, and obtain necessary approvals and operating permits.[254] Protests and environmental activism are becoming more frequent. FEI is seeing increased resistance to new projects which is leading to higher execution and cost risks. There have been recent instances of vandalism in respect of fossil fuel assets in North America.[255]

Operating Challenges Are Increasing in Municipalities

136. Municipalities are creating operational barriers, causing delays more frequently, and imposing more requirements on FEI.[256] Municipalities have also begun challenging FEI's right

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[252] Exhibit B1-9, BCUC IR1 8.1, citing to Moody's Sector Profile – Revised classification of environmental considerations reflects evolving standards, December 2020.

[253] Exhibit B1-9, BCUC IR1 8.1, citing to DBRS Morningstar ESG Risk Factors for Regulated Utilities, May 28, 2021.

[254] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 110.

[255] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 110.

[256] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 9.4.1.

to construct and operate in public spaces, and seeking to limit FEI's flexibility in that regard. Since the 2016 Proceeding, municipal challenges have resulted in three regulatory proceedings. FEI and the City of Coquitlam were involved in a three year dispute over requirements for paving and FEI's right to abandon a gas line. The City of Surrey and FEI were involved in a dispute over the terms of an operating agreement between 2017 and 2019. FEI is currently involved in an appeal by the City of Richmond over the terms and conditions of alteration work requested by the City of Richmond.[257] These municipal expectations, requirements and disputes not only result in increased costs to FEI and create schedule uncertainty and delays for specific projects, but also introduce new uncertainty around FEI's operations more generally.

Cybersecurity Has Become a Significant Risk Consideration

137. Cybersecurity was not a significant topic of discussion in the 2016 Proceeding, but it is now a critical enterprise risk for any energy company. Since the 2016 Proceeding, bad actors and their tools have become more sophisticated. At the same time, FEI's reliance on software and network infrastructure to control the gas network and report system status has increased. The recent ransomware attack on Colonial Pipeline, a major pipeline in the U.S., and its impact on energy security in multiple U.S. states, highlights the severity and seriousness of this risk.[258]

(j) Regulatory – Higher Risk

Regulatory		**Higher**
	Regulatory uncertainty and lag	Higher
	Administrative penalties	Similar

138. Regulatory risk arises from the degree to which FEI is dependent on multiple regulators for timely and objective approvals that impact its ability to operate and earn a fair return on and of capital. There are two central and overlapping causes of regulatory risk: (1) regulatory lag (the time between an application and a final order), and (2) regulatory uncertainty

[257] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 9.4.2; Exhibit B1-10 BCOAPO IR1 9.2.

[258] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 9.5.

(which arises from the significant discretion that regulators have in the exercise of their powers).[259] The Edison Electric Institute has noted: "Equity investors also scrutinize a utility's regulatory environment carefully."[260] A stable and supportive regulatory environment is one of the main factors that is considered by the credit rating agencies that assess FEI.[261] The evidence demonstrates that FEI's overall regulatory risk is higher than what was assessed in the 2016 Proceeding,[262] for the reasons stated below.

BCUC Remains Key But Other Regulators Have Assumed Greater Importance

139. While the BCUC's influence on FEI's business is pervasive, FEI is subject to a number of other regulatory regimes. Ms. Roy noted the Environmental Assessment processes, municipal requirements, and the requirements and processes of Indigenous communities, all of which have become more complex over time:

> You know, we used to worry the most, probably, about the BCUC and getting approvals from the BCUC. That was the biggest hurdle in many times that we had to overcome. But, you know, what we are seeing now is I would almost liken to having more than one regulator in that sense. You know, we have to make sure we get consent from Indigenous communities, we have environmental assessment processes that we have to go through. We have municipalities that are challenging us and maybe even refusing to give us a permit.
>
> You know this, when we talk about the regulatory risk in this application, we're talking about something much broader than the BCUC . . . .[263]

BCUC Proceedings Are More Complex and Take Longer

140. As in prior proceedings, an important aspect of regulatory lag for FEI is the time between BCUC application filings and final approvals. There is risk associated with operating based on interim rates, with no assurance that the interim rate will be confirmed in the final

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[259] Regulatory uncertainty arises where future decisions are unpredictable, decisions are vague and open to interpretation by current or future regulatory panels, and where decisions have unknown future implications: Exhibit B1-8, Appendix A, FEI Business Risk Assessment, p. 118.

[260] Exhibit B1-21, FortisBC Rebuttal, p. 5.

[261] Exhibit B1-8, Appendix A, FEI Business Risk Assessment, p. 115; Exhibit B1-11 CEC IR1 11.7, 18.4.

[262] Exhibit B1-8, Appendix A, FEI Business Risk Assessment, section 10.

[263] Tr. 5B, p. 835, l. 20 – p. 836, l. 7 (Roy).

decision. There is also the risk that the costs incurred and projects contemplated and required to be undertaken will ultimately not be approved. In the case of capital approvals, delays or non-approval can create obstacles for FEI completing projects on time and on budget or can impede FEI's ability to proceed with important initiatives, such as initiatives in support of decarbonization.[264]

141. There have been developments since the 2016 Proceeding that have increased the risks of regulatory lag.

(a) FortisBC has observed a change in how routine filings are reviewed since the 2016 Proceeding. Most routine applications now involve a public review process whereas previously routine filings could proceed to a BCUC decision with either no process or with a small number of IRs from BCUC staff. One result of this change is that smaller applications are now generally taking longer to receive BCUC approval.[265]

(b) Since 2016, there has been a marked increase in interest and active participation by Indigenous and environmental groups in regulatory proceedings. The increased level of active participation in regulatory processes can cause delays to the overall timetable due to: the need to increase the length (and breadth) of public notice periods; the increased instances of late intervener registration which require timetable extensions; the increase in the number of IRs and the length of time required both for parties to ask IRs and for FortisBC to respond to IRs; and the increased desire by some interveners to file intervener evidence. In some project hearings, special processes have been established to take evidence from Indigenous groups, as well.[266]

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[264] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 10.1.2.2.

[265] Exhibit B1-11, CEC IR1 11.1 and 11.3.

[266] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 10.1.2.2; Exhibit B1-11, CEC IR1 11.2, 11.3.

(c) Broader and deeper engagement is now required due to legislative changes (i.e., 2018 BC *Environmental Assessment Act* and DRIPA). Notably, there is now a requirement to seek the FPIC of Indigenous Peoples prior to proceeding with project development. There are also heightened requirements for environmental work in advance of project development, including in some cases Environmental Assessments.[267] The risk of project and regulatory approval delays due to these factors is very high.[268]

142. Since the 2016 Proceeding, a number of projects and proceedings have experienced delays on account of regulatory lag. In some cases, these delays have been short. For instance, with the Pattullo Gasline Replacement Project, a delay of a few weeks was required in order for the Ministry of Transportation to determine if engagement was sufficient. In other cases, the delays have been much longer. FEI's EGP Project was delayed for years, in part to ensure fulsome inclusion of Indigenous knowledge and impact mitigations. The regulatory timetable for the Okanagan Capacity Upgrade Project CPCN application was delayed at the request of an Indigenous group, and the process has been adjourned while engagement between the Indigenous group and FEI continues.[269] Other projects experiencing delays include the Tilbury LNG Phase 2 Storage Expansion project (EA process),[270] FEI Inland Gas Upgrade CPCN Application,[271] and the Advanced Metering Infrastructure project.[272] FEI's 2017 Price Risk Management Plan and the Biogas Purchase Agreement between FEI and the City of Vancouver also took considerable time to resolve.[273]

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[267] Exhibit B1-9, BCUC IR1 20.1.

[268] Exhibit B1-10, BCOAPO IR1 6.6.1.

[269] Exhibit B1-10, BCOAPO IR1 6.6.1; see also 6.5 for more fulsome discussion of the EGP Project delays; Exhibit B1-11, CEC IR1 11.3; Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 120.

[270] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 120; Exhibit B1-10, BCOAPO IR1 10.3.1.

[271] Exhibit B1-10, BCOAPO IR1 10.3.1.

[272] Exhibit B1-10, BCOAPO IR1 10.3.1.

[273] Exhibit B1-11, CEC IR1 11.5.

143. In prior proceedings, interveners have suggested that FEI is complaining and should accept that regulation is a part of being a public utility. These arguments missed the mark. FEI's observations are not about questioning the merits of the process adopted or the legitimacy of public participation. FEI is simply pointing out that regulatory lag is considered by investors and the increased time and complexity of proceedings—regardless of the cause—does have implications for FEI's business.

The Decision to Revisit Deferral Account Financing Costs Creates Uncertainty

144. Deferral account financing impacts FEI's business risk since the financing has a direct impact on a utility's earnings.[274] Currently, deferral account financing treatment is reviewed as part of the revenue requirement applications for individual utilities and reflects the utility's specific circumstances. The financing treatment of a number of FEI's accounts has been settled for many years. However, the BCUC has determined that the review of deferral account financing costs should be subject to a generic proceeding after the completion of Stage 1 and Stage 2 of this proceeding.[275]

145. A decision to adopt a more generic approach to deferral account financing could lead to approval of unfair and inappropriate financing treatment if a utility's specific circumstances are not fully recognized.[276] A BCUC decision to change the financing treatment of deferral accounts that are currently financed by debt and equity to apply only a debt return would depress FEI's financial metrics.[277] FEI's financial metrics are already weak for its current credit ratings, as discussed in Part Four, Section A.

Uncertainty Around BCUC Support for Important Initiatives

146. All BCUC regulatory applications are subject to some level of regulatory uncertainty. The uncertainty is elevated when it comes to FEI's GHG emissions reduction

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[274] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 118.

[275] BCUC Order G-205-21 (July 7, 2021).

[276] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 118.

[277] Exhibit B1-9 BCUC IR1 22.2; Exhibit B1-20 BCUC IR2 66.1.

strategies, which are fundamental for the future role of the delivery system in the Energy Transition.[278]

147. The BCUC is being confronted by applications and issues that are addressing new policy issues and non-traditional ratemaking principles. There are no "apples to apples" precedents that would provide FEI with some comfort on the approach the BCUC will take.[279]

148. FEI's ability to implement important initiatives will be hindered if the BCUC takes a restrictive interpretation of legislation, applies traditional rate-making principles inflexibly, or emphasizes short-term affordability over resilience and decarbonization goals. Low-carbon gas alternatives such as Renewable Gas have a higher cost basis than traditional natural gas, requiring approval of different cost recovery approaches. The current regulatory framework, including customer cost recovery mechanisms, does not directly support higher cost forms of gas. Different rate structures will need to be approved for customers who may not be able to access natural gas due to governments' carbon intensity targets and would therefore require a Renewable Gas blend or 100% Renewable Gas.[280]

149. The BCUC's approach to capital-intensive CPCN projects could also be influenced by the BCUC's perception regarding the future role of natural gas in BC's energy infrastructure. The need for the Tilbury LNG Storage Expansion Project, the Okanagan Capacity Upgrade Project and even the Advanced Metering Infrastructure Project, has already been questioned by hearing participants on that basis. While FEI considers these and other long-life projects to be necessary and is prepared to explain why that is the case, those types of need arguments were a non-issue prior to the 2016 Proceeding.[281]

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[278] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 10.1.2.1. While public policy is a factor that may be considered in BCUC regulatory decisions, the BCUC is an independent regulator. The risk of uncertainty of approval for FEI's initiatives supporting the future of the gas system is therefore categorically a regulatory risk compared to a political risk: Exhibit B1-9 BCUC IR1 20.2.

[279] See Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, section 10.1.2.1.

[280] Exhibit B1-8-1, Appendix A, FEI Business Risk Assessment, p. 119.

[281] For discussion, see Exhibit B1-8-1, Appendix A, pp. 118-120.

C. CONCLUSION AND REQUESTED FINDING

150. The BCUC should find that FEI's business risk has increased significantly since the 2016 Proceeding. The increased risk, along with the factors discussed in the next Part, supports FEI's proposed capital structure.

PART FOUR: OTHER FACTORS SUPPORTING 45% COMMON EQUITY FOR FEI

151. As discussed in Part Two, FEI's credit rating is important to debt finance on reasonable terms in all market conditions, which bears on the financial integrity and capital attraction elements of the Fair Return Standard. The BCUC must also have regard to the comparability of FEI's overall allowed return (capital structure and ROE) with its North American peers. In those regards, the following points support a BCUC finding that FEI's proposed 45% common equity ratio is just and reasonable:

(a) An increase in FEI's common equity is required to support its existing credit rating, which is under strain from weak financial metrics, increased weighting for unfavourable ESG considerations and potential changes in interest deductibility rules.

(b) FEI's proposed equity thickness is still at the low end of the range of reasonableness when compared to its peers, with whom it competes for capital.

A. THICKER EQUITY IS IMPORTANT TO SUPPORT FEI'S CURRENT CREDIT RATING, WHICH IS UNDER STRAIN

152. Utilities like FEI (and FBC) are large consumers of both equity and debt capital. Their fundamentals are watched carefully and scrutinized thoroughly by the financial analyst community for equity investors, and by credit rating agencies and debt analysts for debt holders.[282] FEI (and FBC) is rated by DBRS Morningstar ("DBRS") and Moody's Investors Service ("Moody's").[283] The evidence discussed below demonstrates that maintaining FEI's existing A-category rating is important for accessing capital on reasonable terms in varied market conditions. An increase in FEI's common equity ratio is required to support its existing credit

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[282] Exhibit B1-8, Application, p. 25.

[283] Exhibit B1-8, Application, p. 30. Table 6-1 in the application presents Moody's and DBRS' rating categories for long-term debt.

rating, which is under strain from (1) weak financial metrics, (2) increased weighting for ESG criteria, and (3) potential changes in interest deductibility rules.

(a) FEI's "A" Rating Is Important Determinant of Access to, and Cost of, Debt Capital

153. In simple terms, a credit rating is a formal, independent opinion of a borrower's ability to service its debt obligations. The majority of ratings are used by debt investors in their investment appraisal processes. FEI's existing A-category credit rating is thus a critical determinant of whether the company is able to issue debt on reasonable terms and pricing in varied market conditions – a key facet of both financial integrity and capital attraction elements of the Fair Return Standard.

154. One implication of an FEI downgrade to below an A-category credit rating would result in FEI incurring significant additional interest costs to finance its large capital program.[284] Maintaining FEI's existing credit rating is particularly important at present, due to its large ongoing capital expenditure requirements. An increase in the cost of borrowing driven by a credit rating downgrade would have a significant financial impact on FEI and customers.[285]

155. It is fundamentally important to recognize that assessing the impact of a credit rating downgrade goes much, much further than a financial calculus of additional interest charged on future debt. A downgrade could be expected to decrease the pool of potential debt investors for FEI, which affects access to capital. FortisBC's traditional investors include insurance companies and pension funds who tend to hold these investments to maturity. These types of investors are conservative by mandate, are subject to prudent and well-defined investment policies and tend to invest in higher quality bonds with a significant majority of investments focused on A or higher rated companies. Therefore, even in normal market conditions, BBB rated companies tend to receive less interest from these types of investors compared to A rated

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[284] Exhibit B1-9, BCUC IR1 9.6.

[285] Exhibit B1-8, Application, p. 25

companies.[286] The inclination of institutional investors to invest in higher rated companies becomes especially apparent during financial crises. When markets are more volatile, BBB-rated companies can be—and have been—shut out of the Canadian debt capital markets entirely.[287]

156. There are other significant ramifications of a downgrade, that are not readily predictable and quantifiable. As FortisBC put it:

> It is important to note that a downgrade to a lower credit rating is not a simple transition to another lower credit rating state. A credit rating downgrade itself is a profoundly negative economic event and its overall impact would be so pervasive that it is not possible to reliably quantify the true impact to customers. FEI has its credit rating referenced in a significant number of borrowing and commercial arrangements. A downgrade may trigger immediate requirements to post alternate security or increase rates in a variety of agreements.
>
> Beyond the immediate financial impact of a downgrade, the general designation of being a recently downgraded issuer has a significantly negative impact from a capital market perspective. This is particularly so in the case of FEI, which has approximately $3.1 billion of outstanding debt rated at an A level, whose fair values would be immediately impaired to the holders of this debt in the event of a downgrade. As these investors are the same investors that FEI would seek to sell new issuances, this will significantly impede the ability of FEI to raise incremental financing going forward. Therefore, the actual impact of the downgrade itself is the bigger consideration than the change in the cost of debt at different rating levels.[288]
>
> [Emphasis added.]

(b) FEI Has Weak Financial Metrics for its Current Rating

157. One of the primary determinants of FEI's (and FBC's) credit rating are financial metrics specified by the credit rating agencies. As discussed below, the credit rating agencies currently view FEI's financial metrics as being weak, with one of the key financial metrics critically

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[286] Exhibit B1-9, BCUC IR1 6.4.

[287] Exhibit B1-21, FortisBC Rebuttal Evidence, pp. 2-5; Exhibit B1-9, BCUC IR1 6.4.

[288] Exhibit B1-13, RCIA IR1 17.2.

close to a rating downgrade threshold.[289] An increase in FEI's equity component would support the company's current credit ratings.[290]

Financial Strength Is Heavily Weighted in Rating Methodology

158. The FortisBC utilities are rated by Moody's and DBRS, with Moody's assigning lower credit ratings. In cases where credit ratings diverge between different rating agencies (a "split rating"), the investor focus is typically on the lower rating.[291] A rating downgrade by Moody's would therefore have a more significant impact on FortisBC's credit risk from a lender perspective.[292]

159. FEI carries an A3 rating from Moody's, which is the lowest level of the A category and just one notch above a Baa1 rating. A one-notch Moody's downgrade would put FEI into the Baa/BBB category. This would result in one debt rating in the A category (DBRS) and one rating in the Baa/BBB category (Moody's). Since investors typically focus on the lower rating, this would result in FEI being considered principally a BBB rated entity.[293] As discussed above, this outcome would have an adverse impact on FEI's cost of debt and access to capital markets.

160. Moody's rating methodology for utilities is primarily based on four key factors: the regulatory framework (25% weight); ability to recover costs and earn returns (25% weight); diversification (10% weight); and, financial strength (40% weight).[294]

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289 Exhibit B1-8, Application, p. 25.

290 Exhibit B1-9, BCUC IR1 9.6.

291 Exhibit B1-8, Application, p. 31: The impact of split rating on risk premium has been studied in a 1997 study by R. Cantor et al. titled "Split-rating and the Pricing of Credit Risk", which concluded that credit risk pricing "*in the investment-grade sector is more conservative - placing more weight on the lower rating than the higher rating*" and that "*the market prices split rated bonds between the yield implied by the lower rating and that implied by the average rating*".

292 Exhibit B1-8, Application, p. 31.

293 Exhibit B1-8, Application, pp. 32-33.

294 Moody's Rating Methodology for Regulated Electric and Gas Utilities, June 2017: Exhibit B1-8, p. 32.

161. Financial strength, the factor to which Moody's assigns the most weight, is determined with reference to financial metrics. As shown in the table below, with the exception of the Debt to Capitalization ratio, all of FEI's financial metrics are consistent with a Baa/BBB rating. In other words, FEI's ability to maintain an A rating is marginal. FEI has no room to absorb unusual or unexpected negative events without dropping below downgrade thresholds for key financial metrics.[295]

Table 6-4: FEI's Key Financial Indicator Scores Compared to Minimum A3 Rating per Moody's Utility Rating Methodology

	FEI's Score	A - Rating Threshold[54]	2018	2019	2020	LTM Sept 2021
CFO pre-WC + Interest / Interest	Baa	4.5x-6.0x	2.5x	3.0x	2.9x	3.6x
CFO pre-WC / Debt	Baa	19.0% - 27.0%	13.6%	13.6%	11.3%	12.7%
CFO pre-WC - Dividends / Debt	Baa	15.0% - 23.0%	8.8%	8.7%	6.6%	7.9%
Debt / Capitalization[55,56]	A	40.0% - 50.0%	47.8%	47.5%	48.8%	47.9%

Source: Moody's Credit Rating Report for FEI, dated November 25, 2021.

Financial Metrics Are Weak Due to Low Allowed ROE and Thin Equity

162. Moody's December 2022 credit rating on FEI characterized FEI's financial metrics as "weak", stating: "These financial metrics are primarily a product of a low allowed equity component of its capital structure, a relatively low return on equity, and depreciation rates.[296]

163. Moody's also identified two factors that could lead to a credit rating downgrade: an adverse regulatory decision or a forecast of a sustained deterioration in credit metrics including CFO pre-W/C to debt of less than 11%.[297] FEI's CFO pre-W/C to debt metric for the year ended December 31, 2020 was only 11.3%, critically close to a rating downgrade threshold. It has seen only limited improvement since then, with the September 2022 value being only 12.9%. The December 2022 Moody's report stated: "We forecast CFO pre-W/C to debt in the 11-13% range

[295] Exhibit B1-8, Application, p. 34; Exhibit B1-9, BCUC IR1 6.1.1, 6.2.1 and 7.3.1.

[296] Exhibit B1-50-1, Moody's Credit Report for FEI dated December 9, 2022, p. 1.

[297] Exhibit B1-50-1, Moody's Credit Report for FEI dated December 9, 2022, p. 2.

for the next several years, a level that provides limited cushion at its current rating" [298] [Emphasis added.]

164. In light of the importance of financial metrics and regulatory supportiveness in Moody's methodology, an adverse outcome in this proceeding has considerable potential to influence FEI's credit rating. In 2013, when the BCUC reduced FEI's equity component of capital structure and ROE, Moody's changed FEI's credit outlook to negative stating "the BCUC's recent generic cost of capital decision (GCOC) . . . is likely to weaken the company's financial metrics further and is the impetus for the company's negative ratings outlook."[299] While FEI's credit rating outlook returned to stable in June 2014, Moody's response to the 2013 Decision signals that FEI's credit ratings cannot be taken for granted. If FEI is downgraded, any subsequent increase in the equity component of the capital structure or ROE would not necessarily lead to a timely credit rating upgrade since ratings are usually sticky and only changed when the rating agency determines that a rating can be maintained in various market conditions.[300]

165. S&P, another rating agency, has highlighted the downgrade risk that companies face from operating with marginal financial metrics for their rating:[301]

> Strategically, an increasing percentage of the industry has been managing their financial measures with only minimal financial cushion from their downgrade threshold. While this strategy of limiting excess credit capacity works well under ordinary conditions, when unexpected risks occur or base case assumptions deviate from expectations, the utility can become susceptible to a weakening of credit quality. This has been one of the primary drivers of the industry's weakening of credit quality over the past two years.

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[298] Exhibit B1-50-1, Moody's Credit Report for FEI dated December 9, 2022, p. 5.

[299] Exhibit B1-8, Application, p. 34.

[300] Exhibit B1-21, FortisBC Rebuttal Evidence, p. 8.

[301] Exhibit B1-9, BCUC IR1 7.3.1 and 13.3.1.

166. Increasing FEI's common equity ratio would directly improve three out of four financial metrics and indirectly improve the remaining financial metric.[302]

(c) ESG Considerations Are Limiting Access to Capital and Putting Pressure on FEI's Credit Ratings

167. The increasing weight being given to ESG considerations by investors and rating agencies, discussed below, means that maintaining the same weak financial metrics may no longer be enough to maintain its current rating. FEI needs a stronger balance sheet to counteract this downward pressure.

ESG Considerations Have Become More Important to Investors Since 2016

168. In recent years, ESG considerations and companies' ESG rankings have attracted a significant amount of interest among institutional investors and credit rating agencies. The evidence demonstrates that ESG will play an increasingly important role in credit rating determinations and investor decision-making.

169. The pool of capital available to utilities like FEI shrinks as a result of large investors restricting participation in the oil and gas sector. Mr. Coyne identified several large institutional investors (such as BlackRock, J.P. Morgan, Santander, and Goldman Sachs) and pension funds that have restricted or prohibited investments in companies seen as contributing to climate change.[303] In addition, in recent years, most of Canada's leading banks established Sustainable Finance groups, announced ESG-related mandates, and are increasingly restricting financing to fossil-fuel related projects. For instance, even since FortisBC filed its evidence in this proceeding, BMO (one of the biggest lenders to the oil and gas sector in Canada) announced its plans to cut emissions from energy loans in a net-zero push:

> Canada's fourth-largest bank said its new target is a 33 per cent cut in scope 1 and 2 emissions from oil and gas borrowers, which refers to the emissions produced by the companies themselves and their suppliers. The reduction is compared to

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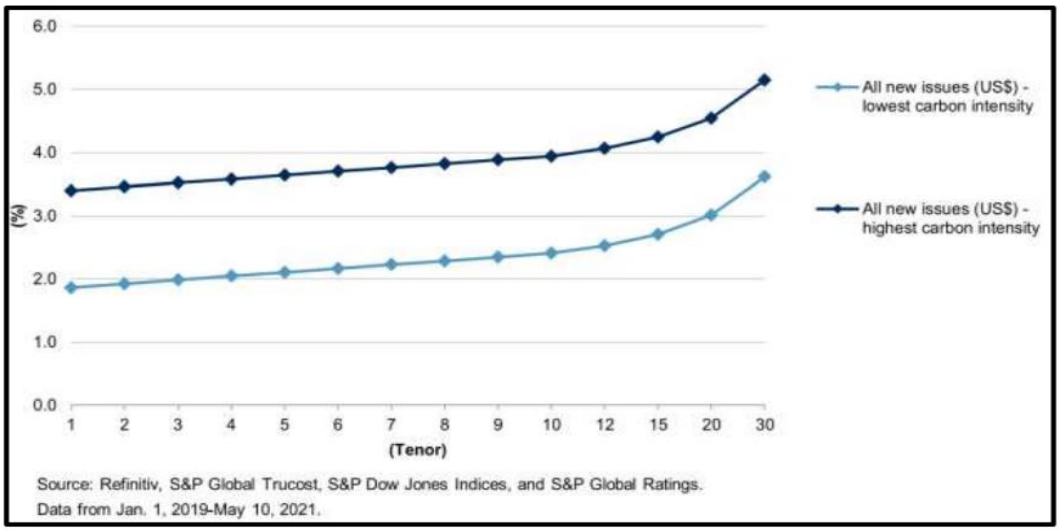
[302] Exhibit B1-9, BCUC IR1 8.4.

[303] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 80-81.

> 2019 levels. The Toronto-based bank is also aiming for 24 per cent cut by 2030 in scope 3 emissions -- those produced from the burning of the fuels that oil and gas companies produce.[304]

170. Mr. Coyne provided market data showing that investors are assigning a higher risk premium to companies with higher carbon emissions. For instance, differences in debt yields between the highest and lowest carbon intensity issuers exceed 150 bps for 10+ year issuances, as shown in the figure below. Betas (the CAPM input quantifying risk relative to the Market Risk Premium) for both gas and electric utilities have increased substantially, indicating that investors are seeing utilities as riskier than they have previously.[305]

Figure 41: S&P Estimated North American Energy New Issues Yield Curve: 2019-2021[117]



171. Moody's started including discussion on ESG related risks in its credit rating reports in 2019. Moody's indicated in an April 2020 report that it expected deeper market integration of climate risks to start constraining the availability of capital for the most-exposed sectors which will impact issuer credit quality.[306] In September 2020, Moody's published Sector-in-Depth – Regulated Electric & Gas Utilities – North America, which discussed how "shifting

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304 Exhibit B1-9, BCUC IR1 4.2.1. See also: Exhibit B1-9, BCUC IR1 8.1.

305 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 58 (Figure 28) and 80-81 (Figure 41); Exhibit B1-9, BCUC IR1 14.3.

306 Exhibit B1-9, BCUC IR1 8.1.

environmental agendas [have raised] long-term credit risk for natural gas investments."[307] Moody's has indicated that gas LDCs are considered to have higher carbon transition risk than electric utilities or combination electric and gas companies.[308] This year, Moody's has begun including an ESG Profile Scores in its credit rating reports.[309]

172. On January 20, 2022, S&P issued a report stating that for the first time ever, the median investor-owned utility ratings fell to the BBB credit rating category. The credit rating agency noted that during 2021, credit quality was primarily pressured by weak financial measures and ESG credit risks. S&P expected that physical and environmental risks will continue to constrain the industry's credit quality in 2022.[310]

173. Concentric noted that S&P has analyzed the financing costs of North American oil and gas companies relative to their environmental impact. S&P concluded that it saw "evidence that issuers with lower carbon intensity were able to issue longer-dated debt at lower financing costs than their more carbon-intense peers".[311]

174. Mr. Coyne's view is that utilities at the forefront of the Energy Transition, like FEI, require a stronger balance sheet than those operating in a business as usual or gas promoting jurisdictions. His experience is that investors in the utility sector are more cautious about investments in jurisdictions with more aggressive policies that place gas at a disadvantage versus alternative fuels, and in some cases will not invest.[312] This is borne out in recent Moody's commentary about FEI, discussed below.

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307 Exhibit B1-9, BCUC IR1 8.1.

308 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 97-99.

309 See, e.g., Exhibit B1-50-1, Moody's Credit Report for FEI dated December 9, 2022, p. 7.

310 Exhibit B1-9, BCUC IR1 8.1, 13.3.1 and Attachment 13.3.1, January 2022 S&P Report. Five gas utilities received credit downgrades by S&P in 2021.

311 Exhibit B1-9, BCUC IR1 4.2.1.

312 Exhibit B1-20, BCUC IR2 77.3.

Moody's Has Reversed Its Assessment of FEI's Energy Transition Risk Exposure

175. Moody's has completely reversed its stance on FEI's long-term risk exposure associated with the Energy Transition. As recently as 2019, Moody's had characterized FEI as having "low" carbon transition risk:

> As a natural gas distribution company, FEI has a low carbon transition risk within the regulated utility sector. We generally consider T&D and LDC utilities to have low carbon transition risk because, unlike integrated utilities, they have no direct carbon emissions. The company intends to increase its use of renewable natural gas as part of its effort to support the Province of BC in achieving its legislated targets of reducing GHG emissions by 40% by 2030 and 80% by 2050 from 2007 levels. The company also expects to lead the transition to lower carbon fuels in marine transportation through LNG bunkering.[313]

176. Only two years later, in 2021, as federal and BC's climate regulations became stricter and ESG considerations took on greater profile, Moody's started describing FEI's carbon transition risk as "very negative":

> FEI has a very negative carbon transition risk because of the risks associated with carbon emissions targets. The Province of BC has legislated targets of reducing GHG emissions by 40% by 2030 and 80% by 2050, levels that exceed the company's own 30% reduction target by 2030 (all based on 2007 figures). The company intends to continue to increase its use of renewable natural gas as part of its effort to reach these goals, in addition to continuing its work on the use of hydrogen gas and other measures to achieve these aggressive targets. The company also expects to lead the transition to lower carbon fuels in marine transportation through LNG bunkering.[314]

177. The December 2022 Moody's report is the first time Moody's has applied its new ESG Profile Scores. It characterized FEI's environmental ESG profile score as "Highly Negative":

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[313] Exhibit B1-8-1, Appendix D-2, Moody's Credit Rating Report for FEI dated August 29, 2019, pp. 6-7 (PDF pp. 877-878/5621).

[314] Exhibit B1-8-1, Appendix D-2, Moody's Credit Rating Report for FEI dated November 25, 2021, p. 6 (PDF p. 888/5621); Exhibit B1-9, BCUC IR1 8.1.

Exhibit 8
ESG Issuer Profile Scores

Source: Moody's Investors Service

178. Moody's explained that:[315]

> FEI's high environmental risk (E-4 issuer profile score) reflects its elevated exposure to carbon transition risk given British Columbia's legislated commitments to reduce greenhouse gas emissions by 40% by 2030 and 80% by 2050 and that all of the company's network operations are gas.

179. There are three noteworthy points about Moody's reversal:

(a) Moody's initial, more favourable, assessment was focussed on FEI's own limited emissions. It now recognizes that policies targeting customer emissions are a significant risk for FEI's long-term growth prospects.

(b) The language Moody's is now using is strong – "very negative carbon transition risk" in 2021 to "Highly Negative" environmental profile in 2022, and they have formalized their evaluation approach and scoring.

(c) Third, in making its most recent "very negative" and "Highly Negative" assessments, Moody's was fully apprised of FEI's efforts to reduce its carbon transition risk. FEI stated:

> FEI updates its investors and rating agencies on relevant matters including challenges associated with the Energy Transition. In past meetings with rating agencies, FEI has discussed its 30-By-30 initiatives as well as how these initiatives may impact price competitiveness. Further, relevant documents such as FEI's Clean

[315] Exhibit B1-50-1, Moody's Credit Report for FEI dated December 9, 2022, p. 7.

> Growth Pathway as well as the long-term resource planning application are publicly available to all stakeholders, including investors and rating agencies. In addition, FEI's executives and employees participate in various conferences, debates and podcasts updating stakeholders regarding the value of the gas network and why a diversified pathway is the preferred choice. Investors and rating agencies may also use the published material by third party researchers or industry advocates that discuss the cost-effectiveness of a more diversified approach.[316] [Emphasis added]

FEI's Investors Are Raising ESG Concerns and Considering Other Investments

180. Mr. Lorimer described how FEI's investors are raising ESG considerations directly with the company:[317]

> But in comparison to FEI, I think there's a, you know, a definite divergence happening in, you know, our comfort with investors and their willingness to invest in the same way as they have in the past in a company like FortisBC Energy. You know, we've had a number of inbound calls from historical investors of ours that have begun to question, you know, whether or not they would be looking to invest in a carbon-based company going forward. And it's not a hard no but it's just something that they're now saying that is going to be more difficult for them to necessarily, you know, pick versus other investment opportunities. So, you know, we've got a very long-standing base of investors. And when you hear that from a couple of our key ones, it is a bit of a flag. You know, they like our business and they like our approach to energy transition but at the heart they still see us as a fossil fuel-based company. And, you know, without going through, you know, what happens behind their closed doors, I think there are beginning to be strong indications that the landscape is shifting. And when you see that and how quickly you see it, it doesn't hit you all at once but it -- step by step it begins to have an effect.

(d) New Climate Related Disclosure Requirements Will Amplify ESG Investor Considerations for FEI

181. Under proposed Securities and Exchange Commission (SEC) rule changes announced on March 21, 2022, Fortis Inc. must include certain climate-related disclosures in its

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316 Exhibit B1-18, CEC IR2 71.2.

317 Tr. 5A, p. 815, l. 19 – p. 816, l. 15 (Lorimer).

registration statements and periodic reports. The required disclosure will include information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. It would also include disclosure of a registrant's GHG emissions, which have become a commonly used metric to assess a registrant's exposure to such risks. Investors and credit rating agencies will have increased visibility and new sources of information regarding FEI's climate related risks and GHG emissions.[318]

(e) Green Bonds Are Niche Products for FEI and Cannot Offset ESG Pressure

182. FEI was asked whether Green Bonds provide a new avenue for accessing capital. Mr. Lorimer explained that it is a niche product, and the opportunities for further issuances are limited:[319]

> So while it was a useful product, you know, as a periodic source of funding, it can't be used for our general corporate purposes and more about funding that happens on a regular basis. It's very narrow and limited to eligible projects, and almost all of the funding was dedicated to our demand side management program. So that was set in advance with a third party verifier who put a green label on our demand side management program and that allowed us to issue a green bond if we used the proceeds for that specific purpose.
>
> So it was useful for that, but it doesn't provide us with, I guess, long-term comfort in the ability to finance our base business for a vast majority of our capital needs.
>
> But I will also mention that these green bond frameworks that we had set up have a lifecycle. So we are coming back to renew our green bond framework with our third-party verifier and developments I think in this area put a bit more at question whether or not the next round will allow us to put some of the programs under the green bond framework.
>
> So I just wanted to perhaps temper expectations around the ability to kind of expand this program. I'd say if anything it's narrowing, and you know, the ability to finance even the programs we have over here, may be a bit more restricted in the next version of our green bond, green bond program going forward. It was a

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[318] Exhibit B1-9, BCUC IR1 8.1; Exhibit B1-13, RCIA IR1 4.4.1.

[319] Tr. 5A, p. 772, l. 7 – p. 773, l. 12 (Lorimer).

useful one, I think, for us at the time and we did get some benefits in pricing from being able to access it.

(f) ESG Means It Will Be Harder to Get By With Marginal Financial Metrics

183. FEI does not have full visibility into how ESG risks will be factored into its credit ratings, but it is reasonable to expect that ESG will play an increasingly important role relative to traditional financial metrics.[320] While RNG and other renewable gases may offer a path forwards for FEI, FEI will continue to rely on conventional natural gas for its base supply for some time. It is unlikely that ESG investors or rating agencies will view FEI as a renewable company that can continue to get by with weak financial metrics.[321] Even investors who are prepared to invest in a gas distribution utility will also perceive significant risk to FEI's pathways to compliance and expect that the risks associated with these initiatives be reflected in the determination of the Fair Return.[322]

B. FEI IS HIGHER RISK RELATIVE TO PEER UTILITIES, BUT IS MORE THINLY CAPITALIZED

184. As discussed in Part Seven, Section B(c), Mr. Coyne and Dr. Lesser agree that FEI is competing for capital in a North American market, characterized by a high degree of integration. Investors compare the risk-adjusted returns provided by utility investments on both sides of the border. FEI's current common equity ratio, a key determinant of the financial risk faced by potential investors, is more than 10% below the US proxy group average of 50-52%.[323] As discussed below, the discrepancy cannot be justified by a risk differential. Increasing FEI's common equity ratio to 45% will still only partly remedy this anomalous situation.

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[320] Exhibit B1-20, BCUC IR2 64.1, 64.1.1; Exhibit B1-9, BCUC IR1 6.2.1.

[321] Exhibit B1-9, BCUC IR1 8.1.1

[322] Exhibit B1-11 CEC IR1 2.5.

[323] Exhibit B1-20, BCUC IR2 78.1; Exhibit B1-8-1, Application, Appendix C, Concentric Report, pp. 4, 149.

(a) Mr. Coyne's Analysis Shows FEI Has Relatively High Business Risk Among North American Peers

185. Mr. Coyne conducted a detailed comparative risk analysis of FEI's risk with the Canadian and US proxy groups and reviewed FEI's financial metrics. Dr. Lesser accepted Mr. Coyne's peer groups (see Part Seven, Section B(b)), but was not tasked with performing a relative risk assessment.[324] In Mr. Coyne's expert opinion, an equity ratio of 45% "would narrow the gap between FEI and its US comparators"[325] and is "reasonable, if not conservative".[326]

186. The discrepancy cannot be justified by a risk differential. In addition to FEI having higher financial risk based on a variety of metrics, Mr. Coyne assessed FEI has "comparable to higher" business risk to the US peer group:[327]

> Based on the business risk analysis, my conclusion is that FEI has comparable to higher business risk than the U.S. Gas proxy group. Factors contributing to this assessment include FEI's more challenging environment with regard to environmental regulations and the Energy Transition, and a higher degree of competition with electricity and alternate fuels. Partly offsetting these factors are FEI's protection against regulatory lag with a forecast test year and full revenue decoupling. From an investor's standpoint, I believe FEI would be considered comparable.
>
> . . .
>
> The financial risk of FEI is comparable to that of the Canadian proxy group and substantially higher than the U.S. Gas and North American Gas proxy groups, based on an analysis of deemed equity ratios at the operating utility level and key cash flow and interest coverage metrics.

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[324] Tr. 4, p. 631, l. 25 – p. 632, l. 3 (Lesser): "Well, really first off, I haven't evaluated FEI and [F]BC's business and financial risk, so I can't comment on whether Mr. Coyne's recommendations for capital structure for both those companies are appropriate or not."

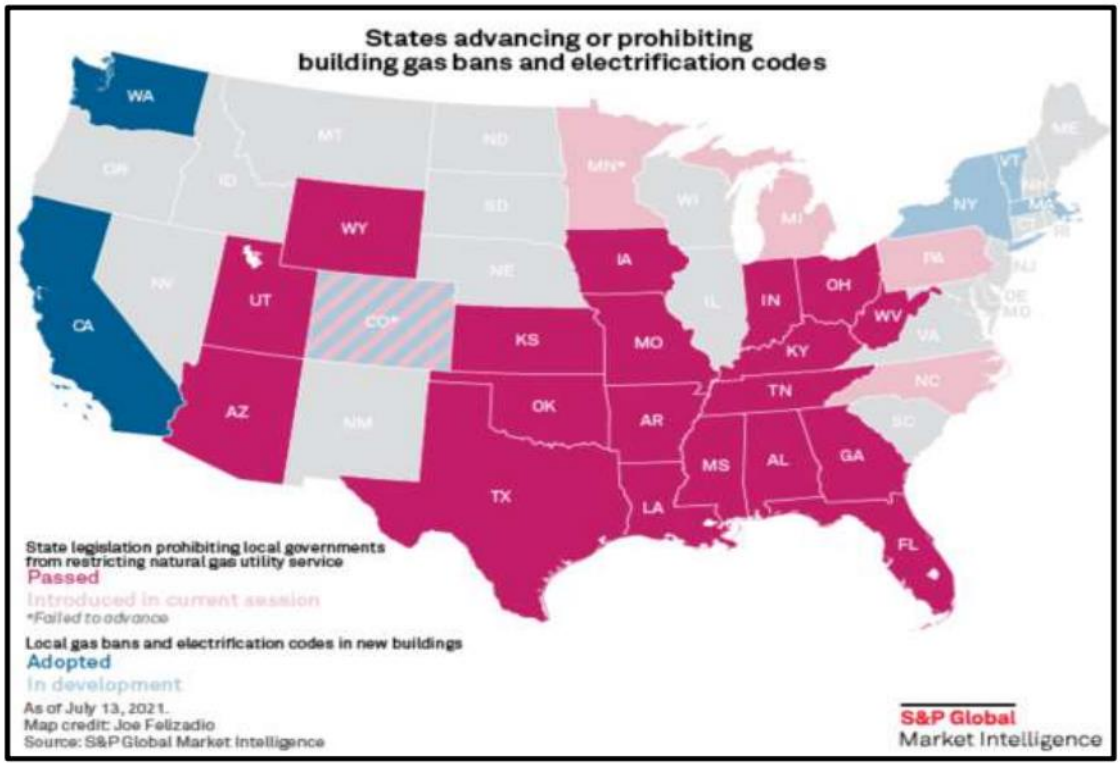
[325] Exhibit B1-8-1, Appendix C, Concentric Report, p. 149.

[326] Exhibit B1-8-1, Appendix C, Concentric Report, p. 162.

[327] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 117 and 123.

187. The 2021 CleanBC Roadmap in British Columbia is more aggressive and will happen sooner than any of the US states which have gas use restrictions.[328] Many of the US peer utilities operate in jurisdictions where natural gas is seen as a clean alternative to coal. A number also benefit from state-legislated prohibitions against local governments instituting gas bans, which are in place in at least 19 US states:[329]

Figure 40: Status of U.S. Building Gas Bans by State[109]



188. FEI and Mr. Coyne were asked, both during IRs and at the oral hearing, whether FEI was, in fact, benefiting from being at the leading edge of the Energy Transition relative to its peers. FEI submits that this is both counterintuitive and incorrect. While FEI is taking certain steps to position itself in response to risk caused by the Energy Transition, it is only having to pursue these initiatives because it is facing much greater uncertainty and more immediate risk.[330]

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328 Exhibit B1-9 BCUC IR1 45.3; Exhibit B1-20, BCUC IR2 76.1.

329 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 78-79.

330 Exhibit B1-8-1, Appendix C, Concentric Report, p. 95; Exhibit B1-20, BCUC IR2 67.1.

Utilities in a less aggressive policy framework face a lower risk environment.[331] Lagging jurisdictions will have the benefit of the certainty of precedent set in first-mover jurisdictions. They will benefit from lessons-learned, new technologies and solutions, as well as the certainty of cost-efficiency and scalability of renewable energy technology.[332]

189. Mr. Coyne explained that, although there are only a few large Canadian gas utilities, a 45% common equity ratio also "recognizes the greater risks of FEI relative to its Canadian investor-owned gas utility peer companies".[333] It stands to reason that FEI would have thicker equity than ATCO Gas and Enbridge, given they are located in jurisdictions with policies more favourable to natural gas.[334] Mr. Coyne observed that only Energir is riskier than FEI.[335] While Energir currently has 38.5% common equity, Energir has an additional layer of deemed preferred equity in its capital structure that reduces financial risk faced by debt holders.[336] The Regie has not considered Energir's cost of capital since 2019[337], such that its current allowed equity ratio is lagging.

190. More fundamentally, as discussed in Part Seven, Section B(c), the systematically lower overall returns in Canada are an anachronism – a vestige of a time when there was less integration with the US; both Mr. Coyne and Dr. Lesser agreed that the BCUC should focus more on the North American market, the largest portion of which is in the US.

C. PROPOSED RESTRICTIONS ON INTEREST DEDUCTIBILITY WOULD INCREASE INCOME TAX EXPENSE

191. The 2021 Federal Budget introduced an earnings-stripping rule to limit the amount of net interest expense that a corporation may deduct in computing its taxable income to no

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331 Exhibit B1-20 BCUC IR2 76.3.

332 Exhibit B1-20 BCUC IR2 76.3.

333 Exhibit B1-8, Appendix C, Concentric Report, p. 149.

334 Exhibit B1-18, CEC IR2 63.1; Exhibit B1-11, CEC IR1 2.3.

335 Exhibit B1-8-1, Appendix C, Concentric Report, p. 149.

336 Exhibit B1-8-1, Appendix C, Concentric Report, p. 149, footnote 225.

337 La Régie de l'énergie du Québec, D-2020-145 (November 4, 2020), footnote 144, online at: http://publicsde.regie-energie.qc.ca/projets/538/DocPrj/R-4119-2020-A-0049-Dec-Dec-2020_11_04.pdf.

more than a fixed ratio of "tax EBITDA".[338] If the proposed rules are passed, the FortisBC utilities may be significantly impacted due to their capital intensive nature and the amount of debt financing in their capital structures. Under the rules as proposed, in any given year, utilities with a relatively high regulated debt component may be limited in the amount of interest expense that they can deduct for tax purposes, which would result in an increase in income tax expense and therefore higher costs for ratepayers. In that case, a portion of interest expense incurred would not be allowed the benefit of deductibility for tax purposes, making the highly-leveraged capital structure less efficient.[339]

D. CONCLUSION AND REQUESTED FINDING

192. The BCUC should find that FEI's financial metrics are already weak for its current credit rating, and provide little margin to accommodate unexpected events or increasing scrutiny from investors, credit rating agencies and financial institutions around ESG related risks.[340] In addition to better reflecting FEI's business risk, a 45% equity ratio will maintain financial integrity and flexibility. It will allow FEI to attract capital on a comparable basis with its North American peers.

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[338] Exhibit B1-8, Application, p. 49.

[339] Exhibit B1-8, Application, p. 49.

[340] Exhibit B1-9, BCUC IR1 6.3.

PART FIVE: FBC'S BUSINESS RISK IS SIMILAR

193. The BCUC last assessed FBC's business risk in the 2013 Stage 2 GCOC Proceeding (the "2013 Proceeding"). FBC's overall business risk is **similar** to what was assessed in the 2013 Proceeding. As Mr. Slater observed: "FBC is experiencing increased risk in various areas, such as operating risk, Indigenous rights and engagement, regulatory risk and challenging economic conditions. However, these increases are not material enough to justify an increase in FBC's common equity thickness and are otherwise offset by FBC's potential to benefit from the energy transition."[341]

A. RISK FACTOR ANALYSIS: FBC'S RISK IS SIMILAR OVERALL

194. Table B1-2 summarizes FBC's assessment of whether its risk associated with particular risk categories and factors is higher/lower/similar relative to how it was represented in the 2013 Proceeding, or whether it is a new risk for this Proceeding.

Table B1-2: Summary of FBC's Business Risk

Business Risk Category	Risk Factor	Change in Risk Since 2013
Business Profile		**Similar**
	Type and Size of the Utility	Similar
	Service area	Similar
	Customer profile	Higher
Economic Conditions		**Higher**
	Overall economic conditions	Higher
Political		**Lower**
	Energy policies and legislation	Lower
Indigenous Rights and Engagement		**Higher**
	Legislative and policy developments	Higher
	Aboriginal rights and title	Higher
	Social license/work interruption	Higher
Energy Price		**Similar**

[341] Exhibit B1-30, Opening Statement of Doug Slater, p. 3; Tr. 5A, p. 705, ll. 16-25 (Slater).

Business Risk Category	Risk Factor	Change in Risk Since 2013
	Power supply cost	Higher
	Competition with electricity	Higher
	Competition with natural gas	Lower
Demand/Market		**Similar**
	New technologies	Similar
	Wholesale and Industrial load	Similar
	Use per customer	Similar
	End-use market share	Lower
Energy Supply		**Similar**
	Security and reliability of supply	Similar
Operating		**Higher**
	Infrastructure integrity	Similar
	Unexpected events	Higher
	Project resistance	New (Higher)
	Cybersecurity	New (Higher)
Regulatory		**Higher**
	Regulatory uncertainty and lag	Higher
	Administrative penalties	Similar

(a) Business Profile Risk – Similar Risk

Business Profile		**Similar**
	Type and Size of the Utility	Similar
	Service area	Similar
	Customer profile	Higher

195. FBC's business profile risk is affected by the limited diversity and size of its customer base, which is also concentrated in a small, but geographically-diverse service area. The evidence bears out FBC's assessment that its overall business profile risk is similar to what was assessed in the 2013 Proceeding, despite a slight increase in FBC's customer profile risk due to greater representation of the Industrial sector in the company's load and revenue profile.

FBC's Vertically-Integrated Nature Contributes to its Business Risk

196. FBC's vertically-integrated structure contributes to a higher risk profile than for a distribution-only utility of a similar size, because of the increased risk associated with ownership and operation of generation assets. Generation technology advances, shifts in fuel prices, and public policy initiatives often outpace the useful lives of generation assets. This leaves a vertically-integrated utility more exposed to the risk of stranded assets, whereas a transmission and distribution company is better able to navigate these shifts through reliance on contracts or wholesale markets.[342] S&P reports that the annual average authorized ROEs for vertically integrated companies are about 30-65 basis points higher than for delivery-only utilities, "arguably reflecting the increased risk associated with ownership and operation of generation assets."[343]

FBC's Small Area Limits Growth Potential and Increases Exposure to Events

197. In the 2013 Proceeding, the BCUC recognized that size-related issues such as concentrated assets and lack of diversity in its customer base affect FBC's risk.[344] FBC has only approximately 147,000 direct and 38,000 indirect customers. FBC's growth potential is limited by being surrounded by BC Hydro's service territory and annual population growth being below one%. Substantial portions of FBC's service area are rural, and FBC remains dependent on relatively few industries.[345] Negative events can have a greater impact on the earnings and viability of a small utility operating in smaller geographic areas. Localized negative events (such as major road closures, adverse weather, etc.) can negatively impact most, or even all, of the service area of FBC with no material impact to the rest of the province.[346]

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342 Exhibit B1-9, BCUC IR1 56.2.

343 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, pp. 8-9.

344 2013 Stage 2 GCOC decision, p. 68.

345 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 10 and section 2.2.

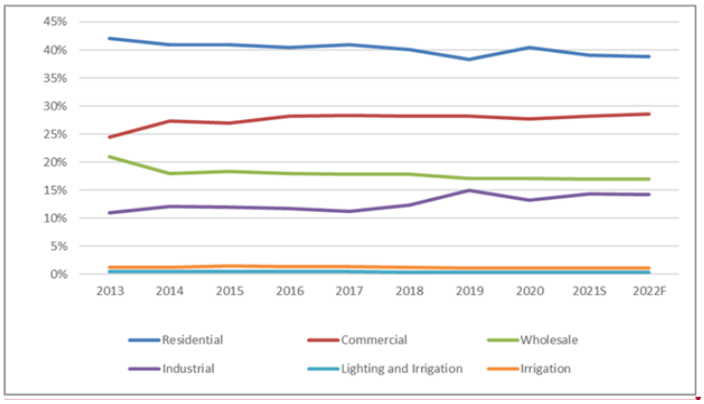
346 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 2.2.

FBC Heavily Reliant on a Small Number of Industrial and Wholesale Customers

198. A concentration of a significant proportion of overall load among a small number of customers is generally undesirable from a risk perspective.[347] As discussed below, two customer classes, Industrial and Wholesale, already represent approximately 25% of FBC's revenue and more than 30% of its load. Only four Wholesale customers represent 17% of FBC's total load. FBC's Industrial load is growing as a proportion of its overall load, increasing from 11% in 2013 to 14% in 2022, as shown in the following figure.[348] This has two implications.

199. First, Industrial load is more volatile and more prone to economic downturns than other classes, making it more risky from FBC's perspective. For instance, in 2019 FBC's Industrial load grew by 23% but the economic crises brought on by the COVID-19 pandemic caused Industrial load to drop by 11% in 2020.[349]

Figure B2-1: The Trend in FBC's Load Profile by Customer Segment[15]



[347] Exhibit B1-8-1-1 (Errata), Revised Appendix B, FBC Business Risk Assessment, p. 11.

[348] Exhibit B1-8-1-1 (Errata), Revised Appendix B, FBC Business Risk Assessment, p. 11; Exhibit B1-10, BCOAPO IR1 11.4.

[349] Exhibit B1-8-1-1 (Errata), Revised Appendix B, FBC Business Risk Assessment, Figure B2-1, p. 11.

200. Since 2013, FEI has augmented its forestry-based Industrial load with one large cryptocurrency customer,[350] raising the overall risk profile of FBC's Industrial load.[351] Mr. Mazza explained the risk associated with cryptocurrency:

> A few things with cryptocurrency that are noteworthy. While we have seen more interest within our service territory for cryptocurrency, it is sensitive to market conditions, it is sensitive to the price of digital currencies obviously, the price of power. And then in terms of actually hooking up to our system, it starts to somewhat be somewhat problematic in terms of infrastructure planning. And to what degree customers are interested in underpinning infrastructure, we haven't seen that. Do they have their credit worthiness? Can they put up performance security? Can they make a contribution? We haven't seen that. So we do see some risks with it. A lot of them are looking for lower cost power but it may not necessarily be there for them in the way that we want to operate the utility. So we do see it as risk. [352]

201. Second, as discussed in the context of demand/market risk below, a significant number of Wholesale and Industrial customers have the ability to receive service from alternate sources of supply with only limited notice.

(b) Economic Conditions – Higher Risk

Economic Conditions		Higher
	Overall economic conditions	Higher

202. The current Canadian economic environment continues to be dominated by uncertainty, and the factors discussed in Part Three, Section B(c) are also relevant to FBC. As confirmed by Moody's,[353] adverse economic conditions pose an elevated level of risk to smaller utilities. Smaller utilities like FBC have less opportunity to diversify their operations and protect

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[350] It accounts for 23% of the load of FBC's top 20 Industrial customers: Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, Figure B7-2; this Figure is discussed by Ms. Roy at Tr. 5A, pp. 821-822; see also: Exhibit B1-20, BCUC IR2 74.1.

[351] Exhibit B1-9, BCUC IR 33; Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, Section 7.2.2.

[352] Tr. 5A, p. 820, l. 13, p. 821, l. 3 (Mazza).

[353] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 13.

themselves against economic-driven volatility. FBC's Industrial load is concentrated in two highly-cyclical sectors (forestry and cryptocurrency).[354]

(c) Political – Lower Risk

Political		Lower
	Energy policies and legislation	Lower

203. FBC's political risk is lower now than in 2013 due to the Energy Transition and the policies outlined in Part Three, Section B(d) that favour electrification and discourage gas consumption. However, interveners appear to be overestimating the Energy Transition's favourable impact on FBC for two reasons described below.

BC Hydro Is the Primary Beneficiary of Fuel Switching from FEI

204. First, BC Hydro, not FBC, is the primary beneficiary of electrification of FEI's natural gas load. There is far greater overlap between FEI's service territory and BC Hydro's service territory. Moreover, Mr. Slater explained that municipal actions are advancing the fastest, and are more impactful on FEI, outside of FBC's territory:

> On the latter point, it should be recognized that BC Hydro is the primary beneficiary from FEI's challenges in the energy transition. Given that the challenges to FEI's business caused by anti-gas policies and climate emergency declarations are primarily occurring in the Lower Mainland and Vancouver Island where the service territories of FEI and BC Hydro overlap, the majority of FEI's customers reside, and importantly the temperate climate means heat pumps are very competitive.[355]

205. In other words, the Energy Transition does not represent a zero sum game for FEI and FBC.

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[354] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 13.

[355] Tr. 5A, p. 706, l. 26-p. 707, l. 9 (Slater); see also: Exhibit B1-8-1, Appendix B, p. 15.

Rapid Load Growth Presents its Own Risks

206. Second, the benefits of government policies favouring electrification of the building and transportation sectors are tempered by the risk that FBC will not have the capacity to meet that demand and operational challenges. As Mr. Mazza described:

> So we look longer term, yes, there's certainly risk to increasing demand. There's infrastructure build-out for example. We've looked at the Kelowna area. What's it going to take if we just start to electrify more and more of that region. And there is substantial concerns there from an operating perspective, from a grid integrity perspective and it's somewhat uncertain right now in terms of what that looks like. So there's more planning required. You know, it's definitely a topic in our long-term electric resource plan, but I would say there's risks there for sure.[356]

207. Heating load typically peaks in winter when capacity is most constrained. A significant increase electricity load in certain portions of FBC's service territory would drive capital investments to add capacity,[357] which challenges rate competitiveness.[358] EV charging could also present operational challenges in terms of overloading distribution transformers with the concentration of EVs in a relatively small area on the FBC system, as discussed later in the context of demand / market risk.

(d) Indigenous Rights and Engagement – Higher Risk

Indigenous Rights and Engagement		Higher
	Legislative and policy developments	Higher
	Aboriginal rights and title	Higher
	Social license/work interruption	Higher

[356] Tr. 5A, p. 808, l. 16 – p. 809, l. 1 (Mazza).

[357] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 14; Exhibit B1-9, BCUC IR1 31.1; Exhibit B1-18, CEC IR2 71.3.

[358] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 14; Exhibit B1-18, CEC IR2 71.3.

208. The evidence described in Part Three, Section B(e) applicable to FEI also applies to FBC.[359]

(e) Energy Price – Similar Risk

Energy Price		Similar
	Power supply cost	Higher
	Competition with electricity	Higher
	Competition with natural gas	Lower

209. Higher electricity rates in FBC's service territory can hinder FBC's ability to attract new customers and can discourage residential customers from using electricity for space heating and water heating, diminishing FBC's market share and use per customer.[360] The BCUC should find that, overall, FBC's risk associated with energy price remains similar compared to the 2013 Proceeding. FBC now faces higher power supply cost and market price risk. It is exposed to similar rate competitiveness risk, with offsetting changes in position relative to BC Hydro and FEI.

Increased Uncertainty Around Power Supply Costs

210. FBC relies on the wholesale market to meet short-term energy gaps and to offset purchases under the BC Hydro Power Purchase Agreement ("PPA") when market supplies are more cost effective. In 2020, wholesale market purchases represented 10% of its energy requirements.[361] The increase in FEI's risk exposure for wholesale market purchases since the 2013 Proceeding is primarily due to three factors:

(a) Since the 2013 Proceeding, a stronger reliance on natural gas-fired power plants in the Pacific Northwest has increased volatility in Mid-Columbia (Mid-C) trading hub prices, as shown in the figure below.[362]

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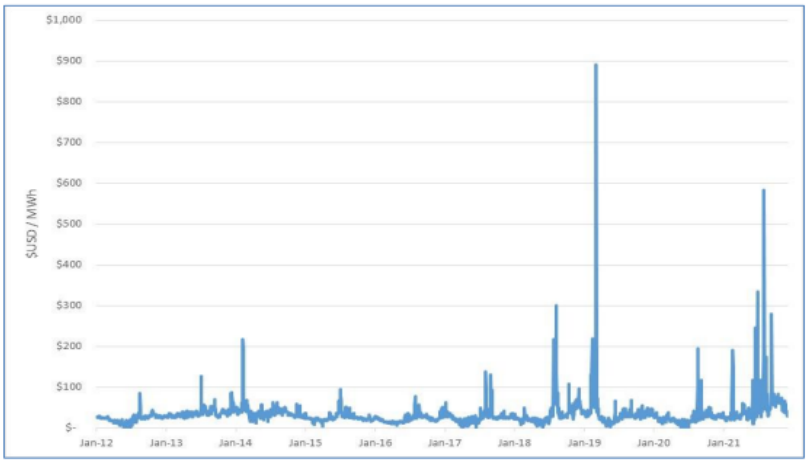
[359] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 5.

[360] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 17.

[361] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.1.1.

[362] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.1.1, Figure B6-1.

Figure B6-1: Day-Ahead Mid-C On-Peak Prices



(b) The surplus of electricity has lessened in the past few years, causing increased competitiveness in the Mid-C market, and greater integration with the California market.

(c) Carbon taxes enacted by federal or state governments are also affecting FBC's energy price risk, as increased carbon prices can increase Mid-C market prices given the region's increasing reliance on natural gas-fired generation.[363]

211. FBC continues to purchase energy under the BC Hydro PPA, as it did in 2013.[364] Mr. Mazza noted that increased demand from electrification would affect energy price under the BC Hydro PPA:

> Right now our annual rate differential to BC Hydro is about 27 percent . . . if we increase our demand by even five to ten percent, our rates go up and that's just because we're getting into the second tranche of the BC Hydro - - of the 3808 PPA, right? That's an example.[365]

212. The risk from the Brilliant Power Purchase Agreement contract rates has increased.[366] FBC purchases approximately 26% of the energy and 19% of the capacity required

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[363] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.1.1.

[364] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.1.2.

[365] Tr. 5A, p. 808, ll. 8-15 (Mazza).

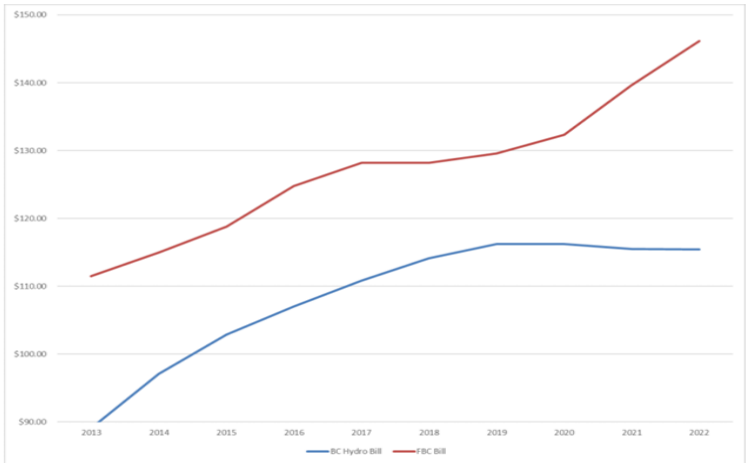
[366] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.1.3.

to serve its customers from Columbia Power Corporation and the Columbia Basin Trust Power Corporation (jointly referred to as "CPC") under the Brilliant Power Purchase Agreement at rates set out in the agreement. In 2026, the Agreement is up for a market price adjustment. At this time, FBC and CPC have yet to agree on a methodology for determining the appropriate market rate. Given the market price risks described above, there is increased risk to the contract rates under this agreement as compared to the 2013 Proceeding.[367]

Rate Competitiveness Risk is Similar

213. FBC faces competition from both natural gas and other electricity service providers. The trends are offsetting. FBC competes with BC Hydro in underdeveloped areas where the borders of FBC's service area and BC Hydro's service area meet. BC Hydro's lower electricity rates limit FBC's ability to expand beyond its currently serviced areas.[368]

Figure B6-3: Monthly Residential Bill Comparison



214. FBC assessed that its rate competitiveness risk compared to BC Hydro is similar to the 2013 Proceeding levels but may trend higher in the coming years. FBC also assessed that its rate competitiveness relative to natural gas is similar to the 2013 Proceeding; however, given

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367 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.1.3.

368 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.2.1. An FBC residential customer electricity bill was 27% higher than a BC Hydro residential customer electricity bill at January 1, 2022, based on usage of 1,000 kWh per month and including the basic Customer Charges: Exhibit B1-8-1-1 (Errata), Revised Appendix B, p. 21.

expected increases to natural gas and carbon tax rates, FBC expects that its rate competitiveness relative to natural gas will improve in the following years.[369]

(f) Demand/Market – Similar

Demand/Market		Similar
	New technologies	Similar
	Wholesale and Industrial load	Similar
	Use per customer	Similar
	End-use market share	Lower

215. The evidence demonstrates that FBC's overall demand / market risk is similar to what it was in the 2013 Proceeding, despite some reduction in risk associated with benefiting from the Energy Transition over the longer-term.

Emerging Technologies Provide Opportunities and Challenges

216. As stated by S&P, "Electric grids . . . are also exposed to risks related to the modernization of electric power to accommodate new technologies and intermittent and decentralized renewable power supply."[370] EV charging load and distributed sources of generation are notable in the context of FBC.

217. EV charging load is expected to increase in the coming years. All else equal, additional EV charging load improves FBC's risk since it would increase FBC's load and revenues. However, increasing EV load in a short period of time or not being able to manage EV charging during peak demand periods can create its own challenges. FBC faces an increasing risk with respect to grid integrity due to incremental peak demand imposed by EV loads. Local distribution transformers can be overloaded unless DSM measures are implemented to shift charging times from peak periods. Transformer and conductor capacity in older neighbourhoods may be

[369] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 6.2.

[370] Exhibit B1-9, Attachment 35.2.2, S&P ESG Evaluation Key Sustainability Factors, PDF p. 338.

insufficient to support connecting EVs, requiring a circuit rebuild to mitigate the risk of overloaded conductors.[371] Capital investment is required to meet additional peak demand requirements imposed by EV loads, contributing to rate increases. Projects could include a 500 kV transmission line project, new distribution substations and feeders, and 138 kV transmission line upgrades and additions.[372]

218. Alternative sources of energy, such as home solar generation, and other distributed generation introduce several risks. First, as customers meet an increasing amount of load from non-utility sources, the load on FBC's system decreases. With less revenue available to pay for the embedded fixed assets, rates necessarily increase. Second, accommodating distributed generation creates uncertainty within the system planning process. It challenges FEI's ability to maintain grid integrity and manage the timing of load on the system to avoid peak demand impacts.[373] Third, new infrastructure must be added to maintain the integrity of the system, putting further upward pressure on rates—potentially driving even more interest in alternative resources.[374]

FBC Continues to Have Wholesale Load Exposure

219. FBC currently has four municipal Wholesale customers, accounting for 17% of FBC's load. FBC's Wholesale customers have a number of options that would allow them to discontinue taking service from FBC. A loss of any or all of the Wholesale customers to a competing electricity supplier would have a large impact on FBC. The loss of their load would result in a reduction of over $51 million in revenue and a substantial rate increase of approximately 6.8% for FBC's remaining customers.[375]

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[371] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 7.1.2; Exhibit B1-11, CEC IR1 48.1.

[372] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 7.1.2.

[373] Exhibit B1-10, BCOAPO IR2 43.1.

[374] Exhibit B1-8-1-1 (Errata), Revised Application, Appendix B, FBC Business Risk Assessment, section 7.1.1.

[375] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 7.2.1.

FBC's Concentrated Industrial Customer Base Has Other Options

220. Any of FBC's eligible Industrial customers can discontinue taking service from FBC by building generation to serve some or all of their load, purchasing electricity on the open market or taking service from BC Hydro through its OATT.[376] FBC's has one cryptocurrency customer that accounts for 22% of load for FBC's top 20 Industrial customers.[377] Cryptocurrency customers are price-sensitive and more mobile than other customers.[378]

Market Share Has Yet to Reflect the Impact of Energy Transition, But Likely Will

221. FBC assessed market share risk as having declined since the 2013 Proceeding, due to the likely impacts of the Energy Transition. The tables below show that, to this point, the use of electricity as a main space and water heating fuel has remained steady since 2009. However, FBC anticipates adding fuel switching load at the expense of FEI over the longer term as the penetration of heat pumps increases.[379] FBC discussed above in the context of political risk that BC Hydro, not FBC, is the main beneficiary of fuel switching from FEI.

Table B7-1: Main Space Heating End-use by Fuel Type

Fuel Type	REUS Year		
	2009	2012	2017
Electricity	38%	37%	38%
Natural Gas	52%	51%	55%
Other	10%	12%	7%

376 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 7.2.1.

377 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, Figure B7-2; this figure is discussed by Ms. Roy at Tr. 5A, pp. 821-822. See also Exhibit B1-20, BCUC IR2 74.1.

378 For further explanation of the factors that make the cryptocurrency industry volatile and inherently risky, please refer to Exhibit B1-20, BCUC IR2 74.1.2, 74.2.

379 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, pp. 38-39.

Table B7-2: Water Heating End-use by Fuel type

Fuel Type	REUS Year		
	2009	2012	2017
Electricity	49%	53%	52%
Natural Gas	42%	45%	46%
Other	9%	2%	2%

(g) Energy Supply – Similar Risk

Energy Supply		Similar
	Security and reliability of supply	Similar

222. As in 2013, FBC's power supply comes from three sources: (i) its own hydro generating plants, (ii) long-term contracts with suppliers, and (iii) the wholesale market. There is risk associated with each supply, but the level of risk remains similar to what it was in the 2013 Proceeding:

(a) FBC generating plants: FBC-owned generating plants are located within the Kootenay region, while most of FBC's customers are in the Okanagan. Failure of a plant generating unit would result in FBC needing to acquire replacement power which may not be available due to either lack of available supply or lack of available transmission, or may only be available at a significantly increased cost on the open market. Changes to the water levels of Kootenay Lake are also being contemplated, which would affect the generation available to FBC.[380]

(b) Long-term supply contracts: FBC has long-term supply contracts with BC Hydro, CPC, Brilliant Power Corporation, and Waneta Expansion Power Corporation. As these agreements expire, there is no guarantee that FBC will be able to renew them, or that they could be renewed at a similar cost.[381]

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[380] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 42.

[381] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 41.

(c) Wholesale market: FBC's access to the wholesale market is dependent on FBC's access to Teck's Line 71. FEI's dependence on the availability of third-party transmission capacity to meet demand increases the risk that FBC is not able to access cost-effective market supply.[382]

(h) Operating – Higher Risk

Operating		Higher
	Infrastructure integrity	Similar
	Unexpected events	Higher
	Project resistance	New (Higher)
	Cybersecurity	New (Higher)

223. The evidence demonstrates that FBC is facing increased operating risk. The frequency and impact of unexpected events on FBC's infrastructure integrity has increased, its operations are more stringently regulated and challenged, resistance to new projects is expected to increase, and cybersecurity has emerged as a significant risk consideration.

Generation Infrastructure Integrity Remains a Risk

224. The primary operating risks associated with FBC's generation assets are related to the age and cost to maintain and upgrade these assets, which are similar to the 2013 Proceeding.[383] FBC is obligated to have the generating units always be available to run for FBC to receive its capacity and energy entitlements as provided for under the Canal Plant Agreement. Failure of one or more of the generating units owned by FBC could potentially result in significant power supply costs to replace the lost entitlements.[384] Most of these assets are over 80 years old, and the concrete and structural elements are deteriorating. While FBC has upgraded or

[382] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 41-42.

[383] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 9.1.

[384] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 9.1.1.

replaced components of all its generating units since 1998, not all components have been upgraded or replaced since their original construction.[385]

Frequency and Impact of Unexpected Events Affecting T&D Has Increased

225. FBC has a large radial system that is primarily above ground, through mountainous and forested terrain. Despite FBC's ongoing sustainment work of its overhead assets, the average age of this infrastructure continues to increase, with the vintage of many distribution assets being greater than 50 years and transmission assets more than 70 years.[386] However, the most significant development since the 2013 Proceeding in relation to the operational risk to transmission and distribution assets is the increased frequency of unpredictable extreme weather events, such as wildfires and flooding.[387] As Mr. Slater stated:

> Well, you know, perhaps most of the electric infrastructure in B.C. wasn't designed for the temperatures of the heat dome, or perhaps it was never designed for the types of wind events we're seeing. So we're having to really look at that and design plans on how we're going to adapt the infrastructure over time and deal with what our - - you know, unfortunately more frequent but hard to predict and damaging, infrastructure damaging events.[388]

226. There have been a number of extreme events in recent years that affected FBC infrastructure, including: the 2015 Rock Creek fire[389]; 2021 Nk'Mip Creek fire, which caused significant damage to FBC's transmission, distribution and fibre optic infrastructure[390]; and, the 2021 Tulameen River and Similkameen River flood, which damaged distribution lines and impeded restoration.[391] The table below shows that, even over the past five years, the frequency of major events has increased:[392]

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385 Exhibit B1-13, RCIA IR1 10.1.

386 Exhibit B1-13, RCIA IR1 10.4.

387 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 9.2; Exhibit B-13, RCIA IR1 10.4.1.

388 Tr. 5B, p. 930, ll. 16-24 (Slater); see also: Tr. 5B, p. 928, l. 8 – p. 930, l. 5 (Mazza).

389 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 48.

390 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 48.

391 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, pp. 48-49.

392 Exhibit B1-13, RCIA IR1 10.4.1.

Material Outages Related to Climate Events

Outage Date	Event Type	Location	Customer Outage Count	Customer-Hours of Interruption
2016/08/07	Windstorm	Kootenays	7,292	54,157.69
2017/02/06	Snowstorm	Kootenays	6,470	37,264.40
2017/05/24	Windstorm	Kootenays	7,935	48,517.34
2017/12/19	Snowstorm	Kootenays	18,657	94,723.78
2018/04/02	Snowstorm	Kootenays	5,211	47,786.99
2018/06/25	Windstorm	Okanagan, Kootenays	8,070	50,483.32
2019/12/31	Snowstorm	Kootenays	6,123	56,624.14
2020/03/04	Windstorm	Kootenays	13,823	63,967.08
2020/09/07	Windstorm	Kootenays	16,599	213,005.04
2020/12/10	Snowstorm	Okanagan	14,777	60,608.34
2021/01/13	Windstorm	Okanagan, Kootenays	10,866	155,173.19
2021/04/18	Windstorm	Kootenays	19,762	200,815.35
2021/11/15	Windstorm/Flooding (Princeton)	Okanagan, Kootenays	27,498	218,720.37

Project Resistance Is Increasing

227. It is reasonable to expect that FBC will see increased resistance to new projects, as has been the case for other project proponents in BC. This which will lead to higher risks to execute projects on time at the lowest possible costs.[393]

Increased Incidences of Cyber-Attacks

228. The discussion on cyber-attacks in the context of FEI (see Part Three, Section B(i)) applies to FBC. Cyber-attacks are on the rise in the industry, with some serious repercussions. FBC has experienced more frequent cyber-attacks,[394] and they are becoming more

[393] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 49.

[394] Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 9.4.

sophisticated.[395] The implications of a successful attack can be extreme, as experienced by Colonial Pipeline, but even smaller attacks can affect FBC's ability to operate effectively.[396]

(i) Regulatory – Higher Risk

Regulatory		Higher
	Regulatory uncertainty and lag	Higher
	Administrative penalties	Similar

229. FEI's submissions in Part Three, Section B(j) on increasing regulatory risk apply to FBC as well[397], and more time has passed since FBC's last cost of capital determination in 2013. In addition, compared to the 2013 Proceeding, the scope and comprehensiveness of the BC MRS requirements has increased, leading to greater exposure for FBC. [398]

B. CONCLUSION AND REQUESTED FINDING

230. The BCUC should find that, with increased risk in some of FBC's risk categories and offsetting potential benefits from electrification, FBC's overall business risk is best characterized as similar to its risk at the time of the 2013 Proceeding.

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395 Exhibit B1-9, BCUC IR1 35.3.1.

396 Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 9.4; Exhibit B1-9, BCUC IR1 35.3.

397 See Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, section 10 for the discussion in the context of FBC. See also Exhibit B1-9, BCUC IR1 35.2.

398 See Exhibit B1-8-1, Appendix B, FBC Business Risk Assessment, p. 55.

PART SIX: OTHER FACTORS DEMONSTRATING 40% EQUITY REMAINS REASONABLE FOR FBC

231. As discussed in Part Two, ensuring that financial integrity and flexibility is maintained, as well as to allowing FBC to attract capital on a comparable basis with its North American peers, are essential elements of the Fair Return Standard. In addition to the similarity in FBC's business risk compared to the 2013 Proceeding, the following points discussed in this Part support maintaining the equity component of FBC's capital structure at a minimum of 40%:

(a) FBC's low allowed ROE and equity thickness are the main contributors to its financial risk and weak credit metrics, which rating agencies currently view as being weak for the respective ratings. Maintaining FBC's financial metrics is important to avoid the risk of a downgrade to non-investment grade.

(b) FBC's lower credit rating restricts is access to liquidity, and the company's access to capital is further restricted by its smaller and less frequent debt issuances.

(c) FBC's ability to issue long-term debt is further restricted by Earnings Coverage Test financial covenants for certain of its outstanding debentures, which must be passed before any new long-term debt financing is permitted and is under pressure from rising interest rates.

(d) FBC's proposed equity thickness is at the low end of the range of reasonableness when compared to its peers, with whom it competes for capital.

A. FBC'S WEAK FINANCIAL METRICS PRESENT A RISK OF DOWNGRADE TO NON-INVESTMENT GRADE

232. Similar to FEI, FBC's credit ratings are reviewed by Moody's and DBRS on an ongoing basis. FBC is rated at the Baa1 level by Moody's and the A (low) level by DBRS meaning that FBC has a split-rating, i.e., one in the Baa/BBB category and one in the A category. As investors typically focus on the lower rating, FBC is considered principally a BBB rated entity.[399]

[399] Exhibit B1-8, Application, p. 39.

233. As shown in the Table below, FBC's metrics are very weak for the current rating – so much so that most of the metrics are consistent with a non-investment grade credit (i.e., Moody's Ba rating category). FBC is at risk of a downgrade if metrics deteriorate further, which would have significant ramifications for FBC's ability to issue debt on reasonable terms and pricing.[400] As described in Part Four, Section A, a downgrade "…is a profoundly negative economic event and its overall impact would be so pervasive that it is not possible to reliably quantify the true impact to customers."[401]

Table 6-7: FBC's Key Financial Indicator Scores Compared to Minimum Baa Rating per Moody's Utility Rating Methodology

	FBC's Score	Baa - Rating Threshold[64]	2018	2019	2020	LTM Sept 2021
CFO pre-WC + Interest / Interest	Ba	3.0x-4.5x	3.6x	2.5x	2.5x	2.7x
CFO pre-WC / Debt	Ba	11.0% - 19.0%	9.8%	8.8%	8.6%	9.6%
CFO pre-WC - Dividends / Debt	Ba	7.0% - 15.0%	6.1%	5.1%	5.0%	5.9%
Debt / Capitalization[65,66]	Baa	50.0% - 59.0%	55.1%	56.0%	54.3%	54.3%

Source: Moody's Credit Rating Report for FBC, dated November 25th 2021.

234. Similar to FEI, key determinants of FBC's weak financial metrics are the low allowed equity component of its capital structure and low return on equity.[402] Moody's most recent credit rating on FBC stated:[403]

> FortisBC Inc.'s (FBC) credit profile is driven by its credit supportive regulatory environment and the monopoly position of its stable vertically integrated utility assets. Like affiliate utility FortisBC Energy, Inc. (FEI), the company has a track record of earning its allowed return on equity and its cash flow continues to be highly predictable. This is offset by the company's weak financial metrics, that we forecast will be in the range of 8-10% CFO pre-W/C to debt. <u>These financial metrics are primarily the product of a low allowed equity ratio, a low return on equity, depreciation rates as well as a significant capitalized lease adjustment.</u>
>
> [Emphasis added.]

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400 Exhibit B1-8, Application, p. 39.

401 Exhibit B1-13, RCIA IR1 17.2.

402 Exhibit B1-8, Application, p. 40; Exhibit B1-20, BCUC IR2 72.3.

403 Exhibit B2-8, FortisBC Undertaking No. 3, Moody's Credit Report for FBC dated December 12, 2022, p. 1.

235. In its latest Credit Rating Report published in December 2022, Moody's identified two factors that could lead to a credit rating downgrade: (1) an adverse regulatory decision or (2) a forecast of a sustained deterioration in credit metrics including CFO pre-W/C to debt of less than 8%. [404] FBC has potential exposure on both factors

(a) FBC's allowed common equity ratio has been stable at 40% since 1996, which would make any reduction a notable change and reflect on the supportiveness of the BC regulatory framework. Traditionally, credit rating agencies have been sensitive to decreases in capital structure or ROE.[405]

(b) As shown above, Moody's considers anything in the 8-10% range for CFO pre-W/C to debt "weak" for FBC. After many years of being above 9%, FBC's CFO pre-W/C to debt metric dropped to 8.8% for the year ending 2019 and then 8.6% for the year ending 2020, before returning to being above 9% for 2022. In other words, this financial metric has been "weak" for years, can fluctuate even without changes in the ROE and capital structure, and has only recently been critically close to a rating downgrade threshold of 8%.[406]

B. LOWER CREDIT RATING RESTRICTS FBC'S ACCESS TO LIQUIDITY

236. Maintaining FBC's credit rating is critical in order to attract investors when FBC issues debt. If downgraded, FBC's access to capital markets would be further diminished and pricing and terms for the financing of the debt component of its capital expenditures and operations would be less favourable.[407]

(a) Being principally a BBB rated company, FBC does not enjoy the same benefits that A rated companies do in terms of access to capital markets and low cost of

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[404] Exhibit B2-8, FortisBC Undertaking No. 3, Moody's Credit Report for FBC dated December 12, 2022, p. 2.

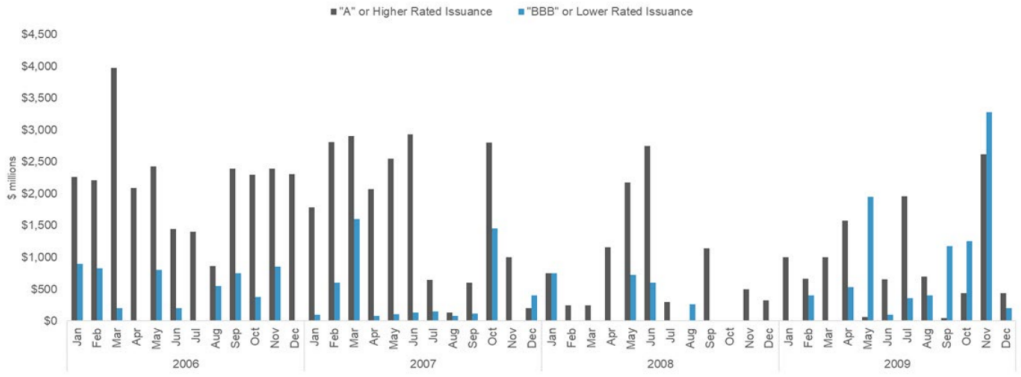
[405] Exhibit B1-20, BCUC IR2 72.2.

[406] Exhibit B1-8, Application, p. 40.

[407] Exhibit B1-9, BCUC IR1 26.1.

borrowing.[408] This is evident from the following figure, which shows how BBB rated companies were shut out of the markets in 2008-2009.[409]

Figure 1: Monthly debt issuance by rating category



Source: Scotiabank

(b) FBC's access to capital is further restricted by its smaller and less frequent debt issuances.[410]

(c) FBC issues debt less often and its issuance size is generally below $100 million. The smaller issuance size does not allow FBC debentures to be part of the bond index in Canada that requires the issue size to be a minimum of $100 million. Not being part of the bond index, combined with less frequent debt issuances and a lower credit rating, contribute to weaker demand and lower liquidity of FBC bonds.[411]

C. FBC'S EQUITY THICKNESS AND RESTRICTIVE FINANCING COVENANTS

237. FBC's ability to issue long-term debt is further restricted by Earnings Coverage Test financial covenants pursuant to the 1983 and 1996 Trust Indentures for certain of its outstanding debentures. The Earnings Coverage Tests must be passed before any new long-term debt financing is permitted.[412]

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408 Exhibit B1-8, Application, pp. 40-41.

409 Exhibit B1-21, FortisBC Rebuttal Evidence, p. 2.

410 Exhibit B1-8, Application, pp. 40-41.

411 Exhibit B1-8, Application, p. 41; Exhibit B1-20, BCUC IR2 73.1.1.

412 Exhibit B1-8, Application, p. 41.

238. The Earning Coverage Tests calculate the ratio of net earnings preceding the date of a new debt issuance to aggregate annual interest requirements of all outstanding debt after the issuance. The ratio is required to be above a certain threshold. Since the Earnings Coverage Tests include the aggregate annual interest requirements of all outstanding debt after the issuance, the new debt issuance amount and interest rate impacts the Earnings Coverage Test.[413]

239. If new debt interest rates rise as a result of economic conditions or a downgrade in FBC's credit ratings, the aggregate level of new debt that FBC would be able to issue would be constrained by the Earnings Coverage Test financial covenants. For example, if the coupon rate for FBC's new bonds rises to 5% per annum, FBC would only be able to add an aggregate amount of $200 million in new debt in order to pass the Earnings Coverage financial covenants. The increases in interest rates over the course of 2022 make this a very real concern. This further highlights the importance of maintaining FBC's credit ratings to allow the Company to access debt capital markets to fund its operations.[414]

D. FBC HAS MARKEDLY HIGHER FINANCIAL RISK RELATIVE TO US PEER UTILITIES

240. The Fair Return Standard requires consideration of comparability of returns and whether FBC can attract capital with an appropriate risk-adjusted return relative to peer companies. Mr. Coyne conducted a comparative risk analysis of FBC's risk with the Canadian and US proxy groups and reviewed FBC's financial metrics. Mr. Coyne concluded that FBC's deemed equity ratio should be maintained at 40% at a minimum, and that an increase in FBC's deemed equity ratio could be justified. He assessed that FBC's business risk is comparable to its Canadian peers and comparable to slightly lower compared to the U.S. electric utility proxy group at the operating utility level. However, FBC is much smaller than the proxy group companies in both Canada and the US. FBC also has slightly greater financial risk than the Canadian proxy group and

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413 Exhibit B1-8, Application, p. 41.

414 Exhibit B1-8, Application, p. 42. See also Exhibit B1-9, BCUC IR1 26.3.

markedly greater financial risk than the US electric utility proxy group, based on Mr. Coyne's analysis of deemed equity ratios and key cash flow and interest coverage metrics.[415]

E. CONCLUSION AND REQUESTED FINDING

241. The BCUC should find, for the reasons outlined above, that, at a minimum, FBC's current 40% equity component of its capital structure is required to maintain FBC's already constrained access to capital at reasonable terms and pricing in varied market conditions.

[415] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 150-151.

PART SEVEN: THE APPROPRIATE ROE FOR FEI AND FBC

242. This Part addresses why the evidence supports a finding that the required cost of equity for FEI and FBC is, respectively, 10.1% (on 45% common equity) and 10.0% (on 40% common equity). These proposed ROEs are based on the recommendations of Mr. Coyne, who is the only expert in this proceeding who conducted a full cost of capital analysis.[416]

243. Mr. Coyne considered multiple ROE models. He used model inputs that are theoretically valid and have been previously accepted by regulators (including the BCUC). Dr. Lesser agreed with many of Mr. Coyne's inputs, and in some notable instances Mr. Coyne's inputs were more conservative than Dr. Lesser's preferred inputs. On the handful of key points of disagreement between Mr. Coyne and Dr. Lesser, Mr. Coyne showed greater ability to apply financial theory having regard to the real-world actions of investors and the Canadian regulatory context. He performed various reasonableness checks, all of which validated his ROE estimates. The BCUC should accept Mr. Coyne's analysis and affirm FEI and FBC's proposed ROEs.

244. This Part is organized around the following points:

(a) While the models should inform the BCUC's decision on ROE, it is also important to exercise common sense when considering the results. Mr. Coyne's CAPM and DCF results, as well as the outcome of Dr. Lesser's multi-stage DCF recommendations as calculated by Mr. Coyne ("Lesser Multi-Stage DCF Results"), are intuitive in both direction and magnitude. The same cannot be said for the CAPM output that Mr. Coyne calculated based on Dr. Lesser's recommendations ("Lesser CAPM Results"), which are an outlier and unreasonably low.

(b) The experts are aligned on key aspects of the ROE analysis including: the use of multiple models; using Mr. Coyne's proxy groups; more reliance on North American proxy groups; the incongruity of a "Canada ROE discount" with North

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[416] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 4-5.

American financial market and economic integration; and, the reasonableness of relying primarily on the most recent (October 2022) data.

(c) Mr. Coyne and Dr. Lesser are also aligned on the key aspects of the Multi-stage DCF analysis, and the Lesser Multi-Stage DCF Results are identical to Mr. Coyne's results.

(d) Dr. Lesser's recommendations regarding two aspects of the CAPM model do not make sense in the current market circumstances, and one of those recommendations is driving the unreasonably low Lesser CAPM Results.

(e) The experts agree that it is appropriate to adjust the output of ROE models upwards to account for FEI and FBC having thinner equity than the proxy groups. Mr. Coyne has been conservative in not making this adjustment, since the proposed common equity ratios only partially account for the financial risk differential.

(f) The experts agree that the CAPM underestimates the cost of equity for smaller companies. The BCUC should consider a size premium for FBC, which is much smaller than the electric proxy group companies.

(g) It is reasonable to add 50 bps to the results of the ROE modelling to account for flotation costs and financing flexibility, consistent with the longstanding practice in BC and other Canadian jurisdictions.

(h) Reasonableness checks, including consideration of how the BCUC AAM would play out today, the Ontario AAM and the Equity Risk Premium model results, reinforce Mr. Coyne's ROE recommendations.

A. THE IMPORTANCE OF APPLYING COMMON SENSE TO THE MODEL OUTPUTS

245. A significant amount of debate in this proceeding has occurred at the level of individual ROE model inputs. While these issues are important, it is equally important not to lose

sight of the big picture: The models are tools, and the BCUC must still assess whether the model outputs make sense as an estimate of investor expectations in the current circumstances. Mr. Coyne's model outputs do make sense, as do the multi-stage DCF results based on Dr. Lesser's recommendations. Dr. Lesser's CAPM model recommendations, however, produce results that are both implausibly low and directionally counter-intuitive given objective indicators suggesting a rising cost of capital.

(a) ROE Models Are a Simplification of Economic and Capital Market Conditions

246. The economic and financial data used as inputs in the standard ROE estimation models are "only samples of the various economic and market forces that determine a utility's required return."[417] As the BCUC's consultant observed in the 2013 GCOC, all models "are simplifications of reality and this is especially true of financial models."[418] Mr. Coyne added that the market-required ROE "does not necessarily lend itself to a strict mathematical solution."[419] Ultimately, analysts "must apply informed judgment to assess the reasonableness of results and to determine the appropriate weighting to apply to results under prevailing capital market conditions."[420]

247. The allowed ROE should reasonably reflect investors' forward-looking views of the financial markets in general, and the subject company (in the context of the proxy group) in particular.[421] If investors do not expect current market conditions to be sustained in the future, "it is possible that the ROE estimation models will not provide an accurate estimate of investors' forward-looking required return. Therefore, an assessment of current and projected market conditions is integral to any ROE recommendation."[422]

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417 Exhibit B1-8-1, Appendix C, Concentric Report, p. 13.

418 Exhibit B1-8-1, Appendix C, Concentric Report, p. 46, quoting from 2013 GCOC Brattle Report.

419 Exhibit B1-8-1, Appendix C, Concentric Report, p. 45.

420 Exhibit B1-8-1, Appendix C, Concentric Report, p. 46.

421 Exhibit B1-8-1, Appendix C, Concentric Report, p. 45.

422 Exhibit B1-8-1, Appendix C, Concentric Report, p. 13.

248. The BCUC has recognized the need to consider the modelling results in conjunction with other information, stating in its 2016 ROE Decision:

> The Panel agrees it should consider the "totality of information resulting from applying multiple tests." The Panel also agrees it should consider all of the information from the application of the models presented, as well as other indicators of the fair ROE and should apply its own judgment to determine the appropriate ROE.[423]

(b) Mr. Coyne's Model Results Based on October 2022 Data Align with Current Market Conditions

249. Mr. Coyne's modelling, updated for October 2022 data and based on 90 trading days, provides the following results.[424] As described below, his results make sense in the context of current economic and market conditions. There has been a substantial increase in bond yields since 2016, suggesting a higher cost of equity.

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[423] 2016 GCOC Decision at p. 47.

[424] Exhibit B1-50, p. 5.

Scenario A.2 – Coyne Updated Analysis – 90-day average stock prices and interest rates

Figure 3: Summary of Results – Natural Gas[3] - Oct 2022 Update

	Canadian Regulated Utilities	US Gas Utilities	North American Utilities - Gas
CAPM	10.12%	9.96%	10.30%
Constant Growth DCF	11.98%	9.81%	10.95%
Multi-Stage DCF	10.46%	8.94%	9.72%
Risk Premium		10.12%	10.12%
Average	10.9%	9.7%	10.3%
Avg CAPM and Multi-Stage DCF	10.3%	9.5%	10.0%

Figure 4: Summary of Results - Electric[4] - Oct 2022 Update

	Canadian Regulated Utilities	US Electric Utilities	North American Utilities- Electric
CAPM	10.12%	10.51%	10.24%
Constant Growth DCF	11.98%	9.67%	10.09%
Multi-Stage DCF	10.46%	8.74%	9.11%
Risk Premium		10.16%	10.16%
Average	10.9%	9.8%	9.9%
Avg CAPM and Multi-Stage DCF	10.3%	9.6%	9.7%

250. Most investors use utility stocks in a defensive position for income and relative safety. Government bonds are used by investors in the same manner, such that utility companies compete with government bonds for capital. Intuitively, utility investors' expected return must be higher than government bond yields to attract investment because utility stocks are higher risk.[425] One would expect that if the bond yield increases, the investors' expected return would also increase. There is, in fact, a meaningful and statistically significant correlation over time.[426]

[425] Tr. 4, p. 459, ll. 9-18 (Lesser). Dr. Lesser also alluded to the need for a spread to exist between utility dividend yields and government bond yields in his testimony before the Illinois Commerce Commission Illinois: Exhibit B1-41, p. 36, ll. 665-669.

[426] Tr. 4, p. 581, l. 3 – p. 581, l. 23 (Coyne): While not a perfect correlation, "I would expect them to move in harmony, at least move in the same direction." Mr. Coyne explained that this is due in part to the behaviour of institutional investors, which invest in both bonds and low-risk stocks and thus monitor spreads carefully.

251. The Canadian ten-year bond yield has increased 2.12% between 2016 and October 2022. The 30-year Canadian bond yield increased 1.4% during that period.[427] Mr. Coyne explained why rising bond yields since 2016 indicate a rising cost of equity as follows:

> Take in point this year, when FEI right now is awarded an 8.75 percent equity return, and the cost of capital as measured by bond yields this year, has gone up by over 2 percent. And that's for relatively low-risk utility bond yield. Well, Fortis doesn't have the ability to sit back and say, "We're not going to provide equity into this company because the cost of debt for us has gone up by 2 percent." A natural expectation would be that the cost of equity has gone up in this market.[428]

252. The CAPM and Bond Yield Plus Risk Premium models are premised on this relationship between government bond yields and the cost of equity. As discussed later, both use projected government bond yields as an input, and rising interest rates have increased bond yields.[429] Mr. Coyne explained that "As the risk-free rate increases, the ROE estimate produced by the CAPM and Risk Premium model increases, although the increase is not 1-for-1. For example, a 1% increase in the risk-free rate for the U.S. Gas proxy group would result in an increase of 0.78% in the ROE estimate using the CAPM model. Similarly, a 1% increase in the projected risk free rate in the Risk Premium model would result in an increase of 0.42% in the ROE estimate from that model."[430]

253. The intuitive and statistical relationships between bond yields and utility investors' expected returns also underpin the Automatic Adjustment Mechanisms ("AAM") that adjust ROE based on changes in interest rates and in bond spreads.[431] Hence, Mr. Coyne used the old BCUC AAM and the Ontario AAM as reasonableness checks (see Section H of this Part).

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427 Tr. 3, p. 174, l. 21 – p. 175, l. 16 (Coyne).

428 Tr. 4, p. 628, ll. 9-18 (Coyne).

429 A bond's yield is based on the bond's coupon payments divided by its market price; as bond prices fall, bond yields rise. Rising interest rates cause bond prices to fall, and bond yields to rise.

430 Exhibit B1-13, RCIA IR1 28.1.1.

431 Tr. 4, p. 613, l. 1 – p. 614, l. 4 (Coyne). The BCUC's AAM was based on a .75 relationship between bond yield and allowed ROE.

(c) Dr. Lesser's Recommendations: DCF Results Align, but CAPM Results Are Implausibly Low and Directionally Wrong

254. In response to a request from BCUC Staff, Mr. Coyne undertook a number of scenarios that substituted various inputs for his own calculations, and to reflect recommendations made by Dr. Lesser. The results of that scenario analysis are summarized in the two tables below.[432] Three key take-aways from this analysis when it comes to assessing the reasonableness of the ROE results are:

(a) The Lesser Multi-Stage DCF Results are the same as the results of Mr. Coyne's Multi-Stage DCF analyses for the gas and electric proxy groups. Mr. Coyne's CAPM analysis produces values generally higher than the Multi-Stage DCF results. This is true regardless of the time period used – i.e., based on market data through December 31, 2021 or the October 2022 Update.

(b) The DCF modelling and Mr. Coyne's CAPM analysis all indicate an increase in the cost of equity since the last time the BCUC considered FEI's cost of capital and set it at 8.75%.

(c) The Lesser CAPM Results are a significant outlier in two respects:

(i) The Lesser CAPM Results are an outlier directionally, in that they would suggest that the cost of capital has decreased for gas utilities since the 2016 Proceeding and for electric utilities since the 2013 FBC Proceeding. All other models, regardless of which expert's inputs are used, suggest the opposite has occurred.

(ii) The Lesser CAPM Results are also <u>well</u> below the range of Mr. Coyne's CAPM and DCF results, and the Lesser Multi-Stage DCF Results, for both gas and electric proxy groups. This is true regardless of the time period used. For example, the Lesser CAPM Results for the North American and

[432] Exhibit B1-50, Response to Undertakings, pp. 3, 4.

US proxy groups are between 7% and 8% (i.e., hundreds of basis points below the other results) after adding 50 bps for flotation and financing flexibility.

Table 2: Summary Table – Multi-Stage DCF Results

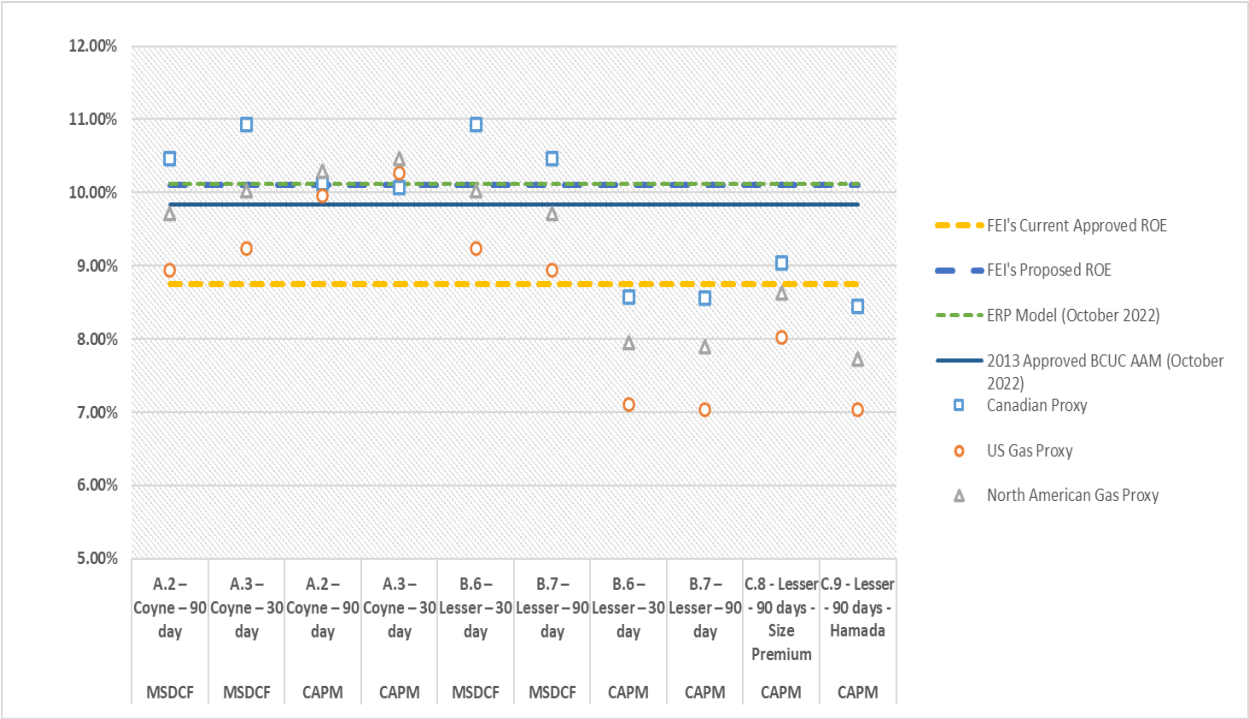
Scenario	As of	Canadian	US Gas	North American Gas	US Electric	North American Electric
A.1 – Coyne - original	Dec 2021	10.28%	9.53%	10.05%	8.82%	9.07%
A.2 – Coyne – 90 day	Oct 2022	10.46%	8.94%	9.72%	8.74%	9.11%
A.3 – Coyne – 30 day	Oct 2022	10.93%	9.24%	10.03%	9.10%	9.52%
B.4 – Lesser – 30 day	Dec 2021	10.33%	9.48%	10.06%	8.86%	9.10%
B.5 – Lesser – 90 day	Dec 2021	10.28%	9.53%	10.05%	8.92%	9.14%
B.6 – Lesser – 30 day	Oct 2022	10.93%	9.24%	10.03%	9.10%	9.52%
B.7 – Lesser – 90 day	Oct 2022	10.46%	8.94%	9.72%	8.74%	9.11%

Table 3: Summary Table – CAPM Results

Scenario	As of	Canadian	US Gas	North American Gas	US Electric	North American Electric
A.1 – Coyne - original	Dec 2021	10.68%	10.67%	11.05%	11.12%	10.80%
A.2 – Coyne – 90 day	Oct 2022	10.12%	9.96%	10.30%	10.51%	10.24%
A.3 – Coyne – 30 day	Oct 2022	10.07%	10.27%	10.46%	10.82%	10.45%
B.4 – Lesser – 30 day	Dec 2021	7.87%	7.23%	7.78%	7.53%	7.49%
B.5 – Lesser – 90 day	Dec 2021	7.88%	7.24%	7.78%	7.54%	7.50%
B.6 – Lesser – 30 day	Oct 2022	8.58%	7.11%	7.95%	7.36%	7.60%
B.7 – Lesser – 90 day	Oct 2022	8.56%	7.03%	7.90%	7.31%	7.55%

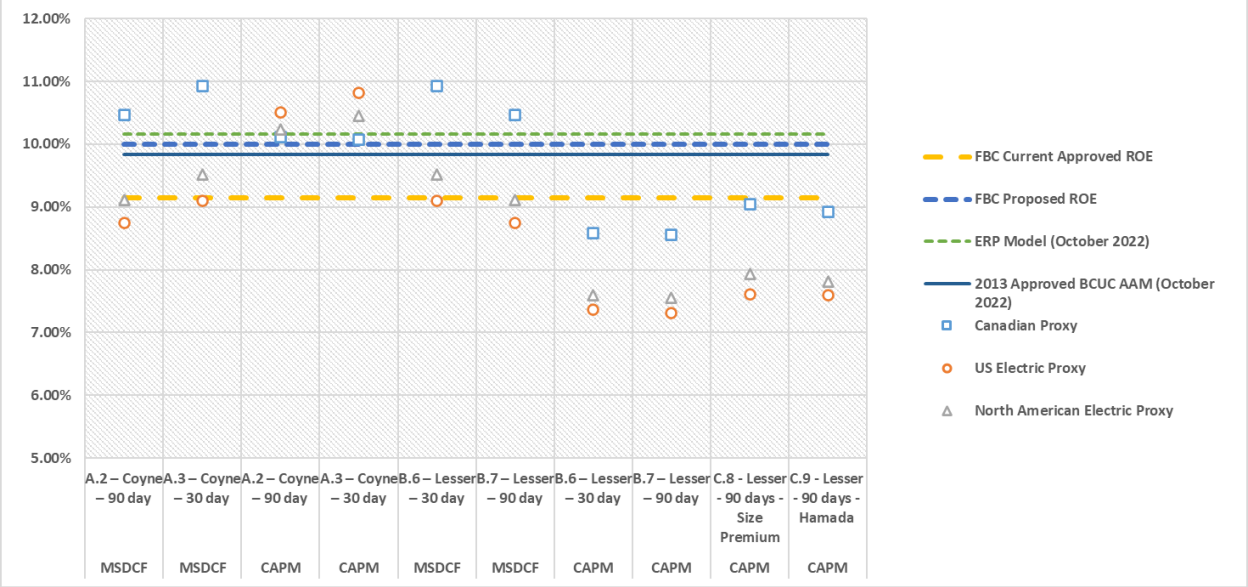
255. The following figure depicts the October data from the tables above, along with the results of the two reasonableness checks that Mr. Coyne provided using data current to October 2022 (BCUC AAM and the Risk Premium model), which are discussed in Section I below. Note that Mr. Coyne's CAPM results for FBC below do not include a size premium (which he calculated as being 105 bps), such that they are conservative. It is easy to see the extent to which the Lesser CAPM Results are an outlier for both gas and electric.

Summary of FEI ROE Model Results Current to October 2022[433]



433 Results taken from Exhibit B1-50, Response to Undertaking, Table 2 and 3. BCUC AAM and Equity Risk Premium model results taken from Mr. Coyne's evidence at the hearing as discussed in Part Seven, Section H.

Summary of FBC ROE Model Results Current to October 2022[434]



Dr. Lesser's CAPM Results Are Below Any Allowed ROE in the Last 20 Years

256. Putting those Lesser CAPM Results in context underscores how unreasonable they are:

(a) The Lesser CAPM Results for the US proxy group (Scenarios B.6 and B.7) are around 7.0% after including 50 bps for flotation costs. Mr. Coyne observed that a 7.0% ROE "would be lower than any authorized ROE for a Canadian regulated utility since at least 2000."[435]

(b) Removing the adder for flotation and financing flexibility costs would reduce the CAPM estimate to about 6.5%, closer to the cost of debt.[436]

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[434] Results taken from Exhibit B1-50, Response to Undertaking, Table 2 and 3. BCUC AAM and Equity Risk Premium model results taken from Mr. Coyne's evidence at the hearing as discussed in Part Seven, Section H. BCUC AAM line is reported as if it was the benchmark utility, and does not include the 40 bps risk premium approved by the BCUC for FBC.

[435] Exhibit B1-50, Response to Undertaking.

[436] Exhibit B1-50, Response to Undertaking.

(c) The Lesser CAPM Results are also well below the ROEs of any company in Mr. Coyne's proxy groups, whether in Canada or the US, gas or electric.

Even Dr. Lesser Questioned the Reasonableness of Results that Low

257. The Lesser CAPM Results, and the overall results when averaging the Lesser CAPM Results with Multi-Stage DCF Results, are so low that Dr. Lesser questioned their reasonableness. He stated, for instance, in reference to FEI:

> Probably what I would say is if I came up with say 7.7 percent myself, and this is hypothetical, if I did it, and that's the result I came up using a DCF methodology and taking the average of DCF methodology results and CAPM results, and I saw that result, I would probably consider it too low. But what the appropriate return is, I simply don't know.[437]

258. Dr. Lesser also stated his belief that results of 7.7% or 8.3% for FEI, based on September 2022 data, "seems a little odd":

> So models provide -- can provide some insight, oh, here's what's going on. So even when you see, say, a result like 7.7 percent or 8.3 percent, your initial reaction might -- would probably be, and mine is, is well, it seems a little odd. But without then -- then I think the process is you go back and see. All right, how did we actually get there? What makes sense? Did we do it correctly or not? I mean because, you know, people -- everyone makes mistakes. I certainly do.[438]

259. Dr. Lesser had the same reservations about ROEs in the range of 7.7% -7.9% for FBC:

> MS. CHEUNG: Q: And just to follow up on Dr. Lesser's comment earlier that the 7.7 percent and 7.9 percent for gas seems low. And wonder if your comment also equally applies to the electric side regarding the 7.7 percent and 8.3 percent on line 17?
>
> DR. LESSER: A: I think it would. Again, I'd be looking at the result. And, again, without knowing how it was actually calculated, it's lower than I would have expected to see. So, but again it's just a matter of looking at all the different inputs

[437] Tr. 3, p. 300, ll. 14-21 (Lesser).

[438] Tr. 3, p. 308, ll. 12-21 (Lesser).

> and then the business and financial risk and trying to come up with something, you know, what appears to be reasonable.[439]

260. Later, with counsel for ICG, Dr. Lesser reiterated that he "would be surprised by" those numbers. While "he wouldn't say that, well that's got to be wrong", it would prompt him to go back and check if he made errors or missed something.[440]

261. It is worth noting that Dr. Lesser made the above comments in reference to a BCUC Staff witness aid that was based on September 2022 data and neither expert could verify the accuracy of Staff's calculations. When Mr. Coyne re-ran the numbers himself based on October 2022 data, the Lesser CAPM Results were even lower than the numbers he questioned at the hearing. FEI and FBC respectfully submit that, in light of Dr. Lesser's commentary above, it would be unreasonable for the BCUC to place any weight on the Lesser CAPM Results.

An ROE that Low Would Have Material Implications for Credit Rating

262. It is difficult to conceive of how either FEI or FBC could avoid a downgrade if the BCUC was to adopt the Lesser CAPM Results. The evidence, discussed in Part Four, Section A above, is that, FEI's financial metrics are already inconsistent with its current credit ratings; with the exception of FEI's Debt to Capitalization ratio. FEI confirmed that "This shows that FEI's ability to maintain an A rating is marginal."[441] FBC's financial metrics are "very weak for the current rating"; most are already consistent with a non-investment grade credit. FBC "is at risk of a downgrade if metrics deteriorate further, which would have significant ramifications for FBC's ability to issue debt on reasonable terms and pricing."[442]

(d) The Unreasonable Lesser CAPM Results Indicate an Unreasonable Methodology

263. Commissioner Morton posed the critical question: "Because it just seems odd to me that if you start with a basic model that makes sense, you can -- a set of logical steps that you

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[439] Tr. 3, p. 311, ll. 1-13 (Lesser).

[440] Tr. 4, p. 677, l. 25 – p. 678, l. 4 (Lesser).

[441] Exhibit B1-8, Application, section 6.2.2.1

[442] Exhibit B1-8, Application, section 6.2.3.1

can then get to a model that doesn't make any sense." FEI and FBC submit that the logical answer to this question is that key individual methodological changes recommended by Dr. Lesser did not make sense on their own. As Mr. Coyne observed: "But if you take it back to its core, I guess I would say that some of these model changes do not make sense and that's why you're getting results vary so much from the original model."[443]

264. Mr. Coyne gave the analogy of replacing parts on a Toyota Prius until the point where, although it still looks like a Prius, it runs like a used Ford.[444] Dr. Lesser embraced the analogy: "Obviously it depends on how you structure the models in the first place, what's your -- is your starting point reasonable or not? And then Mr. Coyne's correct, when you start tweaking various inputs, you can, you know, turn your Prius into a Ford Galaxy or something. Clearly he and I disagree on the reasonableness of some of those inputs."[445] As Mr. Coyne noted, Dr. Lesser did not have the benefit of the typical "dynamic process" of "testing, and making sure you believe it, and going back and looking at your inputted assumptions".[446] Ultimately, however, the scenario analysis that Mr. Coyne performed in response to BCUC Staff's undertaking revealed that some of Dr. Lesser's inputs have turned Mr. Coyne's fully functioning and comprehensive Toyota Prius into a old Ford Galaxy.

(e) Holistic Consideration of Models Avoids Illogical Results

265. The anomalous Lesser CAPM Results serve as a reminder of the importance of the BCUC considering models holistically, rather than making discrete decisions on model elements or inputs in a vacuum. For every modelling decision that Mr. Coyne made that participants have challenged because it directionally produced higher ROE results, there are examples where Mr. Coyne made decisions that had the opposite effect. Often these decisions were interrelated,

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443 Tr. 3, p. 307, ll. 7-10 (Coyne).

444 Tr. 3, p. 306, l. 2 – p. 307, l. 15 (Coyne).

445 Tr. 3, p. 307, l. 22 – p. 308, l. 3 (Lesser).

446 Tr. 3, p. 300, l. 24 – p. 301, l. 19 (Coyne).

either involving trade-offs or having implications for other aspects of his cost of capital analysis. For instance, Mr Coyne:

(a) Did not perform a WACC adjustment to the Multi-Stage DCF results, or a Hamada adjustment in his CAPM modelling, to account for the fact that FBC and FEI are both more highly leveraged than the proxy group companies. This was predicated on the common equity ratio proposal that would reduce the disparity between the allowed equity ratio for FEI with the proxy groups and retaining FBC's existing equity ratio;

(b) Did not add a 105 bps size premium to his CAPM results for FBC, despite both experts believing a ROE size premium is appropriate;

(c) Recommended forecast bond yields rather than actual bond yields, when the former produces lower CAPM and Risk Premium results based on October 2022 data;

(d) Did not advocate for a 50% common equity ratio for FEI, despite both experts acknowledging these is no basis for systemically lower allowed returns in Canada versus the US;

(e) Did not directly base his recommended ROEs on the higher constant growth DCF results, despite the model's theoretical validity; and

(f) Averaged the forward-looking Market Risk Premium with the lower historical Market Risk Premium to moderate the results, despite it also being theoretically valid to only use a forward-looking MRP (like FERC).

266. Assessing each of Mr. Coyne's methodological decisions in isolation risks "cherry picking", producing a result that poorly reflects current market conditions and the forward-looking expectations of investors.

(f) October 2022 90-Day Results Are Lower than 30-Day Results

267. There is one other important observation regarding the results of Mr. Coyne's scenario analysis based on October 2022 data. For every model, except one (the Canadian proxy group CAPM), regardless of which expert's assumptions are being used, the October 2022 results using 30 days of data are higher than the corresponding results with 90 days of data. As discussed in Section C below, this pattern reflects the fact that the temporary disruptions over the summer were still influencing the older data in the 90-day window, but the markets had returned to more normal conditions by October. FortisBC submits that, when using a 90-day period with October 2022 data, the BCUC should recognize that it is tending to understate forward-looking investor expectations.

B. THE EXPERTS ARE ALIGNED ON KEY COMPONENTS OF THE ROE ANALYSIS

268. The fact that the Lesser CAPM Results are so low masks the fact that Mr. Coyne and Dr. Lesser are aligned on the majority of the methodological issues related to the estimation of ROE. Dr. Lesser confirmed his agreement with Mr. Coyne's articulation of the points of agreement set out in Mr. Coyne's Opening Statement,[447] and there are other areas of agreement evident from a detailed review of their respective reports.[448] Four of the key points of agreement, highlighted in this section, are (a) the benefits of using multiple ROE models, (b) the proxy group composition, (c) the current extent of North American integration warranting shifting beyond US proxy groups to using North American proxy groups, and (d) the North American integration also warranting greater alignment between allowed returns in Canada with those in the US.

(a) Experts Agree on the Importance of Applying Multiple Tests

269. Mr. Coyne and Dr. Lesser agree on the importance of using multiple models to estimate a utility's cost of equity. Ultimately, for the reasons discussed below, the BCUC's

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[447] Exhibit B1-30, Opening Statement of Mr. Coyne, p. 3.

[448] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 157-158.

analysis should consider the results of all four of the models used by Mr. Coyne, even if greater weight is applied to the multi-stage DCF and CAPM results.

All of the Financial Models Are Imperfect and All Have Something to Offer

270. As Mr. Coyne put it, "each model brings a different perspective and adds depth to the analysis", and using multiple models mitigates the inherent imperfections in each of the models.[449] He indicated that investors rely on multiple models[450] and that there is additional value in using multiple models during "volatile market conditions, such as those experienced over the last decade".[451] Dr. Lesser was more blunt: "All models are simplifications of reality; no model can capture every possible factor that may affect investors' day-to-day decisions and differences in expectations. Hence, because all models make simplifying assumptions, they all can be criticized."[452]

The Experts Agree on the Merits of Multi-Stage DCF and CAPM

271. Mr. Coyne presented the results of four models: multi-stage DCF, constant growth DCF, CAPM and Risk Premium. His recommendations ultimately reflected the average output of multi-stage DCF and CAPM models, which was the approach adopted in the 2016 Decision.[453] Dr. Lesser indicated that he typically presents the results of a two-stage DCF model and the CAPM, and endorses the use of both.[454]

Higher Constant Growth DCF Results Show Mr. Coyne Was Conservative

272. Mr. Coyne presented the results of the constant growth DCF model, as it "was developed to estimate the cost of equity for dividend-paying companies in mature industries with

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449 Exhibit B1-8-1, Appendix C, Concentric Report, p. 45.

450 Exhibit B1-9, BCUC IR1 44.4.

451 Exhibit B1-9, BCUC IR1 44.3.

452 Exhibit A2-3, Lesser Report, p. 22, emphasis in original.

453 2016 GCOC Decision at p. 86.

454 Exhibit A2-5, BCOAPO IR1 3.1, 7.1 and 8.1.

steady and predictable growth rates, such as public utilities."[455] The results of this model tend to exceed the multi-stage DCF results because the constant growth DCF model removes the constraint in Mr. Coyne's Multi-Stage DCF model that earnings per share growth rates of the proxy companies cannot exceed GDP growth after year 10.

273. There was a lot of debate between the experts (discussed further in Section D(b) below) about whether a company's earnings per share growth can exceed GDP growth forever; however, the fact is that earnings per share for the utility proxy group companies have grown faster than GDP for a sustained period longer than 10 years. The data demonstrating this is summarized in Figure 23 below.[456] The implication of this evidence for the BCUC is that these two models – the multi-stage DCF and the constant growth DCF - are both useful, but imperfect indicators of an estimated range of investors expected returns. Mr. Coyne was being conservative in basing his ultimate recommendations on his multi-stage DCF model results, rather than a blend of the two DCF models.

Figure 23: Utility Earnings, Dividend and GDP Growth Comparisons[71]

	[1] Avg. EPS Growth Historical 2005-2019	[2] Avg. DPS Growth Historical 2005-2019	[3] CAGR GDP Growth 2005-2019	[4] Avg. EPS Growth Forecast 2021-2024	[5] Nominal GDP Growth Forecast
U.S. Gas Proxy Group	3.55%	4.61%	3.59%	5.88%	4.35%
U.S. Electric Proxy Group	4.77%	4.82%	3.59%	5.52%	4.35%
North American Gas Proxy Group	4.85%	6.76%	3.69%	5.91%	4.13%
North American Electric Proxy Group	4.99%	5.13%	3.63%	5.54%	4.20%
Average	4.54%	5.33%	3.63%	5.71%	4.25%

[1] Value Line, average compound annual growth rate in EPS of each company the proxy group
[2] Value Line, average compound annual growth rate in DPS of each company the proxy group
[3] Statistics Canada, Table: 36-10-0104-01 (formerly CANSIM 380-0064)
Bureau of Economic Analysis, Table 1.1.5. Gross Domestic Product, Accessed on January 19, 2022
Combined Proxy Group number is weighted average of Canadian and US results
[4] See Exhibit JMC-4 Constant DCF
[5] See Exhibit JMC-5 Multi-Stage DCF

274. Dr. Lesser, in previous testimony, had given equal weight to the constant growth DCF model despite articulating the same theoretical reservation about the ability of a company's

[455] Exhibit B1-50, Response to Undertaking. See also Exhibit B1-9, BCUC IR1 44.4.

[456] Exhibit B1-8-1, Appendix C, Concentric Report, p. 52.

earnings to grow faster than GDP forever. While Dr. Lesser's testimony in those proceedings was some time ago (2002) and he has since changed his mind, the logic he had applied still has merit. His stated rationale had related to the benefits of having additional data points in the prevailing conditions, characterized by economic uncertainty, unprecedented actions by central banks and the threat of war abroad – all of which are present today.[457]

The Risk Premium Model Is Theoretically Valid and Provides Stability

275. Mr. Coyne also presented results for the Risk Premium model, which considers the relationship between past allowed ROEs and the historical yield on government bonds over a long period of time. The Risk Premium model, which produces results supportive of Mr. Coyne's recommendations, merits the BCUC's consideration due to its theoretical validity and stability.

276. Dr. Lesser accurately characterized the Risk Premium model as "in effect, a simpler version of the CAPM" – simpler because it focuses on bond yields as one driver of the cost of capital.[458] While the Risk Premium model is simpler, FERC has recognized its theoretical validity and value. Though it remains the subject of legal challenges, FERC has adopted the Risk Premium model as one of its three methods (which it weights equally) for determining the cost of capital for regulated electric transmission companies. FERC recently held: "The Risk Premium model has a strong theoretical basis. We continue to find that the defects of the Risk Premium model do not outweigh the benefits of model diversity and reduced volatility resulting from the averaging of more models."[459] (FERC's reference to "defects" in the Risk Premium model should be considered in light of the expert evidence, discussed above, that all of the models have their own defects and attributes.)

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[457] Exhibit B1-40, Arkansas Testimony, pp. 4, 5, 59, 81. Tr. 4, p. 445, ll. 3-12 (Lesser).

[458] Exhibit A2-3, Lesser Report, p. EX. 2. Dr. Lesser distinguished this and other "market based methodologies" like the CAPM and DCF from an "accounting based methodology" like Comparable Earnings that would not reflect current market conditions.

[459] Federal Energy Regulatory Commission, Opinion No. 569-B, issued November 19, 2020, at para 113. This Opinion was vacated on appeal, but on procedural grounds (See US Court of Appeals decision, Exhibit B1-33).

277. Mr. Coyne agrees with FERC that the model provides stability, an attractive feature in the present volatile market and economic conditions:

> But I think it's important to recognize when there are fluid circumstances in markets that we're certainly in the year 2022, that are unusually fluid and dynamic, that it can have an impact on the models that we use to estimate the cost of capital, and it's important to recognize what those impacts are, and if there is -- and make judgment in terms of whether or not they're sustained or temporary, and whether or not they impact some models more than others. One of the reasons why I like to use multiple models including the risk premium, and in the United States I would also use the expected earnings model. To have four models is they give you a little bit more resilience from the pure market-based models, the DCF and the CAPM, that tend to get whip-sawed by these circumstances. So, I think it's important to recognize what's occurred this year and the impacts they're having on models, but ultimately we need to make a model-based determination.[460]

278. As discussed later in Section H, Mr. Coyne has used the Risk Premium model as a check on the results of the other models. It reinforces the reasonableness of Mr. Coyne's recommendations and the extent to which the Lesser CAPM Results are anomalous.

(b) Experts Agree that Mr. Coyne's North American Proxy Groups Should Be Used

279. Even though Mr. Coyne developed his initial recommendation based on the results of his U.S. proxy groups (consistent with previous practice before the BCUC), the evidence on the record indicates it would be appropriate for the BCUC to give primary weight to results based on Mr. Coyne's North American gas and electric proxy groups, in line with the expert evidence of both Mr. Coyne and Dr. Lesser.

Dr. Lesser Agreed that Mr. Coyne's Proxy Groups Should Be Used

280. The role of proxy groups in the ROE modelling is described in the respective reports of both experts.[461] Mr. Coyne selected five proxy groups – Canadian Utilities, US Gas Utilities, US Electric Utilities, North American Gas Utilities and North American Electric utilities -

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[460] Tr 3, p. 171, l. 15 – p. 172, l. 9 (Coyne).

[461] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 37-39; Exhibit A2-3, Lesser Report, pp. 6-7.

using consistent and well-considered screening criteria.[462] He provided detailed information about each proxy company in his Report.

281. Dr. Lesser's Terms of Reference did not include developing proxy groups, but he was pressed to make recommendations in various information requests. His recommendations for adding and subtracting proxy companies from Mr. Coyne's proxy groups were based on cursory analysis, without providing supporting company information. He made a number of errors. During cross-examination he "withdrew" his evidence on proxy groups, conceding that he did insufficient due diligence.[463] He ultimately supported using Mr. Coyne's proxy groups. In any event, adding and subtracting the companies that Dr. Lesser recommended did not materially impact the ROE results.[464]

BCUC Should Give Most Weight to North American Proxy Group Results

282. Dr. Lesser and Mr. Coyne agree that the extent of economic and market integration in North America justifies the use of North America-wide gas and electric proxy groups to estimate the authorized ROE for FEI and FBC. The BCUC should place the greatest weight on the North American proxy group results in light of the expert evidence.

283. Mr. Coyne based his initial recommended ROEs on the US proxy group results, consistent with the BCUC's 2016 Decision.[465] However, he also presented results for North American gas and electric proxy groups. Mr. Coyne's Undertaking response based on October 2022 data similarly included North American proxy group results. In practice, only one Canadian

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[462] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 39-44.

[463] Tr. 3, p. 421, ll. 1-20 and p. 423, ll. 2-6 (Lesser), e.g., "Well, I did some due diligence, and that's -- again, that's why I'm -- I did not do sufficient due diligence on his selection of companies. That's why I'm offering to just withdraw my answer from that discovery question if that would make the proceedings more clear."

[464] The results were either the same or increased slightly in the case of the DCF results for the US Gas proxy group. Exhibit B1-21, Concentric Rebuttal, p. 7; Tr. 3, p. 334, ll. 8-17 (Coyne).

[465] The BCUC, like many other Canadian regulators, has previously recognized the reasonableness of using US proxy groups, citing both increasing integration and the scarcity of Canadian publicly-traded utilities. See: 2016 GCOC Decision at pp. 52-53 and Exhibit B1-8-1, Concentric Report, p. 38 for reference to decisions in other jurisdictions.

gas company and three Canadian electric companies pass the screens, so there are substantial similarities in the composition of the US proxy groups and the North American proxy groups.[466]

284. Mr. Coyne indicated he has been advocating for using North American proxy groups approach for many years.[467] Mr. Coyne encouraged the BCUC to consider embracing this approach going forwards:

> So I think you could effectively add three to four companies in your electric proxy group that would pass those screens, but only about one on the gas side. But I like it. I think it gives you really what you're after and that is what a North American proxy group looks at. As long as you're willing to accept a little bit less Canadian representation than you have by the way I do it and that is I get the benefit of the doubt to Enbridge, CU on the gas side. I don't think they pass those screens otherwise. But if the Commission were to make that decision, I would embrace it.[468]

285. Mr. Coyne pointed to various metrics and examples in support of his assessment that, while the markets aren't "the same or perfectly integrated", "investors would consider returns in these markets to be closely correlated."[469] For instance:

(a) He provided cross-border trade volume statistics.[470]

(b) He also identified strong correlations across a variety of metrics, including GDP growth and government bond yields. For instance, the 25-year correlation between the annual returns of the S&P TSX and the S&P 500 is 76%, with the difference partly attributable to composition of the indices.[471] Mr. Coyne indicated:

> Based on these macroeconomic indicators, there are no fundamental dissimilarities between Canada and the U.S. (in terms

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466 Tr. 3, p. 338, l. 19 – p. 339, l. 11 (Coyne).

467 Exhibit B1-21, Concentric Rebuttal Evidence, pp. 9-10.

468 Tr. 3, p. 337, l. 23 – p. 338, l. 8 (Coyne).

469 Exhibit B1-13, RCIA IR1 27.1.

470 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 34-35.

471 Exhibit B1-13, RCIA IR1 27.1.

> of economic growth, inflation, or government bond yields) that would cause a reasonable investor to have a materially different return expectation for a group of comparable risk utilities in the two countries.[472]

(c) The risk premiums for Canada and the U.S. are highly correlated because of the economic integration and free flow of capital across the border.[473]

(d) There is also significant cross-border deal flow in the utility sector. Mr. Coyne identified 24 instances in recent years where Canadian utility holding companies had acquired US utilities. There have been four instances during that period where US utility companies acquired a Canadian utility company.[474]

(e) Mr. Coyne recounted his firsthand experience of how institutional investors like Brookfield Asset Management and various government pension funds approach utility investment today, noting that "They're looking at the specific utilities and their risk characteristics." He added: "And they're not asking us questions about U.S. versus Canadian differences, they're asking us questions about what are the growth prospects of this utility, what's the regulatory environment like there."[475]

286. Dr. Lesser was in full agreement with Mr. Coyne on the extent of integration of the North American economy and capital market,[476] and advocated the use of integrated North American gas and electric proxy groups.[477] Dr. Lesser similarly reasoned that "…capital markets are international. Thus, companies must compete for capital worldwide, not just in their local province or country. Hence, *per se* geographic constraints on the location of proxy group

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[472] Exhibit B1-8-1, Appendix C, Concentric Report, p. 35.

[473] Exhibit B1-13, RCIA IR1 29.1. Dr. Lesser agreed with Mr. Coyne: Exhibit A2-24, BCOAPO IR2 20.1.

[474] Exhibit B1-11, CEC IR1 59.2 (Concentric).

[475] Tr. 4, p. 672, l. 5 - p. 673, l. 18 (Coyne).

[476] Exhibit A2-3, Lesser Report, p. 14; Exhibit A2-20, BCUC IR2 1.3 (Lesser); Exhibit A2-24, BCOAPO IR2 20.1 (Lesser); Tr. 3, p. 383, l. 3 – p. 384, l. 21 (Lesser).

[477] Exhibit A2-20, BCUC IR2 1.3 (Lesser): "In my opinion, a better statistical approach would be to simply to combine the Canadian and US companies into a joint U.S. – Canadian proxy groups for electric and natural gas, respectively."

companies may eliminate comparable firms."[478] He observed that FERC now allows for Canadian companies to be included in proxy groups for setting ROEs for pipelines and transmission utilities, given the integration and the similarity in how they are regulated.[479]

287. Mr. Coyne's Scenario Analysis based on October 2022 data includes results for North American gas and North American electric proxy groups.[480] The October 2022 results for the North American proxy groups are similar to Mr. Coyne's original recommended ROEs for FEI and FBC.

(c) Agreement that North American Integration Inconsistent with Systematically Lower Allowed WACC in Canada Versus U.S. Utilities

288. The experts also agree that the extent of North American financial market and economic integration also renders anachronistic the tendency for Canadian regulators to set allowed utility returns, including the allowed returns of FEI and FBC, far below the allowed returns of US utilities.

289. As Dr. Lesser noted, companies with comparable business risk and financial risk should provide roughly equivalent expected Weighted Average Cost of Capital ("WACC") values when markets are efficient -- failing which the utility with a lower return will have a difficulty attracting capital on comparable terms.[481] At one time, systematically lower allowed WACC (i.e., the combined effect of allowed ROE/common equity ratios) between US and Canadian utilities could plausibly be justified based on perceived disconnects and differences between the respective economies and markets. However, the evidence of both experts regarding the extent of integration, discussed above, means that investors directly compare the allowed returns of Canadian utilities with those of US utilities. In such circumstances, based on the comparable risk principle, the only theoretically valid basis for a WACC differential between FEI/FBC and the US

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478 Exhibit A2-3, Lesser Report, p. 14.

479 Exhibit A2-3, Lesser Report, pp. 14-15.

480 Exhibit B1-50, Response to Undertaking.

481 Exhibit A2-3, Lesser Report, p. 86; Tr. 3, p. 382, ll. 5-19 (Lesser).

proxy companies would be a systematic differential in business risk attributable to the jurisdiction in which utilities are located.

290. Mr. Coyne provided the following historical context for systematically lower allowed ROE/common equity ratios in Canada compared to the US, indicating that the ostensible driver was no longer valid:

> It's been the view, in my view, of Canadian regulators that at one point in time I think there was -- there wasn't as much integration between the industries and there wasn't as much regulatory cooperation and collaboration. And with the advent of the integration of the industries and regulatory models that have evolved along similar lines, those distinctions that were greater 20, 30 years ago have narrowed to the point where they're much smaller. And as a result of that I think it's viewed by analysts and increasingly by regulators as being a fairly integrated industry. And I think Dr. Lesser shares that view, based on the comments I've heard him make. And it happens physically because of cross border trade. If you look at how the transmission networks are managed, they're managed in a collaborative way between Canada and the U.S. under NERC standards. And the amount of, you know, gas trade back and forth cross-border and ownership. You know just look at Fortis as a case in point. Fortis owns Canadian companies and U.S. companies, so the operations of those companies are integrated. So I think the differences that existed 20 or 30 years ago have narrowed. And Canadian regulators and the credit rating agencies used to have Canadian offices and U.S. offices, and now they're taking a global approach to how they look at credit. And the country distinct -- distinguishes -- distinguishing elements that they used to look at I think have faded according to what Moody's and S&P tells us. So I think -- to your question, I think those differences that were brought about by -- a different evolution of regulation in Canada and the U.S. have narrowed. The allowed ROEs have narrowed, but the allowed equity ratios are probably the biggest gap that exists at this point in time.[482]

291. In other words, integration of capital markets "supports the reasonableness of using U.S. proxy groups and U.S. authorized returns in establishing the appropriate investor-required return for FEI and FBC without making an adjustment to those U.S. returns for differences in risk between the two countries."[483]

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[482] Tr. 4, p. 673, l. 23 – p. 675, l. 9 (Coyne).

[483] Exhibit B1-8-1, Appendix C, Concentric Report, p. 33.

292. In addition to the evidence of integration discussed above, Mr. Coyne provided the Economist's recent country risk ratings for Canada and the U.S. as of August 2021 (Figure 17 below), which highlights the comparability of Canada and the US from a risk perspective.[484]

Figure 17: Country Risk Ratings

	Canada	U.S.
Sovereign Risk Rating	A	AA
Currency Risk Rating	A	A
Banking Sector Risk Rating	AA	A
Political Risk Rating	AAA	AA
Economic Structure Risk Rating	A	A
Overall Country Risk Rating	A	A

293. In short, the current systematically lower allowed returns for Canadian utilities that are competing directly for capital against their US counterparts are an anachronism. FEI's proposed ROE and common equity ratio will narrow that gap, but not resolve it. As discussed in Part Four, Section B, FEI faces higher business risk relative to the gas proxy groups. In the case of FBC, only a small portion of the remaining differential can be explained by FBC having slightly lower business risk than the electric proxy groups, and there are offsetting factors including its small size and industrial load concentration. On balance, Mr. Coyne concluded: "However, the difference is not significant enough to cause an investor to assign a notably lower risk profile to FBC."[485]

(d) The October 2022 Results Are an Appropriate Basis for Decision Making

294. Mr. Coyne's ROE calculations using October 2022 data are the most current analysis, and should be given the greatest weight. Mr. Coyne that "…this Commission is best served by having the most up-to-date market information it can to make and use its informed judgment around how the capital markets are impacting the models and what a fair return is."[486]

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[484] Exhibit B1-8-1, Appendix C, Concentric Report, p. 34.

[485] Exhibit B1-8-1, Appendix C, Concentric Report, p. 141.

[486] Tr. 3, p. 174, ll. 14-18 (Coyne).

Dr. Lesser affirmed his belief in the Efficient Market Hypothesis, which is based on the market reflecting current information.[487]

295. Although the BCUC should be giving the most weight to October 2022 data, the BCUC can take additional comfort from the fact that there is reasonable alignment between the ROE results based on December 2021 data and the results based on October 2022 data. Mr. Coyne regarded the December 2021 results as more reflective of "more normal market circumstances" than the September 2022 results filed prior to the oral hearing.[488] The October 2022 results showed the markets emerging from extraordinary market conditions over the Summer, which had supressed the September 2022 Update model results.[489] Mr. Coyne provided the following context for the temporary volatility in results:

> These are extraordinary conditions. When you have a S&P 500 index that has declined by 22.6 percent, that shakes up market participants. And the same is true for the TSX. And when we have the federal governments in both Canada and the U.S. raising interest rates at unprecedented speeds in response to unprecedented inflation, I don't think any objective observer could help but to notice these are somewhat extraordinary capital markets and economic circumstances we find ourselves in this year.[490]

296. Mr. Coyne elaborated on the October data beginning to reflect more normal conditions again:

> So stock prices for utilities hung in there against what some would have thought were circumstances that would have depressed those prices. But that didn't occur until we got into September and into October, when we finally started to see some alignment around what expectations would be for stock prices for utilities. They

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487 Tr. 3, p. 382, l. 25 – p. 383, l. 2 (Lesser).

488 Exhibit B1-30, Coyne Opening Statement, p. 2.

489 See Tr. 3 p. 296, l. 9 – p. 297, l. 7 (Coyne) for Mr. Coyne's explanation of specifically how the extraordinary conditions impacted the models and, in particular, why they resulted in lower results than December 2021 data or October 2022 data.

490 Tr. 3, p. 173, l. 23 – p. 174, l. 6 (Coyne).

began to respond. They came down, the dividend yield started to tick up more in sync, but yet not fully in sync with where bond yields were going.[491]

C. APPLICATION OF THE MULTI-STAGE DCF MODEL: EXPERTS ARE GENERALLY ALIGNED

297. Dr. Lesser and Mr. Coyne are, as Mr. Coyne put it, "in violent agreement"[492] on the application of the multi-stage DCF model in most respects. As a consequence, the results of the multi-stage calculations under their preferred approaches (Scenarios A2 and B7) are identical; all scenarios fall in the range of 9.75%-10% for the North American gas proxy group and 9.1%-9.5% for North American electric proxy group. The following submissions focus on the remaining areas of disagreement that, while conceptually important, are immaterial to the results in this case. FEI and FBC submit that on these disputed issues, for the reasons outlined below, the BCUC ought to find that Mr. Coyne's rationale is most compelling.

(a) Using Multiple Data Sources for EPS Growth Rates Is a Sensible Approach

298. Mr. Coyne and Dr. Lesser agree that projected earnings per share growth rates should be used in the DCF model rather than dividends per share or sustainable growth rates.[493] However, they disagree on the source of earnings per share growth rate information. FEI and FBC submit that there is a sound logic to relying on multiple data sources (as Mr. Coyne has done), rather than relying on a single source (as advocated by Dr. Lesser).

299. Mr. Coyne averages four sources – Zacks, SNL, Value Line and Thompson First Call (the latter is synonymous with I/B/E/S and Yahoo). Three of the four sources are consensus forecasts, and Value Line is an independent analyst forecast. Mr. Coyne explained that the purpose of using earnings per share growth rates in the DCF analysis is to reflect investor expectations, and investors have access to all of these sources of data when formulating those

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[491] Tr. 4, p. 574, ll. 3-12 (Coyne).

[492] Tr. 3, p. 295, ll. 24-26 (Coyne).

[493] Exhibit B1-21, Concentric Rebuttal, p. 2; Exhibit A2-12, BCUC IR2 5.1 (Lesser).

expectations. Using multiple forecasts also reduces the potential for anomalous data to influence results. Mr. Coyne elaborated:

> So, as I mentioned I used four sources. And one of the reasons I do that, and one of the reasons I like to include Value Line is that Yahoo, Zacks, and S&L are all consensus forecasts. So that is they gather consensus of the equity analysts that cover these companies, and then they report out the consensus view from those individual analysts. And some have argued that these analysts aren't as objective as somebody whose job it is just to provide a forecast. And that's what Value Line does. So, I like to include Value Line for that reason, there are no questions regarding their objectivity presumably. But one of the benefits of averaging four sources is that you get to mitigate the impact of anyone that will differ from another. And there can be some substantial differences, and I would be very concerned with just using one source.[494]

300. During the hearing, Mr. Coyne provided several examples where using an average of several data sources had mitigated anomalous results in a single data source.[495] Mr. Coyne also noted that I/B/E/S / Yahoo has had some coverage shortcomings for Canadian companies in the past, as well as instances where updates lagged other sources; any such concerns are mitigated by using multiple sources.[496]

301. Dr. Lesser's rationale for sole reliance on I/B/E/S does not withstand scrutiny:

(a) Dr. Lesser's opposition to the use of multiple sources is difficult to reconcile with his support for the Efficient Market Hypothesis, which contemplates that investors will make use of all available information. He acknowledges that all of these sources are available to, and used by, investors.[497]

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[494] Tr. 3, p. 314, l. 11 – p. 315, l. 1 (Coyne). See also Tr. 4, p. 590, ll. 6-19 (Coyne).

[495] Tr. 3, p. 315, ll. 1-22 (Coyne).

[496] Tr. 3, p. 323, ll. 1-5 (Coyne); Exhibit B1-21, Concentric Rebuttal, p. 11.

[497] Tr. 4, p. 472, l. 5 – p. 473, l. 13 (Lesser); Tr. 4, p. 473, ll. 4-13 and p. 472, ll. 22-24 (Lesser). Exhibit B1-41, Arkansas Testimony, p. 15, ll. 13-20.

(b) In his 2002 testimony in Illinois, Dr. Lesser averaged the results of Value Line and I/B/E/S.[498] He used only Value Line in his Arkansas evidence from that same year, his rationale being: "The value Line Investment Survey reports are well known, commonly used sources of information for investors, and are thus a reasonable source of information on which to rely."[499] At the hearing, Dr. Lesser conceded that Value Line is still a well-known, commonly used source of information for investors.[500]

(c) Dr. Lesser expressed a concern about considering forecasts that are based on different sources and different methodologies; yet, he uses multiple ROE models based on entirely different methodologies and data to mitigate the potential for anomalous results.[501]

(d) Dr. Lesser's concern about different forecast horizons is overstated. Three of the forecasts use a five-year horizon. While Value Line uses 3-5 years, Mr. Coyne explained that this is not materially different from the others in practice: "And generally speaking, these analysts will have a sharper view of the next three years anyway, and they kind of get into equilibrium growth by the time you get to years four and five. So, I don't think that's a meaningful difference in terms of the overall analysis."[502] Mr. Coyne added that, in any event, the Value Line estimates "are generally within the range of those other sources".[503]

(e) Dr. Lesser noted that I/B/E/S is free and expressed concern about the cost of obtaining the other sources. However, Zacks is also free.[504] He already uses Value Line for betas, and the earnings per share information is found on the same page

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498 Exhibit B1-41, Illinois Testimony, p. 34, ll. 634-637.

499 Exhibit B1-40, Arkansas Testimony, p. 44, ll. 16-21.

500 Tr. 4, p. 486, ll. 14-19 (Lesser).

501 Tr. 4, p. 478, l. 5 – p. 479, l. 8 (Lesser); Tr. 4, p. 477, ll. 20 – p. 478, l. 4 (Lesser).

502 Tr. 3, p. 317, ll. 19-24 (Coyne).

503 Tr. 3, p. 320, ll. 3-8 (Coyne). See also Tr. 3, p. 316, l. 2 – p. 317, l. 3 (Coyne).

504 Tr. 4, p. 485, ll. 3-5 (Lesser).

of the same report.[505] Mr. Coyne noted that, in practice, he always makes his work papers and source data available to the regulator and interveners.[506]

(f) Dr. Lesser indicated that his approach of just using I/B/E/S for EPS growth rates is consistent with what FERC has done. However, FERC has recently endorsed the use of the same Value Line earnings per share growth information in the context of the DCF analysis used to determine the MRP in the CAPM model. FERC cited a prior Opinion in which it had held that "diversifying data sources may better reflect the data sources that investors consider in making investment decisions." FERC also noted that "…Value Line projections incorporate the input of multiple analysts and are updated regularly", and that "Value Line growth rates are widely used by investors."[507] FERC's logic mirrors that of Mr. Coyne.

(b) Using 90-Days of Dividend Yield Data, While Normally Reasonable, May Still Be Skewing DCF Results Downwards

302. The Efficient Market Hypothesis would suggest current prices (i.e., today's spot price) are a better indicator of investors' forward-looking expectations than past data; however, the experts concurred that it is reasonable to use a longer data period as a pragmatic means of moderating daily volatility in stock prices and dividend yields.[508] When interpreting the October 2022 results, the BCUC should consider the 90-day results but also recognize the tendency of a longer data period like 90-days to understate investors' forward-looking expectations due to the lingering effects of extraordinary events earlier this year.

Longer Periods Can Skew DCF Results in Volatile Market Conditions

303. Mr. Coyne selected a 90-day period in his December 2021 Report. Note that when Mr. Coyne is referring to "days" he means "trading days", so 90 trading days would be slightly

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[505] Tr. 4, p. 488, ll. 1-8 (Lesser). This can be seen in the Value Line reports included in Dr. Lesser's Arkansas Evidence (Exhibit B1-40) as Attachment JAL-6.

[506] Tr. 3, p. 319, ll. 2-12 (Coyne).

[507] Exhibit B1-39, Excerpts from FERC Opinion No. 569-B at paras. 90-91.

[508] Tr. 4, p. 442, ll. 13-16 (Lesser).

over four calendar months. All of his "90-day" calculations for October 2022 or otherwise are performed on that basis.

304. In Dr. Lesser's initial IR responses (also before the volatility this past summer), Dr. Lesser indicated had no objection to Mr. Coyne's use of 90 trading days.[509] He added that "left unfettered by a regulator's requirements for such analyses, he would likely use a three month period."[510] (Three months is roughly 60 trading days, though it is possible – it isn't clear – Dr. Lesser was using "three month" as short-hand for 90 trading days.)

305. At the oral hearing, Dr. Lesser acknowledged that he may use shorter periods depending on "what's happened in the market", though not shorter than 30 days.[511] Dr. Lesser commented that in the context at the time of the hearing it would be "perfectly reasonable" to use "between one and three months."[512] This is consistent with what Dr. Lesser had done in two proceedings from 2002 (he used 30 days in one and 60 days in the other), in circumstances that he had characterized as being influenced by the threat of war, emerging from challenging economic circumstances and unprecedented monetary policy intervention.[513] As discussed next, the extraordinary conditions earlier this year are not dissimilar to the conditions highlighted by Dr. Lesser back in 2002. They, too, give rise to the concerns that older data is not reflective of investors' forward-looking expectations.

Market Conditions in Spring and Summer of 2022 Have Been Extraordinary

306. The first half of 2022 was characterized by the threat of war, emergence from a technical recession and economic uncertainty,[514] and unprecedented central bank intervention. As shown in the figure below from the Bank of Canada,[515] over the period from January 2022 to

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509 Exhibit A2-24, BCOAPO IR1 17.1 (Lesser).

510 Exhibit A2-8, FortisBC IR1 5.1.

511 Tr. 4, p. 440, ll. 20-24 (Lesser).

512 Tr. 3, p. 201, ll. 22-25 (Lesser).

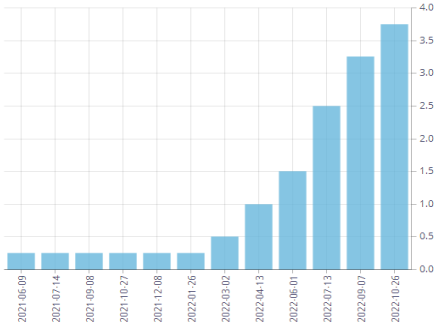
513 Exhibit B1-40, Arkansas Testimony, pp. 47, ll. 7-15; Exhibit B1-41, Illinois Testimony, p. 36, l. 671 – p. 37, l. 681.

514 Tr. 4, p. 448, l. 23 - p. 450, l. 2 (Lesser).

515 Exhibit B1-42.

the oral hearing in October 2022 (eight months) interest rates increased six times for a total of 3.5%. Rates increased 2.25% in the 90-day period used for Mr. Coyne's September 2022 Update, and 1.25% in September and October 2022 alone. Central banks are signalling that interest rates are going to continue to increase, not decrease.[516] Rates increased again by another 50 bps in December 2022, which is not reflected in the figure.

Recent data



Date*	Target (%)	Change (%)
October 26, 2022	3.75	+0.50
September 7, 2022	3.25	+0.75
July 13, 2022	2.50	+1.00
June 1, 2022	1.50	+0.50
April 13, 2022	1.00	+0.50
March 2, 2022	0.50	+0.25
January 26, 2022	0.25	---
December 8, 2021	0.25	---
October 27, 2021	0.25	---
September 8, 2021	0.25	---
July 14, 2021	0.25	---
June 9, 2021	0.25	---

*As of 2021, a change takes effect the day after its announcement.

307. Investor expectations as to dividend yields today will bear little resemblance to what expectations were prior to the unprecedented increase in interest rates. Intuitively, dividend yields on utility stocks must be higher than government bond yields to attract investment because utility stocks are higher risk,[517] and there is in fact a meaningful and statistically significant correlation over time.[518]

308. This relationship between dividend yields and government bond yields is visible in the figure below,[519] with a notable exception being that the spread had narrowed over the

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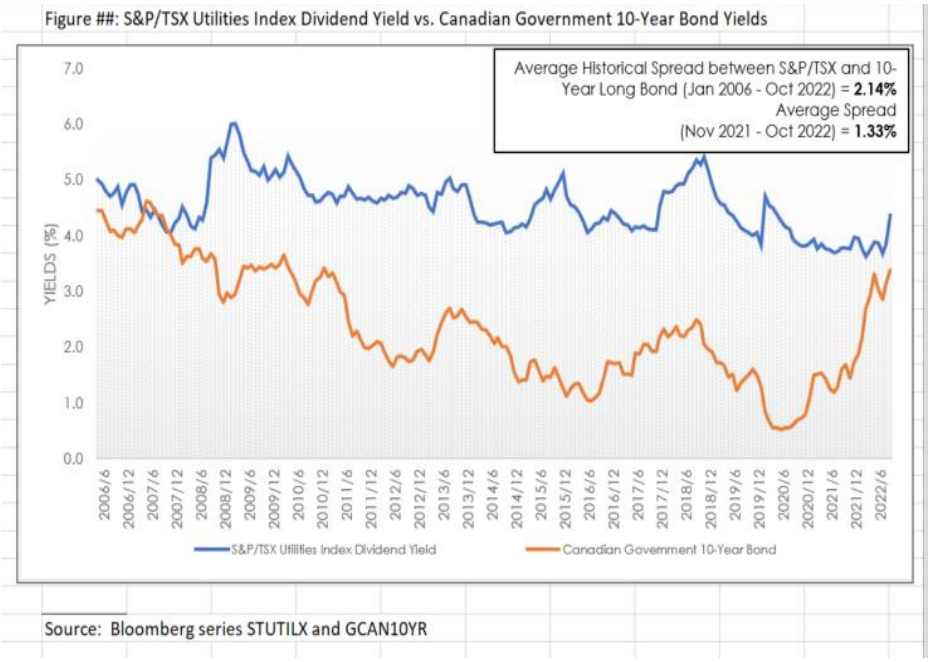
516 Tr. 4, p. 452, l. 23 - p. 454, l. 12 (Lesser).

517 Tr. 4, p. 459, ll. 9-18 (Lesser). Dr. Lesser also alluded to the need for a spread to exist between utility dividend yields and government bond yields in his testimony in Illinois: Exhibit B1-41, p. 36, ll. 665-669.

518 Tr. 4, p. 581, l. 3 – p. 581, l. 23 (Coyne): While not a perfect correlation, "I would expect them to move in harmony, at least move in the same direction." Mr. Coyne explained that this is due in part to the behaviour of institutional investors, which invest in both bonds and low-risk stocks and thus monitor spreads carefully.

519 Exhibit B1-43 updated Figure 14 from Concentric Report, p. 31.

summer of 2022. The narrowing spread evidenced that the market took some time to respond to the dramatic change in interest rates and government bond yields.



309. The timing of the September 2022 Update, in conjunction with the use of a 90-trading day data period, coincided with the transitory period of suppressed dividend yields and produced much lower results than Mr. Coyne's original analysis based on December 2021 data.[520] Mr. Coyne's Scenario Analysis (current to October 2022) shows higher results compared to the September 2022 Update. The increasing DCF results reflect the market returning towards the more intuitive and sustainable relationship between utility dividend yields and government bond yields. Mr. Coyne explained:

> Well, we had government bond yields that had increased by over one and a half percent, but we really hadn't seen much if any response in the dividend rate for utilities, and that to me was unsustainable. Because within -- two things, you expect two things to happen with increasing bond yields. Increasing bond yields are not good for utilities because utilities use a lot of capital. And generally speaking it's -- you'd expect to see some downward pressure on utility prices, but we hadn't seen that. And I think the reason we hadn't seen that is that utilities are considered generally a safe harbour when times are tough and markets are volatile. And that was certainly the case in 2022. So stock prices for utilities hung

[520] Exhibit B1-8-1-2 September Update.

> in there against what some would have thought were circumstances that would have depressed those prices. But that didn't occur until we got into September and into October, when we finally started to see some alignment around what expectations would be for stock prices for utilities. They began to respond. They came down, the dividend yield started to tick up more in sync, but yet not fully in sync with where bond yields were going.[521]

310. Mr. Coyne noted that "the DCF model is producing results that look more like they did back in December"[522] and summed-up by stating: "And as you have seen over the course of the last month or so, we've seen them come back into closer alignment. So, it's beginning to correct."[523]

Indications Are that 90-Trading Day Period Is Still Suppressing October 2022 Results

311. Although dividend yields are now responding to the new interest rate environment, there are objective indicators suggesting that lagging data inherent in using a 90-trading day period is still supressing the DCF results. Mr. Coyne's Sensitivity Analysis (which is current to October 2022) shows that a shorter time horizon (30 trading days vs. 90 trading days) consistently increases the multi-stage DCF results. This can be seen, for instance, when comparing Scenarios A2 and A3 (excerpted from Mr. Coyne's summary table and highlighted below).[524] This is an indication that dividend yields were lower in August and September 2022, compared to October 2022.

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[521] Tr. 4, p. 573, l. 15 – p. 574, l. 12 (Coyne). See also: Tr. 4, p. 571, l. 14 – p. 573, l. 1 (Coyne); Tr. 4, p. 578, l. 24 – p. 579, l. 18 (Coyne).

[522] Tr. 4, p. 583, ll. 25-26 (Coyne).

[523] Tr. 4, p. 579, ll. 13-15 (Coyne).

[524] Exhibit B1-50, Undertaking Response, p. 3.

Table 2: Summary Table – Multi-Stage DCF Results

Scenario	As of	Canadian	US Gas	North American Gas	US Electric	North American Electric
A.1 – Coyne - original	Dec 2021	10.28%	9.53%	10.05%	8.82%	9.07%
A.2 – Coyne – 90 day	Oct 2022	10.46%	8.94%	9.72%	8.74%	9.11%
A.3 – Coyne – 30 day	Oct 2022	10.93%	9.24%	10.03%	9.10%	9.52%

312. Mr. Coyne confirmed that, while the BCUC should have regard to the outputs from December 2021, September 2022 and October 2022, ". . . at the end of the day I do think that the most current information is what you should probably place the greatest weight on."[525] However, Mr. Coyne also encouraged the BCUC to put the model outputs in context: "So it's been a year of adaptations and disruptions in capital markets. But I think that the point I was making is that you need to understand what's happening to capital markets in 2022 in order to be able to interpret the results we're getting from the models."[526] The BCUC should find that the October 2022 results are potentially understating the investor-required return.

(c) Mr. Coyne's Multi-Stage DCF Is More Conservative than FERC's Methodology

313. Mr. Coyne's approach to the multi-stage DCF model is more conservative than FERC's approach. Dr. Lesser agreed that the FERC approach "can lead to higher allowed ROEs than his [Mr. Coyne's] approach, but that assumes all short-term growth rate forecasts are greater than GDP."[527] The evidence is that short-term growth rate forecasts are indeed greater than GDP.[528]

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525 Tr. 4, p. 586, ll. 9-12 (Coyne).

526 Tr. 4, p. 571, l. 14 – p. 573, l. 1 (Coyne).

527 Exhibit A2-20, BCUC IR2 5.4.

528 This can be seen in Exhibit B1-8-1-2, Mr. Coyne's September Update, Excel Attachments. The average growth rate for years 1-5 is higher than the GDP growth rate in perpetuity.

D. APPLICATION OF THE CAPM: ONE METHODOLOGICAL CHOICE ACCOUNTS FOR UNREASONABLY LOW LESSER CAPM RESULTS

314. The fact that the Lesser CAPM Results are so much lower than the results of any other modelling done in this proceeding (regardless of which expert's approach is used) masks the fact that the experts agree on most aspects of the CAPM analysis.[529] In fact, their most significant methodological disagreements on the CAPM are in respect of only two issues. Adopting one of Dr. Lesser's recommendations would actually increase Mr. Coyne's CAPM results at present.[530] As such, a single recommendation of Dr. Lesser – i.e., in determining the MRP, assume that growth in the S&P 500 will be limited to the rate of GDP growth after year 5 – accounts for almost all of the discrepancy between his very low CAPM results and the results of all other modelling in this proceeding. As discussed below, the fact that Mr. Coyne's CAPM model produces more intuitive results is attributable to his CAPM analysis being based on inputs better suited to the current market conditions.

(a) Determine Risk Free Rate Using Forecast, Not Current, Government Bond Yields

315. Mr. Coyne and Dr. Lesser disagree on whether to determine the risk free rate in the CAPM with reference to forecast government bond yields (Mr. Coyne) or current government bond yields (Dr. Lesser). In the current market conditions, other things being equal, Mr. Coyne's approach actually reduces CAPM results relative to Dr. Lesser's recommended approach since current government bond yields are higher than forecasts. Nevertheless, FEI submits that the BCUC should find that Mr. Coyne's approach is most reasonable. It is a conceptually important issue for the determination of cost of capital, and FEI submits that Mr. Coyne's approach best reflects how investors actually make decisions.

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[529] See, e.g., Exhibit B1-21, Concentric Rebuttal, p. 3; Exhibit A2-20, BCUC IR2 7.1 (Lesser); Tr. 4, p. 635, l. 7 – p. 636, l. 7 (Lesser). Tr. 4, p. 635, l. 7 – p. 636, l. 7 (Lesser).

[530] Tr. 3, p. 287, l. 23 – p. 288, l. 1 (Coyne).

There Is a Sound Logic to Using Forecasts that Investors Actually Use

316. Mr. Coyne uses forecasts from Consensus Economics, which are a group of 250 prominent economic and financial forecasters at banks, investment firms and similar institutions.[531] The logic of using a consensus forecast is rooted in investor expectations, which are at the heart of the Fair Return Standard. Mr. Coyne stated, for instance:

> But what I would say is the cost of capital for a public utility should be set based on investor expectations. And it's my view that investor expectations are going to look at forecasts for bond yields as the underlying risk-free rate rather than just to open up the Wall Street Journal and say, okay, today's bond yield is 20 percent, there it is, I expect that to be the case forever. We know that's not the case.
>
> And an element of an efficient market hypothesis, in my view, is that investors will have expectations and they will be informed by a broad view of the markets and the economy. And those are best represented -- better represented by 250 smart people who think about these things than just where the bond has to be trading today.
>
> So I believe for that reason that a forecast is a preferred approach, especially when you consider here in B.C. where you're going to set that cost of capital that'll be in place for many years. Having expectations around what those markets are going to look like over a future period is even more appropriate.[532]

317. As Mr. Coyne noted, the entire forecasting industry is predicated on investors using forecasts, rather than just the current price, in making investment decisions:

> You know, the efficient market hypothesis, there are as many proponents for it as there are detractors. I think Dr. lesser would agree. It basically says that everything you need to know is in today's stock price or today's bond price. But yet we have whole industries that are based on trying to predict the future of what's happening in capital markets. And when you have a group of 250 people that are saying, "Well, I understand today's bond prices but I see inflation doing this, I see the economy doing this. When I put all those dynamics together and I see what the central bank is doing, I think the trend is up. So my view is that they're not going to stay where they are today." So, especially when it comes to interest rates there is inevitable a divergence between today's bond yields. Otherwise you wouldn't

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[531] Tr. 3, p. 183, ll. 11-18 (Coyne).

[532] Tr. 3, p. 186, ll. 4-26 (Coyne).

> have trading in those bonds around expectations if you're going to do something different in the future.

318. Mr. Coyne's approach is consistent with the logic underpinning AAMs approved by Canadian regulators, which have long been calibrated to forecast bond yields rather than current bond yields.[533] The BCUC's approved AAM was based on Consensus Economics forecasts, the same source used by Mr. Coyne.

Dr. Lesser's Rationale Departs from What Happens in Real Life

319. Dr. Lesser conceded that, in the past, he had used the same approach as Mr. Coyne.[534] His reasons for changing his approach to use current bond yields are not compelling.

320. Dr. Lesser's primary rationale is summarized in the following passage from his report:

> The EMH [Efficient Market Hypothesis] explains why it is not appropriate to use a forecast of future government bond yields when applying the CAPM. Under the EMH, today's yield on long-term government bonds reflects investors' collective expectations about interest rates. Using a forecast of future yields on such bonds thus amounts to "double-counting" future expectations.[535]

321. Dr. Lesser conceded at the hearing that "double counting" is a misnomer, as Mr. Coyne is using the forecast instead of current bond yields (not adding them together).[536] Dr. Lesser also acknowledged that investors look beyond the current price to inform investment decisions.[537] As such, Dr. Lesser's position is ultimately predicated on the hypothesis that current prices reflect future expectations, whether gleaned from forecasts or otherwise. In reality, however, current prices reflect many considerations other than investor expectations about the

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[533] Tr. 3, p. 184, ll. 13-16 (Coyne); Exhibit B1-9, BCUC IR 38.4 (Concentric).

[534] Tr. 4, p. 534, ll. 9-16 (Lesser). See also Exhibit B1-41, Illinois Testimony, p. 43; Exhibit B1-40, Arkansas Testimony, p. 70.

[535] Exhibit A2-3, Lesser Report, p. 46.

[536] Tr. 4, p. 542, l. 14 - p. 543, l. 2 (Lesser).

[537] Tr. 4, p. 530, ll. 11-18 (Lesser); p. 533, l. 21 – p. 534, l. 2 (Lesser).

future. Mr. Coyne noted, for instance, that institutional investors settle trades at prices based on portfolio requirements and other more pragmatic considerations:

> A bond yield market is a chaotic place. There are billions and trillions of dollars traded each day in bond markets. Some traders have to get into positions, they have to get out of positions. They're optimizing what they need to do in that moment. That's different than having a three-to-five year outlook on what those markets are going to be.[538]

322. Mr. Coyne elaborated:

> See, the price today is -- in a bond market, there are buyers and sellers and it's where they're willing to settle on the 30-year bond rate today, and they have a whole host of considerations that they need to satisfy in those trades. But if you were to sit down and ask them, "Do you think that that's going to be the 30- year bond yield five years from now?" I guarantee you that you would not find one of them that would say, "Yeah, that's my expectation in five years." They're all going to have a different view of how the economy is going to evolve and how inflation is going to evolve. So we're not trying to determine whether or not that is the best indicator today of what the value of a 30-year bond yield is, I will grant you that, but that is not the indicator of what the market thinks 30-year bond yields are going to trade at two, three, four, five years down the road. And that's what we're trying to determine that underlies the risk-free rate trajectory that's built into these costs of capital models.[539]

323. Mr. Coyne also put his observation in the context of recent market conditions, noting that bond yields settled at low amounts in late 2021 despite the widespread expectation at the time that interest rates were going to increase:

> I have to ask you a question in response. And that is, do you think that back in December, when the Canadian 30 bond yield settled at a $1.76, that those were anyone's expectations for where bond yields were going to be at the end of this year? I would say no. But they still needed to have a portion of their portfolio in those bond yields for a variety of purposes so they're willing to settle on that price.

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[538] Tr. 4, p. 606, ll. 4-10 (Coyne).

[539] Tr. 4, p. 687, l. 6 – p. 688, l. 1 (Coyne).

> But they're not sitting there thinking that that price is going to be the same price a year from now, or two years from now. It's a dynamic market that changes.[540]

324. At the hearing, Dr. Lesser added a more prosaic concern: In his view, utilities were overcompensated following the 2008-2009 financial crisis because, in retrospect, actual bond yields ended up being consistently below forecasts due to central bank intervention that lasted until 2021.[541] There are two answers to Dr. Lesser's concern:

(a) First, from a theoretical standpoint, inquiring whether or not forecasts or current yields are more accurate in hindsight is a "red herring". The exercise of determining ROE is focussed on investor expectations, not how well their investments met their expectations in retrospect. As Mr. Coyne observed: "It doesn't have to be what actually happens, and this can be -- this is where I think this conversation can get off track, that you're not trying to determine what's going to happen in the future. What you're trying to determine is what investors expect is going to happen in the future."[542] [Emphasis added.] Mr. Coyne's observation is consistent with Dr. Lesser's recognition that "perceived risk is not necessarily the same thing as actuarial risk….[I]f perceived risks are commonly believed, they will be nevertheless -- they will nevertheless be relevant to the calculation of expected returns."[543]

(b) Second, wholly apart from those theoretical shortcomings, the circumstances that caused Dr. Lesser's reticence about using forecasts are no longer present. Interest rates have been increasing rapidly since late 2021 - so much so that actual yields have not kept pace; forecast yields are now below the actual yields. Today's

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[540] Tr. 4, p. 689, l. 23 – p. 690, l. 8 (Coyne).

[541] Tr. 3, p. 178, l. 15 – p. 179, l. 12 (Lesser).

[542] Tr. 4, p. 686, ll. 12-17 (Coyne); see also Exhibit B1-13, RCIA IR1 23.4.

[543] Tr. 4, p. 475, ll. 1-11 (Lesser). Dr. Lesser similarly noted in his Report that "The EMH does not claim all public information is accurate, nor that all investors act rationally": Exhibit A2-3, Lesser Report, p. 6.

circumstances are more analogous to the 1980s, when actual bond yields tended to exceed forecasts:

> So, what you would find, and this perhaps is where Dr. Lesser formed his opinion, is forecasts tend to overstate what was really occurring with actual bond yields over the last 20 years. If you look at the general trend. And now here we are -- for those of us with two-decades of old memories will remember that, but if you go back to the 1980s, the opposite was true, because we had circumstances that look more like today where inflation ran higher, energy prices ran higher, and as a result that forecast understated what was really going on. So, the track record there has been mixed at best. But again, the important point isn't in my view whether or not the forecast had it right, but was it a reasonable representation of investor expectations? Because that's what really determines the forward-looking cost of capital.[544]

Mr. Coyne noted that, had he adopted Dr. Lesser's approach back in December of 2021, he would have underestimated what happened to government bond yields. Even the Consensus Forecast underestimated what occurred.[545]

Mr. Coyne's Approach Is More Conservative in the Current Conditions

325. The following figures compare forecast bond yields to actual bond yields since December 2021.[546] In both cases, forecast yields are now below the actual yields. As a result, accepting Dr. Lesser's recommendation would, other things equal, increase Mr. Coyne's CAPM values.[547] Dr. Lesser also agreed the figures show that, regardless of whether one uses current or forecast bond yields, the cost of capital has increased since December 2021.[548]

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544 Tr. 3, p. 189, l. 24 – p. 190, l. 14 (Coyne).

545 Tr. 3, p. 185, ll. 1-8 (Coyne).

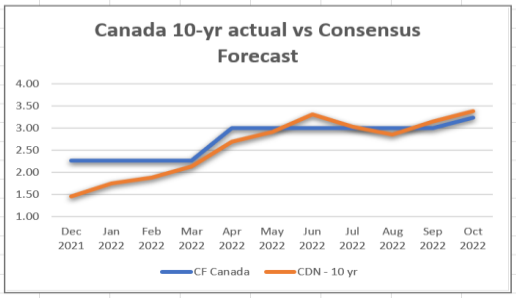
546 Exhibit B1-48.

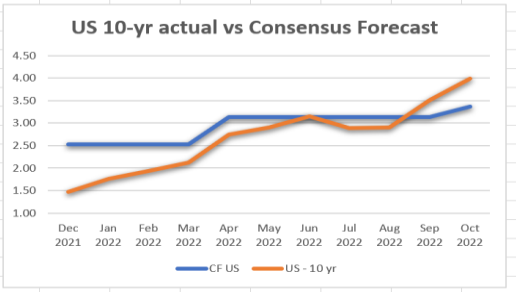
547 Tr. 4, p. 544, ll. 3-8 (Lesser).

548 Tr. 4, p. 544, ll. 9-15 (Lesser).

	CF Canada	CDN - 10 y	CDN - 30
Dec 2021	2.27	1.45	1.76
Jan 2022	2.27	1.75	1.98
Feb 2022	2.27	1.88	2.15
Mar 2022	2.27	2.13	2.31
Apr 2022	3.00	2.70	2.65
May 2022	3.00	2.92	2.89
Jun 2022	3.00	3.31	3.21
Jul 2022	3.00	3.03	3.00
Aug 2022	3.00	2.85	2.89
Sep 2022	3.00	3.15	3.08
Oct 2022	3.23	3.38	3.37

	CF US	US - 10 yr	US - 30
Dec 2021	2.53	1.47	1.85
Jan 2022	2.53	1.76	2.10
Feb 2022	2.53	1.93	2.25
Mar 2022	2.53	2.13	2.41
Apr 2022	3.13	2.75	2.81
May 2022	3.13	2.90	3.07
Jun 2022	3.13	3.14	3.25
Jul 2022	3.13	2.90	3.10
Aug 2022	3.13	2.90	3.13
Sep 2022	3.13	3.52	3.56
Oct 2022	3.37	3.98	4.04





326. FEI submits that it is important to resolve this recurring issue on a theoretically defensible basis, even if that means Mr. Coyne's CAPM results are lower than they otherwise would be if the BCUC were to adopt Dr. Lesser's recommendation. In the event that the BCUC ultimately endorses Dr. Lesser's approach, other things being equal, the BCUC should adjust Mr. Coyne's CAPM results upwards.

(b) The Constant Growth DCF Model, Tempered by Historical Results, Should Be Used to Determine the Forward Looking MRP

327. The MRP is, conceptually, an "estimate of how much more an equity investor has to pay for capital in order to subordinate their interest to other more senior holders, such as debt, or preferred shareholders."[549] Mr. Coyne and Dr. Lesser agreed that the forward-looking MRP should be computed based on the total return on the S&P 500 Index (for US proxy groups) and TSX 500 (for Canadian proxy groups),[550] but disagreed as to how to compute the total return. Mr. Coyne used the constant growth DCF model, moderated by giving 50% weighting to historical

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549 Tr. 4, p. 669, ll. 3-10 (Coyne).

550 Mr. Coyne commented: "And almost all analysts use a market return which is the S&P 500 or the TSX, because it's directly observable and it's a broad measure of a return that any investor can have access to. So, for those of us that maintain a retirement fund, one of the options you have is to choose the TSX or the S&P 500, and not worry about buying individual stocks. So, it's widely perceived to be the market rate of return." Tr. 3, p. 251, ll. 11-19 (Coyne).

data.[551] Although Dr. Lesser previously shared Mr. Coyne's views,[552] he now advocates for a multi-stage DCF model. Dr. Lesser's recommended approach in this regard is the reason for the very low Lesser CAPM Results. As discussed below, there is a compelling logic to Mr. Coyne's approach and it is consistent with prior BCUC decisions and FERC's approach.

Analyst Forecast of S&P 500 / TSX 500 Returns Reflects Investor Expectations for Market

328. The constant growth DCF model employed by Mr. Coyne uses analyst growth forecasts for the S&P 500 and TSX 500 projected out over time because those estimates reflect expectations of what an investor could earn by investing long-term in the S&P 500 or TSX 500:

> And to bring it back down to ground level, to estimate a required return for a utility investor, you're saying here's the S&P 500 or the TSX, you can have that. Do you require a different return than that? Yes. And how do you measure it? Beta, that's the difference in return from the difference in risk. And I'll apply it to that market return. We know that any investor has access to that S&P 500 or to the TSX return. And so the assumption is that that is the baseline. And it's a reasonable baseline because it is such a broad representation of the overall financial markets. It's not supposed to be a representation of the economy. It's not, it's a group of well run, succeeding companies that provide the investor the alternative return. You have to bring it down to the fair return standard at the end of the day. And the fair return standards says that you start with a risk adjusted comparable return and that's what it allows you to do.[553]

329. Consistent with Mr. Coyne's evidence, Dr. Lesser stated in his report (referring to indexes like the S&P 500) that "Based on empirical research, it turns out that a portfolio of 50 or so stocks is all that is needed to mimic the entire market portfolio."[554] He added at the hearing

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551 Tr. 3, p. 242, ll. 16-22 (Coyne).

552 Exhibit B1-21, Concentric Rebuttal, pp. 18-19 recounts the process that Dr. Lesser used in prior testimony, which (like Mr. Coyne) involved using the constant growth DCF model, averaging the results with the historical MRP. See also Tr. 4, p. 505, l. 19 – p. 506, l. 13 (Lesser).

553 Tr. 3, p. 256, l. 10 – p. 257, l. 3 (Coyne). See also: Tr. 3, p. 251, l. 11 – p. 252, l. 25 (Coyne) and Exhibit B1-9, BCUC IR1 39.3.

554 Exhibit A2-3, Lesser Report, p. 36.

that the S&P 500 is used as a proxy for the returns of the overall market "because it's very well diversified",[555] and stated:

> Yes, you are can actually use -- really what the capital asset pricing model is based on is diversification. And so, you know, people -- your financial advisors will say, "Don't put all your money in gold, buy a broad market index, stock index like the S&P 500." So, we use the S&P 500 as a proxy for the entire market. And it's a good proxy in terms of, it actually turns out once you diversify beyond about 50 stocks you'll do a very good approximation of the overall market return because of diversification, the properties of variance and co-variance.[556]

330. Using the expected returns on the S&P 500 or TSX 500 fits within the overall logic of the CAPM model. Under the CAPM, expected total market return (for which S&P 500 index or TSX is used as a proxy) can be computed in a DCF model using analyst growth estimates. The forward-looking MRP is then calculated by subtracting the risk-free rate from the estimated total market return. Beta, defined in this case as the volatility of a utility stock return relative to the total market return (for which the same market proxy is used), is then applied to that market risk premium to determine an investor's expected risk premium in utility stocks relative to the market as a whole.[557]

331. Mr. Coyne's approach of averaging the analyst forecasts with historical returns on the S&P 500 is a concession to past controversy about how to forecast the forward-looking MRP, and "if left to my own druthers absent that debate I'd probably give it [the forecast] 100 percent weight."[558] Averaging the forecasts with historical returns has the effect of moderating the CAPM results.[559] Mr. Coyne characterized it as "a very conservative approach".[560]

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555 Tr. 4, p. 504, ll. 14-18 (Lesser).

556 Tr. 3, p. 255, ll. 1-13 (Lesser).

557 Tr. 3, p. 230, l. 15 – p. 231, l. 19 (Coyne).

558 Tr. 3, p. 217, l. 21 – p. 128, l. 14 (Coyne).

559 Tr. 3, p. 231, ll. 21-26 (Coyne).

560 Tr. 3, p. 242, ll. 16-22 (Coyne).

Dr. Lesser's Approach Means Assuming the S&P 500 / TSX 500 Only Grows at the Rate of GDP Growth After Five Years

332. The multi-stage DCF model that Dr. Lesser advocates uses analyst growth forecasts for years one to five, but then immediately substitutes GDP growth rates starting in year six and on into the future. In other words, Dr. Lesser's approach is effectively assuming that companies in the S&P 500 are only going to grow at the rate of GDP growth starting in year six.

333. Given that the companies in the S&P 500 include some of the world's largest companies, with operations all over the world, this is self-evidently not realistic. Mr. Coyne put it this way: "So if I was on a board of directors on a S&P or TSX company and they said, "We've got a plan we're going grow at the same rate of economy." I'd say, "You've got to do better."'"[561] Referencing the impact of Dr. Lesser's assumption on Microsoft and Amazon, both of which have growth rates well in excess of GDP growth, Mr. Coyne stated: "And that's why to me it's so limiting and unrealistic because of the haircut you're basically putting on the earnings potential for these companies that are the drivers of our economy."[562]

334. Dr. Lesser conceded that the empirical effect of his approach is not realistic, stating that "companies absolutely can grow faster than GDP after five years".[563]

335. The historical data backs that up. Mr. Coyne included an analysis in his Report showing that, over a 92-year period (1929-2020) average annual returns on large company stocks have exceeded nominal GDP growth by 5.55%.[564] The S&P 500 average earnings per share have grown at 9.82%, versus the average annual GDP growth of 6.28%. If you take the same data for the most recent three decades, the S&P 500 earnings per share have grown 15.89% and the

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561 Tr. 3, p. 234, ll. 14-17 (Coyne).

562 Tr. 3, p. 242, ll. 8-11 (Coyne). See also Tr. 3, p. 245, l. 22 – p. 246, l. 1 (Coyne). Mr. Coyne's response to Exhibit B1-20, BCUC IR2 84.1.1 illustrates the distortion that occurs for companies like Microsoft, which has a projected EPS growth rate of 13.62% (i.e., more than double the 5.79% resulting from Dr. Lesser's approach).

563 Tr. 4, p. 508, l. 2-p.509, l. 10 (Lesser).

564 Exhibit B1-9, BCUC IR1 39.4.

economy has grown 4.56%.[565] He posed the rhetorical question: "Why would we assume that all of a sudden they are only gonna grow these companies' earnings at the rate of the economy? I just don't think that's realistic."[566] He added:

> So on its surface I would say that's an interesting theory that these companies can only grow at the same rate of the economy, but that's just not been what history shows us. So, I think is an unduly conservative assumption regarding future earnings growth of these companies.[567]

336. Mr. Coyne also demonstrated that earnings per share and dividends per share of regulated utilities in Canada and the US grew faster than nominal GDP over the period 2005-2019.[568] This is notable because utility companies are traditionally regarded as widows and orphans stocks with stable returns, not (as Dr. Lesser conceded) high growth stocks.[569] Mr. Coyne observed: "If regulated utilities are generally slower growth companies, then it stands to reason that the broad market can also increase by more than the level of GDP growth."[570]

337. Mr. Coyne put the 8.5% output of his methodology (i.e., constant growth DCF, with forecast moderated by 50% weighting to historical data) in the context of historical returns: "So, that's within the range of how the S&P companies have performed vis-à-vis the economy historically. And much less than what they've done over the last 30 years, because they've outpaced the economy by over 11 percent over the last 30 years."[571]

338. Dr. Lesser's approach produces a MRP that defies logic. Mr. Coyne put it in context as follows:

> A U.S. MRP of 3.30% or 3.78% (as calculated in Scenarios B.6 and B.7 [Lesser October 2022 results, 30 and 90 days, respectively]) is outside any reasonable

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565 Tr. 3, p. 233, ll. 5-9 (Coyne); Exhibit B1-26, BCOAPO IR1 94.1 on Rebuttal Evidence.

566 Tr. 3, p. 233, ll. 1-4 (Coyne).

567 Tr. 3, p. 233, ll. 1-15 (Coyne).

568 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 51-52; Exhibit B1-9, BCUC IR1 39.4.

569 Tr. 4, p. 503, ll. 8-14 (Lesser).

570 Exhibit B1-9, BCUC IR1 39.4.

571 Tr. 3, p. 248, l. 9 – p. 249, l. 4 (Coyne).

> range of the MRP estimates and 3.5% to 4.0% lower than the historical U.S. MRP of 7.46% from 1929-2021. And the historical MRP is understated because it is based on government bond yields of approximately 5.0%, compared with average bond yields of 3.4% to 3.9% in October 2022, so one would expect a higher than historical MRP given current bond yields, and not lower, as indicated by Dr. Lesser's method.
>
> Using Dr. Lesser's method for calculating the forward-looking MRP produces CAPM results that are well below the multi-stage DCF model results, the constant growth DCF results and the risk premium model results. This calls into question the reliability of the CAPM results using Dr. Lesser's inputs.
>
> Adjusting the CAPM results for small size and differences in financial leverage (scenarios C.8 and C.9) produces higher CAPM results, but still well below the results of other models and other allowed returns[572]

Mr. Coyne's Use of Constant Growth DCF for MRP Aligns With that of FERC

339. FERC has been using the constant growth DCF model in determining the MRP since it began using the CAPM model,[573] and has rejected Dr. Lesser's approach more than once. FERC's Opinion No. 569 summarizes the logic of using the constant growth DCF model, mirroring Mr. Coyne's explanation. (FERC upheld this decision on reconsideration, reiterating the reasoning below, in Opinion 569-B.)[574]

> As described above, the required return on the overall market is determined by conducting a DCF study of "a representative market index, such as the Standard & Poor's 500 Index." We find that there are at least two reasons why it is not necessary to include a long-term growth projection based on GDP in a DCF analysis of the dividend paying companies in the S&P 500. First, the S&P 500 is regularly updated to ensure, among other things, that it only includes companies with high market capitalization and that it remain representative of the industries in the economy of the United States.
>
> Although the value of the S&P 500 index is held constant when one company is replaced by another as CAPs state, the updating of the companies in the index has

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572 Exhibit B1-50, Response to Undertaking No. 1, pp. 2-3.

573 Tr. 3, p. 224, l. 3 – p. 225, l. 22 (Coyne, Lesser). Although Dr. Lesser noted the decisions were remanded back to FERC by the US Court of Appeal, Mr. Coyne is correct that it was done on procedural grounds only. There was no suggestion in the Court of Appeal decision that FERC's approach to the CAPM MRP was problematic.

574 Exhibit B1-39, FERC Opinion, No. 569-B, para. 99.

the general effect of substituting companies with declining stock values and market capitalization with companies with growing stock values and market capitalization. As Mr. McKenzie testified for the MISO TOs, "As a result formerly successful firms are supplanted by new firms with potential for high growth." CAPs contest this reasoning on the ground that, although the companies in the S&P 500 are updated, the MISO TOs performed a DCF analysis of a specific group of about 400 companies, and there is no reason to expect that a group of stocks "will enjoy long-term growth at short-term rates without being affected by changes in the economy as a whole." This argument misses the point. Although the MISO TOs' applied their DCF analysis to the specific companies who happened to be the dividend paying members of the S&P 500 at that point in time, the purpose of the analysis was to determine a required return on the overall market as represented by an investment in the S&P 500, which is regularly updated. Thus, it is reasonable for the inputs used in the DCF analysis, including the growth projections, to be selected based on the assumption that the subject companies will be updated in the manner described above.

265. Second, we find that, because the dividend paying members of the S&P 500 constitute a large portfolio of stocks, they include companies at all stages of growth. Some are relatively young companies with new products that have not yet fully penetrated the markets and thus are likely to have quite high IBES growth rates. However, other companies are mature companies with limited growth potential which are likely to have quite low IBES growth rates. The inclusion of the IBES growth rates of such mature companies in the overall average IBES growth rate of all the dividend paying members of the S&P 500 performs the same role as the inclusion of the long-term GDP growth rate in the DCF analysis of a single utility: it reflects the fact that companies cannot maintain indefinitely the high growth rates of their early years. Thus, using the IBES growth rates of all dividend paying S&P 500 companies, without using a long-term GDP growth projection can reasonably reflect investors' consensus expectations about the S&P 500 Index as a whole.

266. In summary, while it may be unreasonable to expect an individual company to sustain high short-term growth rates in perpetuity, the same cannot be said for a broad representative market index that is regularly updated to include new companies. Put differently, a portfolio of companies behaves differently than an individual company. Accordingly, the rationale for incorporating a long-term growth rate estimate in conducting a two-step DCF analysis of a specific utility or group of utilities for purposes of directly estimating cost of equity does not apply to the DCF analysis of a broad representative market index with a wide variety of companies that is regularly updated to include new companies for purposes of determining the required return to the overall market.[575] [Emphasis added.]

[575] Exhibit B1-45, FERC Opinion, No. 569, paras. 264-266.

340. Dr. Lesser contended that FERC's second point in the passage above was inconsistent with its first point, which is incorrect. FERC's first point addressed market capitalization (size) and the second point addressed growth rates. The S&P 500 is selected based on market capitalization, not growth rates.[576] Very large, mature companies can have low growth rates and still be very large companies for a long time.

Dr. Lesser's Premise – "The Entire Market Effectively Is the Economy" – Is Demonstrably False

341. Dr. Lesser does not dispute that the S&P 500 can and has grown faster than GDP, but contends that it is "irrelevant" because the S&P 500 is being used as a proxy for the market as a whole and "The entire market cannot grow faster than the economy in the long-run because the entire market effectively is the economy."[577] As discussed below, Dr. Lesser's premise – that "the entire market effectively is the economy" – is an oversimplification and demonstrably false. Dr. Lesser's pivot at the hearing still departs from the reality of how markets work.

342. The following figure from the US Federal Reserve compares the market capitalization of the US Wilshire 5000 versus the US GDP.[578] The figure demonstrates that GDP and market capitalization are not the same thing, since the total market capitalization of this 5000 company subset of the total US market on its own regularly exceeds the US GDP.

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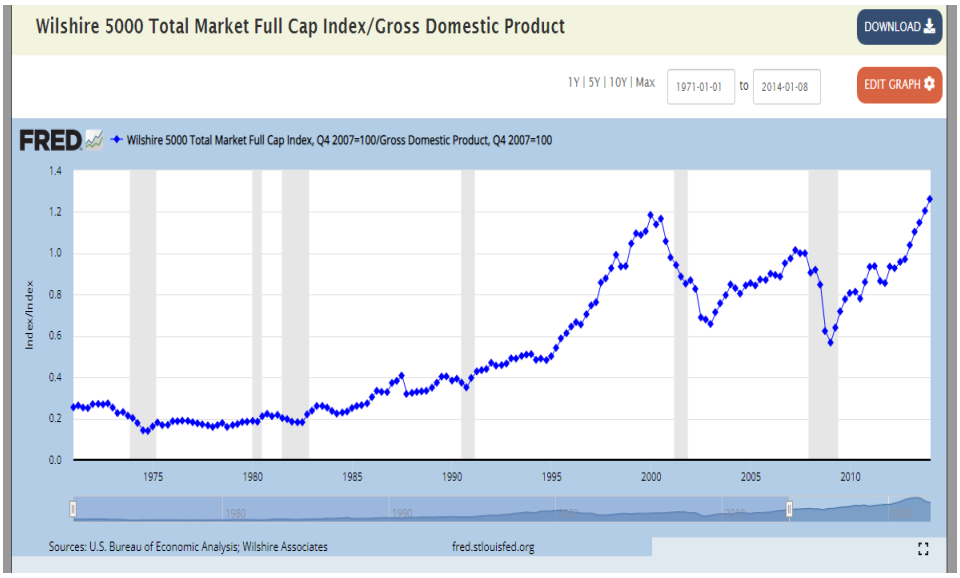
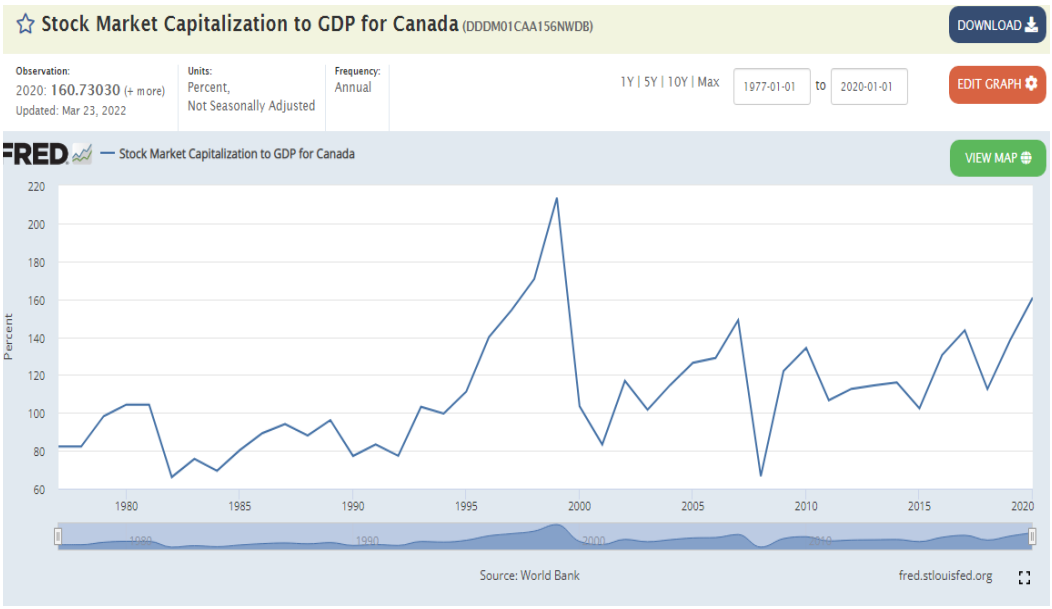
[576] Commissioner Keilty identified this distinction in a question to Dr. Lesser: Tr. 4, p. 496, l. 24 – p. 497, l. 1 (Keilty). See also Tr. 4, p. 497, ll. 8-21 (Lesser).

[577] Exhibit A2-24, BCOAPO IR2 18.5 (Lesser). See also Tr. 3, p. 241, ll. 18-22 (Lesser): "Because that's what I consider the market, the entire market really is the economy. And ultimately that market return cannot grow so fast that it's multiple times the sum of all economic activity because it's part of the overall economic activity."

[578] Exhibit B1-46.



343. It is a similar story for Canada. The following figure compares Canada's "stock market capitalization" (which appears to be the TSX market capitalization[579]) to Canada's GDP.[580] It shows a marked difference between GDP and market capitalization of Canada's largest (by far) stock exchange, market capitalization of the TSX often exceeding Canada's entire GDP, and an upward trend showing that the TSX has been growing at a faster rate than GDP over the last 45 years.



579 Tr. 4, p. 525, ll. 9-18 (Ghikas).

580 Exhibit B1-47.

344. It is also self-evident from the figures above that the *growth* of both the Wilshire 5000, a much broader subset of the US economy than the S&P 500, and TSX are also consistently outpacing GDP *growth* over the last half-century.[581]

345. Mr. Coyne also explained that the differences between GDP and the market capitalization data seen in the figures above is intuitive, as GDP is only a measure of value of goods and services produced in Canada or the US. Market capitalization is the total number of shares x price. The price of a stock is a function of earnings per share, and (as Dr. Lesser acknowledged[582]) a Canadian/US company's earnings per share can be affected by operations outside of the country. Mr. Coyne stated in this regard:

> And -- but you also have to bear in mind that these companies aren't limited to the U.S. economy. Most of these companies, I would argue, in the S&P 500 and TSX are outsourcing in India and China, they're using supply chains around the world. Why would they be limited to a U.S. or Canadian economy when they're participants in a global economy?[583]

346. The GDP growth rates are higher in countries like India (8.9% in 2021) and China (8.1% in 2021) than the growth rates of the US (5.7% in 2021) and Canada (4.6% in 2021)[584], so there is no logical reason why growth of the US / Canadian market should be limited to the GDP growth rate of US / Canada.

347. Earnings per share, and thus market capitalization, can also be increased by the acquisition of private companies within the country, despite that acquisition *per se* having no material impact on GDP. Dr. Lesser acknowledged that transactions are frequently entered because they are expected to be accretive to earnings.[585]

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581 Tr. 4, p. 516, l. 9 – p. 517, l. 13 (Lesser).

582 Tr. 4, p. 519, l. 4 – p. 520, l. 12 (Lesser).

583 Tr. 3, p. 234, ll. 7-13 (Coyne).

584 Tr. 4, p. 519. l. 4 – p. 521, l. 26 (Lesser).

585 Tr. 4, p. 522, l. 1 – p. 524, l. 2 (Lesser).

348. Dr. Lesser, after conceding these points during cross-examination,[586] qualified his statement that "the entire market effectively is the economy": "My argument is that the profits from the S&P 500, which is a flow, in the long run can't exceed the entire value of the economy. Because the way GDP is defined is consumption plus investment plus government spending. And those profits go to investment which is a component of GDP"[587] In essence, Dr, Lesser is arguing that all of the profits from the companies in the US or Canadian market are realized in the same country, such that the GDP (defined as consumption plus investment plus government spending) is always going to be larger than entire market returns. This argument is flawed since markets are international and corporations can and do invest their profits in the highest growth jurisdictions. In other words, companies like Apple are not limited to investing their profits only in the US and their investments in other countries do not reflect in the US or Canada GDP. Indeed, it would not be unreasonable to expect that many mining and energy companies on TSX or NYSE will not have any operations in Canada or U.S.

349. It is also noteworthy that all of Dr. Lesser's arguments are premised on a perpetual time horizon. While the theoretical argument that corporate earnings growth rates cannot exceed GDP growth rates *in perpetuity* may sound compelling – forever is, after all, a long-time - a fifty-year time horizon (which FERC uses for DCF modelling) is a more reasonable reflection of the real world in which investors operate. Dr. Lesser, in describing in his report why he was looking at historic market returns over 50 year periods, acknowledged that the present value of returns after 50 years is *de minimis*:

> (FERC considers a 50-year time frame to be a proxy for perpetuity because the present value of future earnings received more than 50 years from now will have a de minimis impact on the overall present value. For example, the present value of $1 discounted at a 10% rate for 50 years is less than one cent.)[588]

Market earnings have grown faster than GDP for almost 100 years.

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586 Tr. 4, pp. 519-522 (Lesser).

587 Tr. 4, p. 511, ll. 18-20 (Lesser).

588 Exhibit A2-3, Lesser Report, p. 49.

Averaging With Historical Data Renders Moot Dr. Lesser's "Statistical Impossibility" Argument

350. Dr. Lesser argued that it was "a statistically impossibility" for the forward market risk premiums to be 12%-13% over a 50 year period, as historically the average MRP over a 50 year period did not exceed 8.57%.[589] As Mr. Coyne pointed out, his CAPM analysis did not assume a MRP of 12%-13%. His approach of averaging the analyst estimates of growth rates with Canadian and U.S. historical returns resulted in Mr. Coyne using 8.49% in his model, which is consistent with the historical data Dr. Lesser put forward.[590] The averaging supressed Mr. Coyne's December 2021 CAPM results by approximately 180-190 basis points.[591]

351. Moreover, Dr. Lesser's preferred approach of using the Multi-Stage DCF for determining the forward looking MRP produces results that are below historical MRPs. This is counterintuitive, since historical MRPs were the product of higher interest rates than exist today and there is an inverse relationship between interest rates and the MRP.[592]

E. THE BCUC MUST ACCOUNT FOR DISPARITIES IN FINANCIAL RISK BETWEEN FEI/FBC AND PROXY GROUPS

352. As discussed below, the experts agree that it is appropriate to adjust the output of the DCF and CAPM models upwards where the subject utility has thinner equity than the proxy group used to estimate its cost of equity. This applies to both FEI and FBC. Mr. Coyne did not adjust his DCF or CAPM results upwards because his analysis assumes the BCUC will set FEI's and FBC's common equity ratios at 45%, and 40%, respectively. However, as discussed below, Mr. Coyne's approach is still conservative; even the proposed common equity ratios for FEI and FBC only partially account for the financial risk differential.

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589 Tr. 4, p. 649, ll. 20-24 (Lesser).

590 Tr. 4, p. 651, ll. 16-23 (Coyne). The historical market risk premium for the U.S. was calculated over the period from 1926-2020, while in Canada, the historical market risk premium covered the time period from 1919-2020: See Exhibit B1-9, BCUC IR1 40.1.

591 Exhibit B1-21, Concentric Rebuttal, p. 18.

592 Exhibit B1-9, BCUC IR1 40.5.1 and 40.6; Tr. 3, p. 217, ll. 11-20 (Coyne); Tr. 4, p. 613, l. 1 – p. 614, l. 4 (Coyne).

(a) Cost of Capital Models Understate ROE for Utilities With Relatively Thin Equity

353. Dr. Lesser explained in his Report that ROE models – both DCF and CAPM - will mis-estimate the cost of capital for a utility when there is a mismatch between the common equity ratio of the subject utility and the common equity ratios of the peer group used:

> When setting an allowed ROE value for a regulated utility, the resulting WACC value may not reflect risk comparability if the capital structure of the regulated utility under review differs from those of the proxy group. For example, if the average capital structure of the proxy group is 50% equity and 50% debt, while the subject utility has a capital structure of 25% equity and 75% debt, then because the subject utility has more financial risk, equity investors will require a higher expected return.[593]

354. Dr. Lesser explained that regulators will address this type of mis-estimation in one of two ways: (1) an adjustment to ROE, or (2) deeming the equity ratio for regulatory purposes to be "equivalent to" that of the peer group.[594] With respect to the first option, Dr. Lesser identified that DCF results can be adjusted using a WACC adjustment, which is an empirical adjustment that involves aligning the WACC of the subject company and the proxy group average and solving for ROE. The Hamada adjustment is the methodology used to adjust ROE in the context of the CAPM analysis.[595]

355. Mr. Coyne confirmed his "complete alignment" with Dr. Lesser regarding the need to account for disparities in financial risk and the methods used to do so.[596]

356. FEI and FBC currently have significantly lower common equity ratios relative to the applicable peer groups.[597] The average common equity ratio of the US gas utility proxy group is

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[593] Exhibit A2-3, Lesser Report, p. 86; see also: Tr. 3, p. 270, ll. 5-21 (Lesser).

[594] Exhibit A2-3, Lesser Report, pp. 86-87; Tr. 3, p. 270, ll. 5-21 (Lesser).

[595] Exhibit A2-3, Lesser Report, p. 87; Exhibit A2-20, BCUC IR2 8.2.1 (Lesser); Exhibit A2-5, BCOAPO IR1 4.1 (Lesser).

[596] Tr. 3, p. 271, l. 22 – p. 272, l. 5 (Coyne).

[597] As discussed in Part Seven, Section C(b) above, the experts agree that Mr. Coyne's peer group companies are appropriate.

53.4% and the average of the US electric proxy group is 49.7%.[598] The result of applying Mr. Coyne's and Dr. Lesser's approach is that any disparities in financial risk for FEI or FBC should be addressed through a higher ROE than would be suggested by the outputs of Mr. Coyne's models.

(b) Mr. Coyne Did Not Adjust ROE Results Upwards to Account for FEI/FBC's Thinner Equity

357. Mr. Coyne considered the discrepancy in financial risk in the context of his capital structure recommendations, rather than adjusting ROE, as this was most consistent with how the BCUC typically accounts for relative risk. However, as Mr. Coyne noted in the following passage, his recommended (and FEI's proposed) common equity ratio of 45% is still below, albeit closer to, the peer group average. Based on his recommended 40% common equity ratio for FBC, the current large disparity with the US electric peer group will remain. He explained that his approach was conservative:

> As Dr. Lesser mentions, you could do it a couple of different ways to account for that difference. One is you could use the Hamada adjustment, which gives you a good theoretical underpinning for how you'd adjust the ROE. The second is you could use something that's a little bit more intuitive, as Dr. Lesser mentioned, which is the WACC approach to come up with an equivalent ROE based on calibrating the difference in capital structure. The third approach is to look at the underlying equity ratio for the Canadian company in this case and determine if some movement towards that proxy group is appropriate, right? And I did that this time. That's the approach that I have used.
>
> And in the case of FEI, I determined that some movement towards the proxy group capitalization is appropriate. And I reached that conclusion based on the risk of FEI as moving not just equivalent to the U.S. proxy group but above it. So therefore my recommendation was a judgmental approach that is behind my 45 percent recommendation and not an adjustment to the ROE. It's also been my experience that Canadian commissions prefer to adjust for risk using the capital structure and not ROE. So in the case of FEI, that was my approach.
>
> In the case of FBC, even though the capital structure for FBC is 10 percent below that of the proxy group companies, I chose not to make any adjustment for that in the ROE recommendation because of the risk profile of FBC being what I considered to be relatively favourable, comparable to the proxy group, but it

[598] Exhibit B1-8-1, Appendix C, Concentric Report, pp. 120, 142.

> allows for the fact that Canadian commissions award lower capitalizations or allowed equity ratios than do their U.S. counterparts. So I didn't propose a movement in that capital structure in this point in time, not any change in ROE.
>
> So, it's a more conservative approach on that basis, but I felt as though it was fair and reasonable given the circumstances of these two companies.[599]

358. There are several important take-aways for the BCUC from the expert evidence on relative financial risk.

(a) Even a 45% common equity ratio for FEI will not fully address the disparity in financial risk with the gas proxy groups, i.e., the common equity ratios will not be (in Dr. Lesser's words) "equivalent". The residual difference, which remains substantial, cannot be justified based on a business risk differential. Mr. Coyne's assessment (discussed in Part Four, Section B above) is that FEI's business risk is higher, not lower, than the gas proxy groups.

(b) The significant discrepancy in common equity ratios between FBC and the US and North American electric proxy group cannot be reconciled by relative business and financial risk (discussed in Part Six, Section D above). Rather, Mr. Coyne's recommendation to maintain the existing common equity ratio also reflected the pragmatic consideration that Canadian regulators tend to award lower common equity ratios. As discussed in Section B(c) above, in light of the extent of economic and market integration, there is no longer any justification for this tendency of Canadian regulators to award lower ROEs than US companies. As such, Mr. Coyne's recommended capital structures and modelled ROEs must be viewed as conservative.

(c) The BCUC could not approve a common equity ratio below 45% for FEI or 40% for FBC without also adjusting the DCF and CAPM results upwards. These upward

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[599] Tr. 3, p. 272, l. 20 – p. 274, l. 9 (Coyne).

adjustments in ROEs would be necessary to offset the larger disparity in financial risk.[600]

F. SIZE PREMIUM: EXPERTS AGREE BCUC MUST ACCOUNT FOR FBC'S SMALLER SIZE

359. The experts agree that the CAPM model underestimates to cost of equity for smaller companies. The BCUC should find that Mr. Coyne's CAPM results for FBC are understated.

360. Mr. Coyne stated that a size premium is evident from Ibbotson's published data on historical returns, which Ibbotson arranges by company size.[601] Dr. Lesser agreed that there is an empirical basis for including a size premium in the CAPM analysis, and he typically incorporates one in his analysis. Dr. Lesser identified the Duff and Phelps published size premiums as being the appropriate values to use; Dr. Lesser is not aware of any regulators using a different approach.[602] As he stated, "In estimating the allowed ROE for a regulated utility using the CAPM, the size premium is simply added to the CAPM results…".[603]

361. FERC approves of the use of a size premium. FERC stated in Opinion No. 531-B, for instance:[604]

> 92. In Opinion No. 569, the Commission affirmed the approach in Opinion No. 531-B that the size adjustment is "a generally accepted approach to CAPM analyses." The Commission stated that substantial evidence in the record supported the conclusion that investors rely on *Value Line* betas. While the Commission acknowledged that there is an imperfect correspondence between the size premia being developed with different betas, it concluded that the size adjustments improve the accuracy of the CAPM results and cause it to better correspond to the costs of capital estimates employed by investors.

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600 Tr. 3, p. 380, ll. 3-11; p. 381, ll. 19-24 (Lesser).

601 Exhibit B1-21, Concentric Rebuttal, p. 28.

602 Exhibit A2-5, BCOAPO IR1 7.1 (Lesser).

603 Exhibit A2-3, Lesser Report, p. 56.

604 Exhibit B1-39, FERC Opinion No. 569-B. This order has been vacated by the US Court of Appeals and remanded back to FERC (Exhibit B1-33), but only on procedural grounds. There was no suggestion that FERC's reasoning is in error.

…

> 95. In Opinion No. 569-A, the Commission affirmed that the size adjustment is necessary to correct for the CAPM's inability to fully account for the impact of firm size when determining the cost of equity. The Commission reiterated its finding in Opinion No. 569 that there is substantial evidence indicating that investors rely on *Value Line* betas in making investment decisions. Furthermore, the Commission explained it was not persuaded by arguments that betas calculated based on the NYSE cannot be used with the S&P 500. The Commission upheld its finding that size adjustments are appropriate for the utility industry and that they improve the overall accuracy of the CAPM results. [Emphasis added.]

362. In the interest of being conservative, Mr. Coyne did not incorporate a size adjustment in his CAPM model. However, he confirmed that he believes a size premium is appropriate for FBC, and calculated the size premium using the Duff and Phelps published values (shown below[605]) to be 105 bps.[606] Mr. Coyne's size premium of 105 bps is the difference between decile 2 (reflective of the median size of the electric proxy groups) and decile 7 (reflective of the size of FBC). Had Mr. Coyne used the *average* proxy group size (decile 1) rather than the median, the size premium would have been 127 bps. Comparing deciles in this fashion allows for consideration of the relative difference in size between the proxy companies and the subject utility, FBC.

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[605] Exhibit A2-3, Lesser Report, p. 56.

[606] Exhibit B1-8-1, Appendix C, Concentric Report, p. 5, footnote 3.

Table 1: CRSP Size Premiums, 2021

Decile	Market Capitalization Range (Millions of US$)		Size Premium
	Low	High	
1	$29,025.80	$1,966,078.88	-0.22%
2	$13,178.74	$28,808.07	0.49%
3	$6,743.36	$13,177.83	0.71%
4	$3,861.86	$6,710.68	0.75%
5	$2,445.69	$3,836.54	1.09%
6	$1,591.87	$2,444.75	1.37%
7	$911.586	$1,591.77	1.54%
8	$451.955	$911.103	1.46%
9	$190.019	$451.8	2.29%
10	$2.194	$189.831	5.01%

363. At the hearing, Dr. Lesser suggested a different approach to using Duff and Phelps values, which involved just adding the value in the right column to each proxy company based on the size of the proxy company.[607] However, his approach would yield the counter-intuitive results that (a) the larger the proxy companies, the smaller the size premium conferred upon the target company; (b) the size premium yielded by the table would be negative (-0.22%) when proxy companies are in the largest decile; and (c) since Dr. Lesser's approach does not directly account for the size of the subject company, a tiny subject utility in decile 10 would ostensibly get the same size premium as a subject utility in decile 5; in fact, his approach actually creates a larger size premium for FEI (approximately 100 bps for the US gas proxy group and 73 bps for the North American gas proxy group) than it does for FBC (40 bps for the North American proxy group and 30 bps for the US proxy group), despite FEI being significantly larger.

364. The BCUC has previously found, exercising a judgement-based approach, that the authorized ROE for FBC should be 40 basis points higher than that of FEI due, in part, to the small size of FBC.[608] This is smaller than what the Duff and Phelps table would indicate.

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607 Tr. 4, p. 467, l. 26 – p. 469, l. 3 (Lesser).

608 Exhibit B1-9, BCUC IR1 57.1.

365. In short, the BCUC should find that Mr. Coyne's CAPM results for FBC are very conservative by virtue of not including size premium of 105 bps, or alternatively a minimum of 40 bps.

G. FLOTATION COSTS AND FINANCING FLEXIBILITY ARE KEY COMPONENTS OF A FAIR RETURN

366. FEI submits, for the reasons articulated below, that it is reasonable to add 50 bps to the results of the ROE modelling for flotation costs and financing flexibility, consistent with the longstanding practice in BC and other Canadian jurisdictions. Alternatively, if the BCUC wishes to address these considerations in the common equity ratio, the proposed common equity ratios of FEI and FBC should be increased.

(a) BCUC and Other Canadian Regulators Consistently Make the ROE Adjustment

367. The BCUC has approved a 50 bps adder in each of the last two cost of capital proceedings.[609] In the 2013 GCOC Decision, the BCUC referenced a description of the flotation and financing flexibility allowance as consisting of: (1) flotation costs comprising financing and market pressure costs arising at the time of the sale of new equity; (2) a margin, or cushion, for unanticipated capital market conditions; and (3) a recognition of the "fairness" principle.[610]

368. The BCUC is not alone in this regard. Regulators in Alberta, Ontario, Quebec, New Brunswick, Newfoundland and Labrador and PEI, consistently allow an ROE adder for flotation costs and financing flexibility. (With respect to the remaining provinces: Saskatchewan and Manitoba do not employ regular ROE analysis and Nova Scotia is a negotiated settlement). Only Quebec deviates from the 50 bps adder, instead adding 30-40 bps.[611]

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609 2013 GCOC Stage 1 Decision, p. 80; 2016 GCOC Decision at pp. 84-85.

610 2013 GCOC Decision, Stage 1, at p. 80 and 2016 FEI Decision, at pp. 84-85.

611 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 70-71.

369. As discussed next, the longstanding practice of Canadian regulators is rooted in sound principle.

(b) Shareholder Requires Compensation for Issuance Costs that Are Not Addressed in DCF and CAPM Models

370. Mr. Coyne explained that, since cost of capital models use secondary market trading data as inputs, the model outputs do not account for issuance costs incurred by the shareholder (Fortis Inc.) to raise equity on behalf of FEI and FBC.[612] Dr. Lesser has acknowledged that issuance costs are real costs.[613] The issuance cost debate in the current proceeding focussed on two issues: (1) whether the issuance costs should be recognized by the ROE adder, in operating expenses or by increasing FEI/FBC's common equity ratio; and (2) whether the typical amount awarded by BCUC and other Canadian regulators (50 bps) is appropriate. FEI submits, for the reasons set out below, that the typical 50 bps adder remains an appropriate way to reflect issuance costs that is consistent with the Fair Return Standard.

Treating Flotation Costs as Operating Costs Does Not Compensate the Shareholder

371. A key to understanding why regulators in Canada consistently allow utilities to recover flotation costs as a component of ROE, rather as an operating expense, is that most large Canadian utilities (including FEI and FBC) are not stand alone utilities that issue their own equity. FBC and FEI rely entirely on Fortis Inc. to raise equity and inject capital into the operating utility business.[614] Treating issuance costs actually incurred by the shareholder (Fortis Inc.) as an operating cost of FEI or FBC would leave the shareholder uncompensated because *FEI and FBC do not earn any return on operating expenses that would flow back to Fortis Inc*.

372. As Commissioner Morton observed, and Mr. Coyne confirmed, the effect of the ROE adder for flotation costs is to treat issuance costs as if they are rate base item on which FEI

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612 Tr. 3, p. 343, ll. 8-22 (Coyne).

613 E.g., Exhibit B1-41, Lesser Illinois Testimony, p. 54: "The issuance of equity is not without cost."

614 Exhibit A2-33, BCUC Witness Aid, p. 54.

and FBC earn a return that flows back to Fortis Inc. as compensation for incurring the costs.[615] This is appropriate; Mr. Coyne noted that "unlike debt, equity has an indefinite life and does not mature. Therefore, costs associated with the equity issuance are recovered over the life of the equity."[616]

373. Moreover, Mr. Coyne explained that Fortis Inc.'s issuance costs remain on its balance sheet permanently, and thus represents a permanent and ongoing cost to the parent company:

> You know that they've issued equity, you know it's not for free, and the flotation cost is the estimate of what it costs companies to provide equity capital. Not the return on, issuance costs include things like printing costs and legal fees and the other things that just go into what you get. And when you issue -- if Fortis Inc. were to issue a million dollars in equity, it would get back from their banker at the end of the day something a little bit less than a million. It might be -- it might $985,000. The difference between those two are the net proceeds, and that's what we call the flotation costs. And we put that on the balance sheet [of Fortis Inc.] and say that's going to be a permanent cost of that equity, and that's what we'll account for on the float.[617] [Emphasis added.]

374. There is academic support for the approach that Canadian regulators have been using. In his 2006 book, *New Regulatory Finance*, Dr. Roger Morin supports recovery of flotation costs through an adjustment to the authorized ROE rather than as an expense regardless of whether common equity was issued in a particular year. Dr. Shannon P. Pratt also recognizes the appropriateness of recognizing flotation costs in ROE in her book *Cost of Capital Estimation and Applications*, stating:

> Flotation costs occur when new issues of stock or debt are sold to the public. The firm usually incurs several kinds of flotation or transaction costs, which reduce the actual proceeds received by the firm. Some of these are direct out-of-pocket outlays, such as fees paid to underwriters, legal expenses, and prospectus preparation costs. Because of this reduction in proceeds, the firm's required

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615 Tr. 3, p. 346, ll. 20-25 (Coyne).

616 Exhibit B1-13, RCIA IR1 31.3.

617 Tr. 3, p. 344, l. 15 – p. 345, l. 3 (Coyne). Mr. Coyne clarified in a subsequent exchange that he was referring to the balance sheet of Fortis Inc., not the balance sheet of FEI and FBC.

> returns on these proceeds equate to a higher return to compensate for the additional costs. Flotation costs can be accounted for either by amortizing the cost, thus reducing the cash flow to discount, or by incorporating the cost into the cost of capital. Because flotation costs are not typically applied to operating cash flow, one must incorporate them into the cost of capital.[618]

375. Dr. Lesser, in prior evidence filed in the US in 2002, had advocated addressing unrecovered issuance costs through an adjustment to ROE.[619]

Issuance Costs for Stand Alone FEI / FBC Would Be Higher than for Large Proxy Companies

376. Dr. Lesser provided data on typical issuance costs as a percentage of equity issued, and Mr. Coyne agreed that the data sounded reasonable.[620] Mr. Coyne translated Dr. Lesser's data into basis points of ROE, indicating that issuance costs of that magnitude represent approximately 21-25 bps of ROE for the US gas proxy group and 19-25 bps based on the US electric proxy group.[621]

377. Mr. Coyne noted, however, that "The larger the scope and scale of the company generally the lower the floatation cost and vice versa."[622] The proxy companies are much larger than FEI and FBC, and the BCUC must treat FEI and FBC on a stand-alone basis.[623] Mr. Coyne explained that FEI and FBC, on a stand-alone basis, could be expected to have much higher issuance costs than Fortis Inc., for instance.[624]

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618 Exhibit B1-20, BCUC IR2 83.3; Exhibit B1-21, Concentric Rebuttal, pp. 21-22.

619 Exhibit B1-41, Illinois Testimony, p. 54 (Lesser)

620 Tr. 4, p. 624, ll. 5-17 and p. 625, ll. 6-23 (Coyne). Mr. Coyne noted that his previous lower estimate of 10-15 bps had been unrefined; he had made no attempt to account for factors like issuer size.

621 Exhibit B1-9, BCUC IR1 6.1 (in Exhibit A2-33, BCUC Witness Aid, p. 60); Mr. Coyne's calculations based on Dr. Lesser's evidence are included in Attachments 6.1A and 6.1B.

622 Tr. 3, p. 351, ll. 20-22 (Coyne). See also Tr. 4, p. 624, ll. 5-11 (Coyne), where Mr. Coyne explained that this is due to some costs being fixed.

623 See discussion in Part Four, Section C (FEI) and Part Six, Section D above.

624 Exhibit B1-9, BCUC IR1 43.3.1.

378. FEI submits that, based on the above evidence, the BCUC should find that issuance costs for FEI and FBC are reasonably estimated as being at least 25 bps.

(c) The Utility Should Be Compensated for Maintaining Additional Equity for Financing Flexibility

379. The remainder of the 50 bps ROE adder typically allowed by the BCUC and other Canadian regulators recognizes the importance of financial flexibility. As described below, the adder is fundamental to meeting the Fair Return Standard in two ways. First, it compensates the utility for maintaining a buffer of equity above the deemed equity ratio, which is key to financial integrity. Second, from the perspective of comparable earnings and capital attraction, it goes some way to addressing the lower overall returns in Canada relative to US companies with whom Canadian utilities compete for capital.

The Evidence Demonstrates the Importance of Financial Flexibility

380. In essence, financial flexibility means having the ability to raise capital under a variety of economic and market conditions, including periods such as the financial crisis of 2008 and 2009 and the COVID-19 pandemic of 2020 to 2022.[625]

381. Utilities are capital intensive and do not necessarily have latitude to defer or avoid investments in the system. Stronger financial metrics facilitate obtaining debt financing.[626] Mr. Coyne elaborated:

> And it's an estimate based on -- that recognizes there are some real flotation costs that happen here, we know that that's part of the 50 basis points. And in addition to that along the way Canadian regulators have adopted an approach allowing some cushion around the cost of financial flexibility that's designed to allow for conditions that if I set the cost of capital precisely right and I allowed the flotation cost that's right to the penny, it's a little bit of a buffer in case market circumstances change and I want to allow a little bit of a degree above my estimated cost of capital for financial flexibility, that's the second piece of it. And

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[625] Exhibit B1-9, BCUC IR1 43.1.

[626] Tr. 3, p. 361, ll. 13-25 (Coyne).

> that's been the evolution of the 50 basis points, that's why they practice in Canada. But it is an estimate.[627]

382. Mr. Coyne characterized as impractical Dr. Lesser's suggestion to wait and see if a problem arises in raising capital. The suggestion would place utilities in a very difficult position in challenging market conditions when an immediate injection of capital is critical:

> So it's not practical -- intellectually I can understand what Dr. Lesser is saying. "Hey, we've got a need right now. Let's go knock on the Commission's door and say we need it right now." Well, that's a six-month process and a Commission -- a utility treasurer doesn't have that luxury. When they need capital, they need to go to the market then. And there are circumstances when that arise and they don't have the opportunity to come to the Commission and say it's unusual. So it does serve a purpose and the idea is to set a cost of capital that works for all anticipated market conditions and I don't think it's in anybody's best interest to have a utility coming back saying, "I need to make an adjustment right now because of COVID." There were many other things to worry about then that are more pressing.[628]

383. Dr. Lesser expressed multiple times his belief that there is no evidence that raising capital has been a problem for FEI and FBC.[629] In fact, there is ample evidence on the record to support the need for a strong balance sheet to provide financial flexibility, particularly in adverse market conditions.[630] It includes:

(a) FortisBC's Rebuttal Evidence provided market data demonstrating that debt issuers with A and BBB ratings were effectively shut out of the debt markets for periods during the financial crisis and the early days of the COVID-19 pandemic. There was no debt issuance in the Canadian market by either A or BBB rated companies in October 2008. For the majority of 2008 (8 out of 12 months) and the first several months of 2009, BBB (i.e., FBC's Moody's rating) or lower rated issuers were not able to issue bonds in the Canadian marketplace. The US Federal Reserve's characterization of the markets following the collapse of Lehman

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627 Tr. 3, p. 347, l. 21 – p. 348, l. 11 (Coyne).

628 Tr. 3, p. 369, ll. 10-26 (Coyne).

629 Tr. 3, p. 366, ll. 4-9 (Lesser). See also Tr. 3, p. 365, ll. 5-11 (Lesser).

630 Exhibit B1-27, CEC IR2 90.1.

Brothers was that "funding markets for terms beyond overnight largely ceased to function".[631]

(b) FEI and FBC maintain $700 million and $150 million credit facilities, respectively, and these credit facilities are extended on an annual basis to maintain a 5-year maturity period to avoid a situation where FortisBC would be required to renew its credit facilities during periods of significant market disruptions. However, on advice from FortisBC's lenders and due to significant market volatility in 2020, FortisBC did not extend these facilities and thus was not able to maintain a 5-year maturity period. The shorter maturity period for the credit facilities increased refinancing risk until the next extension.[632]

(c) A report by the Edison Electric Institute from February 2009 described how the financial crisis impacted utilities' equity financing as follows: "Equity financing also has been difficult to secure, and utility deals have been scarce." The Report stated:

> Equity investors also scrutinize a utility's regulatory environment carefully. A key determinant of a supportive climate is an allowed return on equity (ROE) that provides adequate compensation for the risk such investors must assume in buying the common stock of a company. In light of the changes in the financial markets in recent months, the current level of ROEs in many jurisdictions likely is to be considered an inadequate recompense for the significant degree of additional risk that now exists in the capital markets.[633]

(d) Mr. Coyne also highlighted several examples of utilities having difficulty raising capital during the financial crisis and Covid-19 pandemic:

> If you were to look at the spring of 2020 which we know was extraordinary, but there were A rated utilities that either had to pull back from the market or they were shocked by the spreads that they were paying. Florida Power & Light, for example went out to

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631 Exhibit B1-21, FortisBC Rebuttal, pp. 3-4.

632 Exhibit B1-27, CEC IR2 84.1.

633 Exhibit B1-21, FortisBC Rebuttal, p. 5.

> market for debt and they're an A rated utility, they're as strong as they come by. And their spread ballooned over treasuries over what they had paid previously. And the same is true for many highly rated utilities and some even pulled back out of the market because they felt as though they couldn't raise debt right then.[634]

(e) Mr. Coyne noted that, even in the current market conditions, he has seen "…multiple utility companies that ordinarily would be accessing equity from their parent companies, selling off portions of their system in order to not have to go to equity markets because they're so unfavourable right now." A financing flexibility ROE adder would help to overcome those challenges.[635]

ROE Adder Compensates for Equity Buffer Above Deemed Common Equity Ratio

384. The ROE adder also compensates FEI and FBC for maintaining a buffer of equity over the approved equity thickness to manage financing needs and ensure that the utility is not over-leveraged.

385. FEI is precluded by BCUC-imposed ring-fencing conditions from having less equity in its capital structure than its deemed common equity ratio.[636] As a practical matter, this condition necessitates FEI holding additional equity in case it must issue debt for unforeseen reasons (which would dilute its equity ratio). In 2021, for instance, FEI's actual average common equity thickness was 39.90%, or 140 basis points higher than its deemed common equity ratio for ratemaking purposes. The key point is that FEI was not able to earn the allowed ROE on 140 basis points of invested equity, despite the fact that the equity buffer was needed to prudently manage its financing needs and comply with BCUC ring-fencing conditions.[637]

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634 Tr. 3, p. 368, l. 24 – p. 369, l. 9 (Coyne). See also Exhibit B-26, BCOAPO IR2 86.2 on Rebuttal Evidence.

635 Tr. 4, p. 629, ll. 5-17 (Coyne).

636 BCUC Order No. G-116-05: "Each Terasen Utility [i.e., FEI] shall maintain, on a basis consistent with BCUC orders and accounting practices, a percentage of common equity to total capital that is at least as much as that determined by the Commission from time to time for ratemaking purposes."

637 Exhibit B1-50, Undertaking No. 4; Exhibit B1-51, BCUC Undertaking IR 2.1.1.

386. FBC takes the same approach of maintaining a buffer above its deemed equity ratio. Even in the absence of ring-fencing conditions, there is a general expectation on the part of Canadian regulators that utilities will not finance deemed equity with debt as it will affect the utility's credit standing.[638]

387. The combined result of (i) deeming a common equity ratio and (ii) precluding the utility (whether by order or expectation) from allowing the actual common equity ratio to be below the deemed ratio, is to reduce the effective allowed overall rate of return below what the regulator has otherwise determined meets the Fair Return Standard. The practice of most Canadian regulators to apply a premium to the approved ROE is implicitly recognizing, and rectifying, this issue.[639] In short, it is essential to comply with what the law says is the "absolute" obligation on regulators to set, and allow the utility an opportunity to earn, a Fair Return.

388. Dr. Lesser's observation that US regulators do not include an adder for financing flexibility overlooks a key distinction between how Canadian and US regulators approach capital structure. The majority of US regulators do not "deem" the equity thickness in the same way, and account for the utility's actual stand-alone capital structure at the end of the test year. Most U.S. utility regulators allow utility management discretion to manage the capital structure within reasonable boundaries.[640]

389. Moreover, it is unnecessary for US regulators to consider an adder for financing flexibility when overall allowed returns are so much higher compared to Canada. In 2020 and 2021, US gas and electric utility allowed returns were in the range of 9.5% on an average of approximately 50%-52% equity.[641] In other words, "that's their cushion that they have over a

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638 Exhibit B1-50, Undertaking No. 4; Exhibit B1-51, BCUC Undertaking IR 2.1.1.

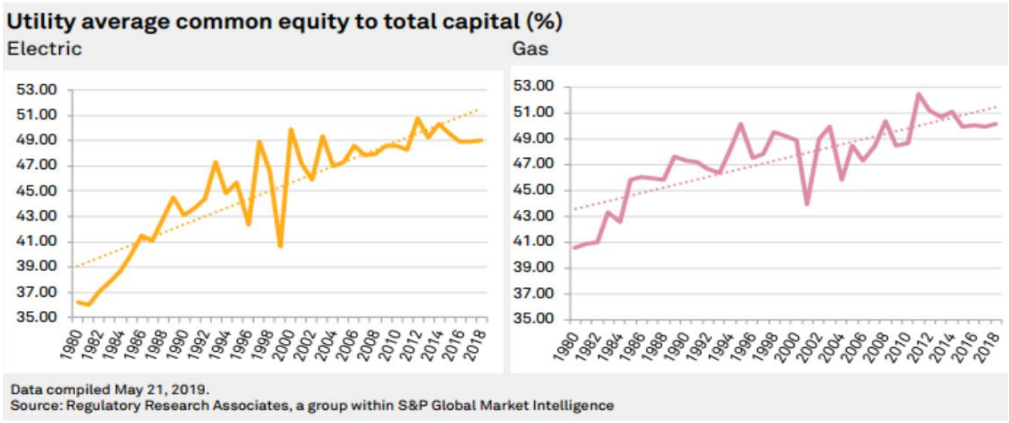
639 Exhibit B1-50, Undertaking No. 4; Exhibit B1-51, BCUC Undertaking IR 2.1.1.

640 Exhibit B1-10, BCOAPO 1.37.3; Exhibit B1-50, Undertaking No. 4; Exhibit B1-51, BCUC Undertaking IR 2.1.1.

641 Tr. 3, p. 367, ll. 23-25 (Coyne, misattributed to Dr. Lesser). Exhibit B1-8-1, Appendix C, Concentric Report, pp. 119, 142, 149.

Canadian company."[642] The following figures show the average authorized common equity ratios for US utilities, and the extent to which they have increased over time.[643]

Figure 5: Authorized U.S. Equity Ratios – 1980-2018[24]



390. Mr. Coyne emphasized that the standard financing flexibility adder still falls well short of making up for the higher overall allowed returns of US utilities, leaving Canadian utilities at a disadvantage when competing for capital:

> But the way I've always looked at it is it's a movement towards recognition that Canadian utilities are thinly capitalized versus other American utilities, and it's some buffer to move them closer to competitiveness in terms of their allowed returns and capital structures. It doesn't go anywhere's near closing that gap, but that's one of the roles it serves. But if you look at a U.S. gas utility or an electric utility with an allowed return of, in the neighbourhood of 9 and a half to 10 percent with a 52 percent equity ratio, they don't have that same need. So it doesn't exist for them. It exists in their allowed capital structure or their ROE.[644]

391. As discussed in Part Four and Six, the proposed common equity ratios for FEI and FBC, combined with the proposed ROEs, will not eliminate the gap with US utilities on a business

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642 Tr. 3, p. 366, ll. 15-17 (Coyne).

643 Exhibit B1-21, Concentric Rebuttal, p. 26.

644 Tr. 3, p. 367, ll. 2-15 (Coyne, misattributed to Dr. Lesser).

risk-adjusted basis.[645] So long as a gap remains, there is a compelling reason for the BCUC to maintain the long-standing practice of adding 50 bps to the ROE model outputs.

(d) The ROE Adder Is Preferable to Additional Equity Thickness

392. Dr. Lesser responded to Mr. Coyne's comments about the challenge posed by Canadian utilities being more thinly capitalized than US utilities by suggesting that it could be addressed instead through thicker common equity ratio.[646] He filed an article that advocated for companies having less financial leverage during times of financial instability to facilitate raising capital.[647] Mr. Coyne confirmed that it is possible to provide additional financing flexibility by increasing the common equity ratio.[648] The evidence shows there are advantages to the current approach.

393. Mr. Coyne's Weighted Average Cost of Capital analysis, prepared at the request of the BCUC, determined that FEI's deemed equity ratio would need to increase by 2.0 to 2.3% for FEI to account for recovery of flotation costs and financial flexibility through the deemed capital structure. FBC's common equity ratio would have to increase by 2.1%. The results are summarized in the following table.[649]

Table 1: Adjustment to Equity Ratio for Flotation Costs and Financial Flexibility

	Equity Ratio	Adjusted for Flotation and Financial Flexibility
FEI – current	38.5%	40.51%
FEI – proposed	45.0%	47.34%
FBC – current/proposed	40.0%	42.10%

645 Exhibit B1-51, BCUC Undertaking IR 1.1; Tr. 3, p. 367, ll. 2-15 (Coyne, misattributed to Dr. Lesser).

646 Tr. 3, p. 370, ll. 1-9 (Lesser).

647 Exhibit A2-28.

648 Tr. 3, p. 357, l. 5 – p. 358, l. 8 (Coyne); Tr. 3, p. 368, ll. 7-16 (Coyne).

649 Exhibit B1-50, Undertaking No. 2, Attachment U.2.

394. However, Mr. Coyne "continues to believe that flotation costs and financial flexibility should be recovered through an adjustment to the authorized ROE of 50 basis points for each company.[650]

395. While Canadian regulators have not previously articulated the rationale for using an ROE adder, the widespread use of an ROE adder is no accident. There are various reasons why an ROE adder continues to make sense, for instance:

(a) Mr. Coyne observed that an ROE adder can be measured using the DCF model and directly improves two interest coverage metrics.[651]

(b) An ROE adder has the benefit of being visible, a clear recognition of the compensation for the utility holding additional equity above the deemed common equity ratio. Regardless of the common equity ratio deemed by the BCUC, FEI and FBC will still have to maintain a buffer. In other words, if the BCUC were to increase the common equity ratio to recognize FEI and FBC are holding a buffer for financing flexibility, FEI and FBC would still have to hold a buffer over that higher deemed equity ratio. This doesn't preclude the alternative approach of translating the adder to additional equity, but the ROE adder is transparent and its purpose defined.

(c) The existing 50 bps adder is helping to sustain FEI's and FBC's existing credit ratings and has been in place for many, many years. As discussed in Parts Four and Six, FEI and FBC (particularly FBC) have challenging credit metrics at present. Moody's November 2021 rating report for FBC, for instance, discussed the ongoing GCOC proceeding stating that it "assumed that there will be no changes stemming from this decision that would put downward pressure on financial metrics."[652] The

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[650] Exhibit B1-50, Undertaking No. 2, Attachment U.2. Mr. Coyne provided analysis for 35 bps and 40 bps in Exhibit B1-51, BCUC Undertaking IR 2.4.

[651] Exhibit B1-51, BCUC Undertaking IR 1.3.

[652] Exhibit B1-21, FortisBC Rebuttal, p. 8.

removal of the adder could be viewed as credit negative – particularly if the adjustment becomes (as Mr. Coyne cautioned) "lost in broader business and financial risk considerations if evaluated with equity ratios."[653] Mr. Coyne observed: "Although the rating agencies say they look at both the authorized ROE and the allowed equity ratio, in Mr. Coyne's experience they tend to focus more on the authorized ROE than the regulatory capital structure when evaluating regulatory decisions."[654]

H. SEVERAL REASONABLENESS CHECKS SUPPORT MR. COYNE'S RECOMMENDED ROE

396. We addressed in Section A of this Part how rising interest rates since 2016 suggest an increased cost of equity. There are other objective indicators, discussed below, that reinforce the reasonableness of Mr. Coyne's ROE recommendations.

(a) The BCUC AAM, Which the BCUC Had Abandoned for Producing Unreasonably Low ROEs, Would Have Produced an ROE of 9.83% for FEI

397. Mr. Coyne calculated what the BCUC AAM would have produced for the benchmark utility (FEI) based on data current to October 2022, using the 2016 approved FEI ROE of 8.75% as the starting point. The result for FEI was 9.83%[655]. In order to derive FBC's ROE using the BCUC AAM, one would add 40 bps risk premium to the output of the AAM, yielding an ROE of 10.23%. These results approach are only slightly below Mr. Coyne's multi-stage DCF model and CAPM results and the Lesser Multi-Stage DCF Results for FEI. The Lesser CAPM Results, by contrast, are both directionally inconsistent with the ostensible BCUC AAM output and significantly lower. (See the Figures in Section A of this Part.)

398. Notably, the BCUC had identified that "the potential for downward bias exists" with the AAM when long-term government bond yields were low, and incorporated a provision

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653 Exhibit B1-51, BCUC Undertaking IR 1.3.

654 Exhibit B1-51, BCUC Undertaking IR 1.3.

655 Tr. 5B, p. 937, l. 17 – p. 938, l. 3 (Coyne).

that the AAM would only operate when long-term government bond yields exceeded 3.8%.[656] Long-term government bond yields were at 3.38% at the time of the oral hearing,[657] below that threshold. As such, the logic underlying the BCUC's prior decisions in respect of the AAM suggests that the 9.83% that Mr. Coyne calculated as an ostensible BCUC AAM output likely understates the fair ROE for FEI. The same would be true for the 10.23% for FBC. In short, the BCUC AAM reinforces that Mr. Coyne's recommended ROEs are a fair estimate of the return that equity investors currently expect.

(b) Ontario AAM ROE as of September 2022 Was 9.36% and Would Be Higher Now

399. The Ontario Energy Board recently adjusted ROEs based on its AAM to 9.36% as of September 2022. Government bond yields and bond spreads are the key inputs in the Ontario AAM. As noted in Section C(b) above, the September 2022 bond yield data had yet to fully reflect the impacts of the significant interest rate changes over the summer, which supressed the Ontario AAM results. Mr. Coyne noted at the oral hearing that government bond yields and bond spreads have since increased, such that the Ontario AAM would produce a higher ROE if re-determined today. Mr. Coyne stated his expectation "that based on where we are with capital markets that the OEB's formula would probably produce numbers that are higher than 9.36% for next year. And depending upon where we go with bond yields, a higher number the year after that."[658]

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656 In Order G-75-13, p.91: "Given that a rise in the long Canada bonds yields may be driven by monetary policy and not a change in market conditions, and there is no evidence to suggest there would be a corresponding change in utility bond rates, the Commission Panel accepts that a potential for downward bias exists. To deal with this the Commission Panel directs that any change in ROE resulting from the AAM formula be subject to an actual long Canada bond yield of 3.8% being met or exceeded. Accordingly, the AAM formula will not be operative as long as the long Canada bond yield is below 3.8 percent." Since 2013, the Canadian long-term bond yield remained below the 3.8% threshold, and in 2016, BCUC Order G-26 129-16 suspended the AAM formula indefinitely.

657 Tr. 5B, p. 938, l. 17 (Coyne).

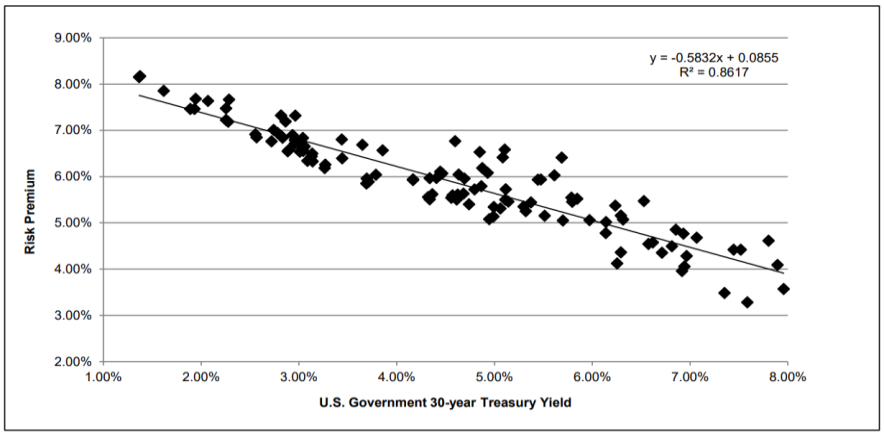
658 Tr. 5B, p. 939, ll. 5-9. See discussion at Tr. 5B, p. 934, l. 4 – p. 939, l. 9 (Coyne).

(c) Risk Premium Model: Allowed ROEs Highly Correlated With Government Bond Yields

400. As discussed briefly in Section A of this Part, Mr. Coyne used the Risk Premium model as a reasonableness check on his ROE recommendation. We explain below why the results supported Mr. Coyne's recommendations.

401. Mr. Coyne's Risk Premium model involved examining the allowed ROEs from 700 gas utility company rate cases and 859 electric utility company rate cases in the US from January 1992 through December 31, 2021, as reported by Regulatory Research Associates. He determined that there is a high correlation between allowed ROEs and government bond yields – R2 values of 0.86 for gas utilities and 0.82 for electric utilities. The following scatterplot illustrates the relationship for gas utilities, and a similar figure for electric utilities is included in Mr. Coyne's Report.[659]

Figure 31: Risk Premium Results – U.S. Gas



402. Mr. Coyne explained the significance of this high correlation as follows:

> So what this is trying to get at is how did utility commissions interpret everything that they looked at in these 1500 some odd cases and make a decision regarding allowed return in the investment environment they were in characterized by the bond yield in that period of time? And you can see the -- that's a very strong linear relationship as you can see the trendline.

---

659 Exhibit B1-8-1, Appendix C, Concentric Report, Exhibit JMC-FEI 9 (PDF pp. 406-407).

> And as I was discussing with Ms. Worth earlier, there is an inverse relationship expressed here. So that as bond yields go up, the risk premium that utility commissions have awarded goes down and vice versa. And I'm estimating that relationship because what I want to do is ask myself, given today's bond yields or projected bond yields, and everything we know about these 1500 decisions, what would a regulator say about the allowed return, with no other information available to them but just based on bond yields.
>
> And it says that 86 -- you can explain 86 or 82 percent of those decision just based by on knowing that bond yield in that period of time. It's a pretty strong association.[660]

403. Mr. Coyne applied the statistics to current and forecast bond yields.[661] The results based on October 2022 forecast bond yields were 10.12% based on the US Gas proxy group and 10.16% for the US Electric proxy group. The results based on *current* bond yields (Dr. Lesser's preference) would be slightly higher because forecast government bond yields are lower than the current government bond yield.

404. These numbers are consistent with Mr. Coyne's recommended ROEs for FEI and FBC, both in terms of direction and magnitude. It is important to recognize that these ROE values are determined with reference to US utilities that have, on average much thicker common equity ratios than FEI or FBC. As discussed in Section E of this Part, other things being equal, one would expect the ROE values to be higher when applied to a utility with thinner equity.

I. CONCLUSION AND REQUESTED FINDING

405. The BCUC should accept Mr. Coyne's recommended ROEs for FEI and FBC as meeting the Fair Return Standard. They are based on sound methodology, they are intuitive in the current market circumstances, align with the DCF results based on Dr. Lesser's

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[660] Tr. 4, p. 654, l. 18 – p. 655, l. 16 (Coyne).

[661] Tr. 4, p. 658, ll. 6-18 (Coyne).

recommendations, and are supported by various reasonableness checks. The BCUC should find that the Lesser CAPM Results are outliers, unreasonably low and counterintuitive.

PART EIGHT: OTHER ISSUES

406. This Part addresses other issues raised in the proceeding, including the potential adoption of an AAM, triggers for future cost of capital proceedings, the implementation of the order and next steps.

A. AUTOMATIC ADJUSTMENT MECHANISM IS NOT WARRANTED

407. Mr. Coyne's report and FortisBC's evidence address AAMs, providing historical context for this issue and discussing the major drawbacks of an AAM approach. FortisBC submits that the BCUC should continue to use periodic regulatory proceedings to set ROE, rather than implement an AAM.

408. AAMs are now uncommon in Canada, according to Concentric's jurisdictional survey.[662]

409. FortisBC submits that attempts to mechanize the cost of capital may lead to ROE values that do not meet the Fair Return Standard, particularly in uncertain market conditions. In addition, AAMs do not create any significant regulatory efficiency, as there is still the need to periodically review the base ROE, formula parameters and their weightings.[663]

410. Concentric's opinion is that an ROE formula can perform reasonably well when economic and capital market conditions are relatively stable and predictable. However, an AAM may not produce returns that meet the three elements of the Fair Return Standard when there are major disruptions to the economy and capital markets, such as the 2008-2009 financial crisis and the 2020-2022 COVID-19 pandemic, extended periods of declining or increasing bond yields, or periods of high inflation.[664]

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662 Exhibit B1-8-1, Appendix C, Concentric Report, pp. 152-155; Exhibit B1-9, BCUC IR1 61.10.

663 Exhibit B1-8, Application, pp. 56-61.

664 Exhibit B1-9, BCUC IR1 61.2.

411. FortisBC notes that bond spreads are still below the 3.8 trigger point in the previous AAM, which was implemented by the BCUC to recognize the potential for downward bias in ROE results when bond spreads are low (See Part Seven, Section H). FEI submits that there is little benefit in approving an AAM when it is unknown whether it will even operate.

412. As FortisBC concluded that a regulatory proceeding is preferable to a mechanical formula, its evidence did not address details related to an AAM such as specifications, frequency or effective date. If the BCUC determines that an AAM formula is appropriate, FortisBC would need to perform more extensive research and consider the possible options and best practices (if any). FortisBC respectfully requests that if the BCUC determines that AAM approach is appropriate, the consideration of the formula's specifications, frequency and effective date be considered in a further stage of the proceeding.[665]

B. TRIGGERS FOR FUTURE APPLICATIONS

413. FortisBC believes that the BCUC should not establish a trigger for future cost of capital proceedings in advance. The established approach, which includes periodic review of utilities' cost of capital, is most appropriate.

414. FortisBC is not aware of any regulator in Canada that uses an automatic trigger mechanism to initiate cost of capital review nor is able to formulate a trigger mechanism that can capture all of the various factors that can impact the investors' opportunity cost.[666]

415. As explained in Mr. Coyne's evidence, off-ramps are often used in incentive rate-setting plans to trigger a review of the plan in the event that the company's actual earned ROE is below or above a specified level and indeed similar off-ramp mechanisms already exist in FEI's and FBC's Multi-year Rate Plans. Cost of capital proceedings, however, are focused on estimating the "opportunity cost" and there is no basis to rely on the variance between realized and allowed

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[665] Exhibit B1-9, BCUC IR1 61.10.

[666] Exhibit B1-8, Application, p. 62.

ROEs to initiate a cost of capital proceeding since this variance does not necessarily reflect the changes in investors' opportunity cost nor the changes in market conditions. Numerous business and capital market factors affect the cost of capital for utilities and these factors are inherently dynamic. In Mr. Coyne's expert opinion, there is no need to change the current approach of conducting periodic cost of capital reviews. Periodic cost of capital proceedings, conducted every three to five years, is the best approach to ensure that the authorized return remains appropriate for BC utilities.[667]

C. IMPLEMENTATION OF ORDER

416. The BCUC invited participants to address the effective dates for FEI and FBC's cost of capital determinations. FEI and FBC submit that, for the following reasons, January 1, 2023 is the most appropriate effective date. The BCUC has (in its Annual Review orders) kept FEI's 2023 delivery rates interim pending the GCOC decision, and ordered the establishment of a deferral account for FBC to capture the impacts of the GCOC decision on 2023 rates, which retain the BCUC's ability to implement a January 1, 2023 effective date.

417. First, the evidence on which the BCUC decision is based was filed between mid 2021 and December 2022. The expert evidence is clear that cost of capital analysis is best undertaken based on recent data, so as to reflect current investor expectations. There would be no logic to delaying the implementation beyond January 1, 2023, as that would increase the lag between the evidence/data and the outcome.

418. Second, an implementation delay gives rise to a legal concern related to the "absolute" right of a utility to an opportunity to earn a Fair Return. The BCUC is determining what constitutes a Fair Return as of late 2022 (i.e., based on evidence and data current to late 2022), but would then be depriving FEI of any opportunity to earn that return during a time when the assessment would logically be expected to be the most applicable and accurate.

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[667] Exhibit B1-8-1, Appendix C, Concentric Report, p. 156.

419. The cost of capital is a real cost of providing service to customers, just like operating expenses or capital costs. The BCUC grants interim rates in revenue requirements proceedings, and trues-up the difference between interim and permanent rates, because it recognizes that failing to do so would mean the shareholder would end up bearing prudently incurred costs and, as a consequence, be unable to earn its allowed return. Deferring the implementation date of this GCOC order would have the same effect as not granting interim rates in a revenue requirements proceeding – the shareholder would unfairly bear a legitimate cost of providing utility service to customers, and consequently be unable to achieve the Fair Return.

420. Third, an mid-year effective date would mean that FortisBC would have to calculate the revenue requirement impact of a change in the earned return mid-year, and would have to determine how such a mid-year change would be applied to rate base. Such a calculation would be complicated and would be inconsistent with the effective date of when FortisBC's annual rates would be made permanent.[668]

D. TIMING AND PROCESS OF STAGE 2 PROCEEDING

421. FEI and FBC are unaffected by Stage 2. FAES will make its own submissions on this point in accordance with the time the BCUC has specified for participants other than FEI and FBC to file submissions.

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[668] Exhibit B1-9, BCUC IR1 2.2.

PART NINE: CONCLUSION AND ORDER SOUGHT

422. The evidence in this proceeding related to business risk, ROE modelling and credit ratings, overwhelmingly demonstrates that the cost of capital for FEI and FBC has increased since the BCUC last set the allowed ROE and common equity ratio for these utilities. FEI submits that, based on the totality of the evidence, the Fair Return Standard is met for FEI with a ROE of 10.1%, based on a 45% common equity ratio. A fair return for FBC 10.1% based on the current 40% common equity ratio. The BCUC should approve FEI's and FBC's proposal.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated: December 23, 2022 ***[original signed by Matthew Ghikas]***
Matthew Ghikas
Counsel for FortisBC Energy Inc. and FortisBC Inc.

Dated: December 23, 2022 ***[original signed by Tariq Ahmed]***
Tariq Ahmed
Counsel for FortisBC Energy Inc. and FortisBC Inc.

Dated: December 23, 2022 ***[original signed by Courtney Gibbons]***
Courtney Gibbons
Counsel for FortisBC Energy Inc. and FortisBC Inc.

BOOK OF AUTHORITIES

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TAB 4

1928
*Oct. 24.
1929
*Feb. 5.

NORTHWESTERN UTILITIES, LIMITED ..... APPELLANT;

AND

THE CITY OF EDMONTON AND BOARD OF PUBLIC UTILITY COMMISSIONERS OF ALBERTA..... RESPONDENTS.

THE CITY OF EDMONTON..... APPELLANT;

AND

NORTHWESTERN UTILITIES, LIMITED, AND BOARD OF PUBLIC UTILITY COMMISSIONERS OF ALBERTA ..... RESPONDENTS.

ON APPEAL FROM THE APPELLATE DIVISION OF THE SUPREME COURT OF ALBERTA

Public utilities—Public Utilities Act, Alta.—Hearings and investigations by Board of Public Utility Commissioners—Powers of Board—Obtaining of evidence—Absence of evidence—Order of Board fixing rates for gas supply in municipality by franchise holder—Return on investment—Inclusion in "rate base" of discount on sale of bonds—Appeal from Board's order—"Question of law."

The Board of Public Utility Commissioners of Alberta made an order in 1922 fixing rates chargeable for gas proposed to be supplied in the city of Edmonton by the predecessor of the appellant company. The Board fixed the rates on the basis of an allowance of 10% as a fair return on the investment in the enterprise, and in determining the "rate base" (the amount to be considered as invested in the enterprise) it included as a capital expenditure a sum which was the discount on the sale of the company's bonds. The rates were to continue in force for three years from the date on which gas was first

*PRESENT:—Anglin C.J.C. and Mignault, Rinfret, Lamont and Smith JJ.

supplied. In 1926 the appellant company applied for continuation of the rates. On this application the city objected to such a high rate of return and to the inclusion in the rate base of the item for bond discount. The Board continued said item in the rate base, but reduced the return to 9% "in view of the elements which go to make up the rate base, and in view of the altered conditions of the money market." The parties appealed (by leave) to the Appellate Division, Alta., and then to this Court, the company against the reduction of the rate of return, and the city against the inclusion of the bond discount item in the rate base. The company contended that no evidence was adduced before the Board of "altered conditions of the money market," and that, without hearing evidence upon the point and giving the company opportunity to establish that the conditions of the money market had remained unaltered since 1922, the Board acted without jurisdiction in making the reduction. Under s. 47 of *The Public Utilities Act, 1923,* Alta., c. 53, as amended 1927, c. 39, an appeal lies from the Board upon a question "of jurisdiction" or "of law," upon leave obtained.

Held 1. The company's last mentioned contention involved a "question of law," and therefore it had a right to appeal.

2. The city's appeal failed; the question raised thereon was not one of jurisdiction or law.

3. The company's appeal failed. The Board had power to reduce the rate of return, notwithstanding that at the hearing before it no witnesses testified as to altered conditions of the money market. The company's contention that to alter the rate of return would be unfair to its shareholders who had invested in the enterprise after the order fixing the rates in 1922, was not a matter open for consideration upon the appeal, as it did not involve a question of jurisdiction or law.

Per Rinfret and Lamont JJ.: A consideration of ss. 21 (4) (5), 25, 43, and 44 of the said Act, the purposes of the Act, and the extent of the powers vested in the Board, leads to the conclusion that the intention of the legislature was to leave it largely to the Board's discretion to say in what manner it should obtain the information required for the proper exercise of its functions; it was not to be bound by the technical rules of legal evidence, but was to be governed by such rules as, in its discretion, it thought fit to adopt. An inference that it had not the proper evidence before it as to the altered conditions of the money market could not be drawn from the fact that no oral testimony in respect thereof was given at the hearing. The company had notice that a reduction was sought and that the city was attacking the methods and principles adopted in fixing the rate of return in 1922. This put the whole question of a fair return at large and informed the company that it would have to establish to the Board's satisfaction every element and condition necessary to justify a continuation of the 10% rate; and there was nothing in the record to justify the conclusion that the company had not the opportunity of making proof at the hearing as to the conditions of the money market.

Per Smith J.: The Board has power to reduce the rate of return without evidence; the question of a fair rate of return is largely one of opinion, hardly capable of being reduced to certainty by evidence, and appears to be one of the things entrusted by the statute to the judgment of the Board.

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APPEALS by Northwestern Utilities, Limited, and the City of Edmonton, respectively, from the dismissal by the Appellate Division of the Supreme Court of Alberta of their respective appeals from the award of the Board of Public Utility Commissioners for the Province of Alberta fixing rates to be paid by consumers of natural gas, for the supply of which within the city of Edmonton the said company, Northwestern Utilities, Limited, has a franchise.

The company applied to the Board for an order continuing the rates which had been fixed for a certain period by an order of the Board made in 1922. The Board made an award fixing the rates, from which each party appealed to the Appellate Division. Under s. 47 of *The Public Utilities Act* of Alberta, 1923, c. 53, as amended 1927, c. 39, an appeal lies from the Board to the Appellate Division "upon a question of jurisdiction or upon a question of law," if leave to appeal is obtained as therein provided. Such leave to appeal was obtained, it being reserved to each party to move before the Appellate Division to set aside the order granting leave to the other party, on the ground that the matters as to which leave to appeal was given did not involve any question of law or jurisdiction.

The company's objection to the Board's award was that it fixed the rates on the basis of an allowance of only 9%, instead of 10% which was allowed under the order made in 1922, as the "rate of return" on the investment in the enterprise. The Board in its award said:—

> In view of the elements which go to make up the rate base, and in view of the altered conditions of the money market, the Board believes it is justified in reducing the rate of return that the company shall be allowed, to nine per cent., and the Board's estimates are on that basis.

The company contended that there was before the Board no evidence of any "altered conditions of the money market," that the "elements which go to make up the rate base" were the same as in 1922, and afforded no reason for changing the rate of return, that to reduce the rate of return would be unfair to its shareholders, who had invested in the enterprise after the order fixing the rates in 1922, that the money was invested and the plant constructed on the strength of the principles laid down in the 1922 award, and that it was clearly understood that the principles then adopted would govern all future revisions.

The city's objection to the award was that, in determining the "rate base" (the amount to be considered as invested in the enterprise) it included (as it had done in the 1922 award) as a capital expenditure a sum which was the discount on the sale of the company's bonds.

The Appellate Division dismissed both appeals (no written reasons being given). Subsequently it made separate orders giving each party leave to appeal to the Supreme Court of Canada. On an application by both parties in the Supreme Court of Canada, the appeals were consolidated.

By the judgment of this Court both appeals were dismissed with costs.

E. Lafleur K.C. and *H. R. Milner K.C.* for Northwestern Utilities, Limited.

O. M. Biggar K.C. for the City of Edmonton.

The judgment of Anglin C.J.C. and Mignault J., was delivered by

ANGLIN C.J.C.—While, with my brother Smith, I incline to the view that the appellant company may have some reason to complain of unfairness in the judgment of the Board of Public Utility Commissioners reducing the rate of return from 10% to 9%, I agree with the conclusion reached by my brother Lamont and concurred in by my brother Smith that it is not open to us to entertain the appeal of the company on that ground. It does not seem to raise either a question of law or jurisdiction within the purview of the statute on which the right of appeal rests. I would dismiss the appeal.

The judgment of Rinfret and Lamont JJ. was delivered by

LAMONT J.—These are separate but consolidated appeals by the Northwestern Utilities, Limited (hereinafter called the Company) and the City of Edmonton, respectively, from the dismissal by the Appellate Division of the Supreme Court of Alberta of their respective appeals against the award made by the Board of Public Utility Commissioners on an application by the company for an

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order fixing the price to be paid by the consumers of natural gas within the city. Subsequent to the dismissal of the appeals, the Appellate Division made separate orders giving each party leave to appeal to this Court. By a further order the appeals were consolidated.

The company is the successor of the Northern Alberta Natural Gas Development Company, which held a franchise from the city for the supply of natural gas to the inhabitants thereof.

Disputes having arisen between the Development Company and the city, and an action having been commenced, the parties, on August 28, 1922, agreed to a settlement of their difficulties. One of the terms of the settlement was that the prices or rates to be paid by the inhabitants of the city should be fixed by the Board of Public Utility Commissioners. An application was accordingly made to the Board, the parties were heard, and, on November 27, 1922, an order was made fixing the rates to be paid. These rates were to continue in force for three years from the date on which gas was first supplied to consumers.

In order to fix just and reasonable rates, which it was the duty of the Board to fix, the Board had to consider certain elements which must always be taken into account in fixing a rate which is fair and reasonable to the consumer and to the company. One of these is the rate base, by which is meant the amount which the Board considers the owner of the utility has invested in the enterprise and on which he is entitled to a fair return. Another is the percentage to be allowed as a fair return.

In the award of 1922, which came into operation in the fall of 1923, the Board included in the rate base as a capital expenditure the sum of $283,900 (10% of the cost of plant) as, " an allowance for the promotion and financing " of the company, and the sum of $650,000 which was the discount on the sale of the Development Company's bonds. It also determined that 10% was a fair return on the investment. The rates thus fixed by the Board, with certain alterations made with the consent of all parties, continued in force for three years. In October, 1926, the appellant company, which had succeeded to the rights of the Development Company, applied to the Board for an order continuing the rates for such period as the Board might see fit. In its

reply to the application the city submitted (par. 23) that the order of November, 1922, should in certain respects be disregarded. One of these was the following:—

(*e*) Rate of Return. It is submitted that the methods and principles adopted in the fixing of the rate of return are erroneous and that the rate of return allowed is too high.

The city also protested against including in the rate base the item for the promotion and financing of the company and the item for bond discount.

In its answer to the city's reply the company alleged (par. 10) that at the hearing in 1922 the city was fully and adequately represented, that it had submitted evidence, that upon the award being delivered it raised no objection to any part thereof, and, therefore, was now estopped from contending that the principles then laid down were wrong in principle or in fact.

In its award the Board continued both the above mentioned sums in the rate base, but reduced the rate of return to the company from 10% to 9%. The reason assigned by the Board for this reduction is as follows:—

In view of the elements which go to make up the rate base, and in view of the altered conditions of the money market, the Board believes it is justified in reducing the rate of return that the Company shall be allowed, to nine per cent., and the Board's estimates are on that basis.

From the award the parties appealed, first to the Appellate Division of the Supreme Court of Alberta, and now to this Court. The company appealed against the reduction of the rate of return on its capital expenditure to 9%. Referring to the reasons given by the Board for making the reduction the company in its factum says:—

1. The city adduced no evidence as to "altered conditions of the money market" and

2. "The elements which go to make up the rate base" in 1927 are the same as in 1922.

The city appealed against the inclusion in the rate base of the item of the bond discount above mentioned.

The *Public Utilities Act* allows an appeal from the Board only upon a question of jurisdiction, or upon a question of law, and even then only when leave to appeal has first been obtained from a judge of the Appellate Division.

As against the company's appeal the city raises the preliminary objection that no question either of jurisdiction or law is involved therein. In my opinion the objection cannot be sustained. The substance of the company's

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appeal is that the Board in making a reduction in the rate of return did so for two reasons, one of which was the "altered conditions of the money market," and that of this no evidence was adduced before the Board. The company contends that, without hearing evidence upon the point, and without giving it an opportunity to establish that the conditions of the money market had remained unaltered since 1922, the Board was without jurisdiction to make the reduction. This contention was not stated in this form in the order granting leave to appeal to the Appellate Division, but the fixing of the rate of return at 9% only, was there set out as an error of the Board in respect of which leave to appeal was granted.

Whether or not the Board can properly base an order (in part at least) on the existence of a state of fact of which no evidence was adduced before it at the hearing and as to which the party affected has not had any opportunity of being heard is, in my opinion, a question of law which depends for its answer upon the construction to be placed upon the *Public Utilities Act*.

I am, therefore, of opinion that the company had a right to appeal.

The question involved in this appeal is: Had the Board jurisdiction to find as a fact how the conditions of the money market had altered between November, 1922, and July, 1927, without any witness testifying at the hearing that an alteration had taken place.

As the Board was determining what would be a fair return on the capital invested by the company in the enterprise, and as it reduced the return from 10% to 9%, it can, I think, be taken that by "the altered conditions of the money market" the Board meant that the returns for money invested in securities in which moneys were ordinarily invested had decreased during the period in question. In other words, that the rate of interest obtainable for moneys furnished for investment was, generally speaking, lower by a certain percentage in 1927 than it was in 1922. That, in my opinion, is all that is involved in the finding.

The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other

hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise. In fixing this net return the Board should take into consideration the rate of interest which the company is obliged to pay upon its bonds as a result of having to sell them at a time when the rate of interest payable thereon exceeded that payable on bonds issued at the time of the hearing. To properly fix a fair return the Board must necessarily be informed of the rate of return which money would yield in other fields of investment. Having gone into the matter fully in 1922, and having fixed 10% as a fair return under the conditions then existing, all the Board needed to know, in order to fix a proper return in 1927, was whether or not the conditions of the money market had altered, and, if so, in what direction, and to what extent.

For the city it was argued that, as one of the statutory powers of the Board was to deal with the financial affairs of local authorities (s. 20 (*d*)), and as this included the power to authorize the issue of new debentures by these authorities and to determine the rate of interest to be paid thereon and also the power to order a variation of the rate of interest payable upon any debt of the local authority (s. 103), the Board must necessarily be familiar with the rate of interest prevailing from time to time and therefore did not require to have witnesses called to furnish it with information which in the regular performance of its duty it was obliged to possess. In view of the powers and duties of the Board under the Act there is, in my opinion, considerable to be said for the city's contention. It is not necessary, however, to determine this question, for in the statute itself I find sufficient to justify the conclusion that the intention of the Legislature was to leave it largely to the discretion of the Board to say in what manner it should obtain the information required for the proper exercise of its functions.

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The material provisions of the Act on this point are as follows:—

21. (4) The Board may in its discretion accept and act upon evidence by affidavit or written affirmation or by the report of any officer or engineer appointed by it or obtained in such other manner as it may decide.

(5) All hearings and investigations before the Board shall be governed by rules adopted by the Board, and in the conduct thereof the Board shall not be bound by the technical rules of legal evidence.

Section 25 provides that upon a complaint being made to the Board that any proprietor of a public utility has unlawfully done or unlawfully failed to do something relating to a matter over which the Board has jurisdiction, the Board shall "after hearing such evidence as it may think fit to require" make such order as it thinks fit under the circumstances. Section 43 provides that the Board may "appoint or direct any person to make an inquiry and report upon any application * * * before the Board." And by section 44 the Board may "review, rescind, change, alter or vary any decision or order made by it." A perusal of these statutory provisions and a consideration of the purposes of the Act and the extent of the powers vested in the Board leads me to the conclusion that the Legislature intended to create a Board which in the exercise of its functions should not be bound by the technical rules of legal evidence but which would be governed by such rules as, in its discretion, it thought fit to adopt (s. 21 (5)). We have not been made acquainted with the rules, if any, adopted by the Board to govern its investigations. Nor do we know what information it possessed as to the altered conditions of the money market; but, as it had authority to act on evidence "obtained in such manner as it may decide" (s. 21 (4)), an inference that it had not the proper evidence before it cannot be drawn from the fact that no oral testimony in respect thereof was given at the hearing. If, in this case, the Board had asked its secretary to inquire from the various financial institutions in Edmonton if there had been any alteration in the conditions of the money market between 1922 and 1927, and the secretary had reported that there had been a certain decrease in the returns from invested capital, would it have been necessary to call witnesses to verify the report? In my opinion it would not. Nor would it have been necessary to afford to either party an opportunity to controvert before the

Board the information so obtained. Then would it have been necessary to mention in the award that the fact that such altered conditions had been established to the satisfaction of the Board by a report of its secretary? I can find nothing in the Act requiring mention to be made of the evidence or of the manner of obtaining it.

Reference was made to s. 86, which provides that no order involving any outlay, loss or depreciation to the proprietor of any public utility or to any municipality or person shall be made without due notice and full opportunity to all parties concerned to make proof to be heard at a public sitting of the Board, except in the case of urgency. A reduction in the rate of return to the company would, in my opinion, come within this section. The Board was, therefore, without jurisdiction to make the reduction unless the company had notice that a reduction was sought and had an opportunity of proving that under the circumstances existing at the time of the hearing the existing rate of return was fair and reasonable. That the company had notice that the city was demanding a reduction is beyond question (par. 23 (*e*)). It had more. It had notice that the city was attacking the methods and principles adopted in fixing the rate of return in 1922. This, in my opinion, put the whole question of a fair return at large and informed the company that it would have to establish to the satisfaction of the Board every element and condition necessary to justify a continuation of the 10% rate. The company does not say that it was refused an opportunity of putting in evidence as to the conditions of the money market. Nowhere does it deny that it could have put in evidence had it so desired. What it does say is that the city did not adduce evidence on the point and that no witnesses were called to testify before the Board in regard thereto. There is nothing before us to justify an inference that the company was not at liberty to call witnesses as to the conditions of the money market had it so desired. Moreover, in the order which the company obtained giving it leave to appeal it did not even suggest that it had no opportunity of submitting evidence as to the existing market conditions. The ground upon which the company relied to meet the city's demand for a reduction, as set out in the answer which it filed, was that as the city had ac-

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cepted the award when it was delivered and had raised no objection thereto, it was now precluded from seeking to set aside the principles upon which the rate of return was based. In its factum it went further and contended that, even if there was no estoppel, the principles then adopted should now be adhered to because it was on the strength of their having been adopted that the shareholders of the company invested their money in the enterprise. This contention cannot be made effective. In the first place, it involves neither a question of jurisdiction nor of law. In the second place, it is the duty of the Board to fix rates which, in its opinion, will be fair and reasonable at the time the order is made and for the period for which they are fixed. If any wrong principle or erroneous view has been adopted it is the duty of the Board at the next revision to correct the error. The argument that it would be unfair to the shareholders now to alter the rate of return is not a matter open for consideration on appeal. Moreover, when these shareholders invested their money they knew that the rates fixed were to be in force for three years only and that it would be the duty of the Board on the next revision to fix rates which at that time would be fair and reasonable under the circumstances then existing.

Our attention was also called to s. 47 (1*a*) as indicating an intention that evidence must be taken on all material points. That subsection reads as follows:—

(1a) On the hearing of any appeal referred to in subsection 1 of this section no evidence other than the evidence which was submitted to the Board upon the making of the order appealed from shall be admitted, and the Court shall proceed either to confirm or vacate the order appealed from, and in the latter event shall refer the matter back to the Board for further consideration and redetermination.

In my opinion this subsection means no more than that no new evidence is to be admitted on appeal.

The appeal of the company should therefore be dismissed with costs.

The appeal of the city should likewise be dismissed with costs. The items which should be included in the rate base cannot, in my opinion, be considered a question of jurisdiction or of law.

SMITH J.—The City of Edmonton had made an agreement with the Northern Alberta Natural Gas Development Company, by which the company obtained a fran-

chise to supply natural gas to the city, and agreed to construct the necessary works. The company failed to construct the works, and the city sued for damages for breach of contract. The actions were settled by an agreement dated 22nd August, 1922, under which the determination of the rates to be charged by the company for gas was referred to the Board of Public Utility Commissioners, and the company was, within six months after the fixing of the rates, to deposit $50,000 with the city, which was to be forfeited to the city as liquidated damages in case the company did not complete the construction of the works as agreed.

A rate hearing was held by the Board after this settlement, at which the company and the city were represented, and the Board made an award, setting out a rate basis and fixing prices for gas on this basis.

The difficulty about proceeding with the works had been the procuring of capital on the basis of prices provided in the original agreement and amendments made. The whole object of fixing a rate base and prices in advance of construction was to facilitate financing by the company. It would necessarily be on the basis of the award that investors would buy bonds and stock of the company. The company had the option of proceeding with the works or abandoning them and forfeiting the $50,000, after seeing the award. In July following the making of the award, the company assigned its franchise and property to the appellant, the Northwestern Utilities, Limited, which, by sale of its bonds and stock, raised the necessary capital, constructed the works, and put them in operation. The rate to be charged for gas was fixed by the award for three years, and at the end of this period the company applied to the Board for continuation of the rates fixed by the award. The rate base fixed by the Board in the award of 1922 contained many items, such as total investment, operating cost, depletion reserve, reserve for repayment of cost of plant, total necessary revenue, amounts of gas to be sold, and the rate of return on capital to be allowed. It is evident that, with the exception of the last of these items, the amounts fixed must have been estimates, liable to be varied by actual results.

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The rate of return to be allowed on capital was fixed in the award at 10%, not based on the ordinary rate of money on the market at the time or on an estimated future rate, but on consideration of the rate that would induce investors to risk their capital in an extremely hazardous and doubtful venture. At the hearing before the Board in 1922, the company had asked a 12% rate of return on capital, and the city had conceded 10%, which the Board fixed, though it stated that under the circumstances a return of more than 10% would not seem to be unjust. The reason set out for not fixing this higher rate was that it might so restrict the market that the higher rate would not compensate for the restriction of the market, and would therefore not be to the advantage of the company. It is, however, stated that in case of future revision, it may be found desirable, under certain circumstances, to increase this rate.

On the revision at the end of three years, this rate was not increased, but was reduced from 10% to 9%, at the instance of the city, and this reduction constitutes the ground of appeal.

In the reasons given by the Board in fixing the new rates, it is pointed out that, where rates have been fixed in advance of construction and financing, the Board is not precluded from subsequently making changes that may appear from subsequent reconsideration to be necessary, and it is then stated that

> those investing in such a case must depend on the fairness of the Board in seeing that the Company is allowed a fair and reasonable return upon its investment, but the Board may, and indeed it should, take into consideration the circumstances under which such investment was made.

In discussing these circumstances in reference to a request by the city for elimination from the rate base of the 1922 award of the item for bond discount, the Board says:

> There is, moreover, an additional factor to be considered in the present case and that is, that in 1922 the inclusion of the allowance for bond discount was practically agreed to by the city in its case and the item was not questioned by the city until at the recent hearing. It is only fair to assume that the fact of the inclusion of the bond discount in the rate base formed part of the inducement for the making of the investment. Under the circumstances, therefore, the Board does not feel justified in adopting the City's contention in this regard.

This lays down a principle with which one heartily agrees, and which applies exactly to the city's application for reduction of the rate of return on capital fixed in the award

of 1922 at 10%. The Board fixed this rate with the assent of the city, and this rate, coupled with the suggestion by the Board that it might be increased, "formed part of the inducement for the making of the investment."

The altered condition of the money market, given as a reason for the reduction of the rate to 9%, seems to me to have no bearing on the matter. The representation to the investor in 1922 was, for the risk you take in placing your capital in a hazardous undertaking, you will be allowed as a basis in fixing rates to be charged for gas a return of 10%. What the regular money market might be three years later could have nothing to do with the decision to invest. The whole question was, viewing the risk, and the chances, as matters then stood, was the chance of 10% on the money worth the risk of a bad investment, with the possibility of the loss of all or part of the capital?

The Board then, in my opinion, laid down a proper principle, and applied it in other instances, but failed to apply it to this item, as to which I think it was particularly applicable. The question is, can this Court set aside the finding of the Board as to this item on the appeal? I agree with my brother Lamont that, whether or not under the Act the Board was entitled to reduce the rate to 9% without evidence, because of a change in money market conditions, is a question of law, and that there is therefore a right of appeal, and it is with some regret that I feel bound to agree with him that the Board had jurisdiction to make the change in rate without evidence, and without giving the company an opportunity to offer evidence. The question of a fair rate of return on a risky investment is largely a matter of opinion, and is hardly capable of being reduced to certainty by evidence, and appears to be one of the things entrusted by the statute to the judgment of the Board.

I am not entirely in accord with the observations of my brother Lamont in reference to the sending out of someone to gather evidence of the state of the money market and acting on that party's report without the knowledge of the company. The objection in such a case would not be the failure to set out in the award the fact of such evidence and its nature, but the failure to disclose it to the company with an opportunity to answer it. If it were a case where, evi-

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dence being necessary, it had been taken in the manner suggested, or otherwise, and a finding based on it without disclosure of it to the company and an opportunity to answer it, I would regard such a proceeding as contrary to elementary principles of justice, and as affording, under the statute, a ground for setting the award as to this item aside and referring it back for reconsideration. It does not, however, appear that any evidence was taken, and as stated, I have concluded that there was power to make the change without evidence.

I therefore concur with my brother Lamont in the disposal of this appeal.

Appeals dismissed with costs.

Solicitors for Northwestern Utilities, Limited: *Milner, Carr, Dafoe & Poirier.*

Solicitor for the City of Edmonton: *John C. F. Bown.*

Ontario Energy Board *Appellant*

v.

Ontario Power Generation Inc., Power Workers' Union, Canadian Union of Public Employees, Local 1000 and Society of Energy Professionals *Respondents*

and

Ontario Education Services Corporation *Intervener*

Commission de l'énergie de l'Ontario *Appelante*

c.

Ontario Power Generation Inc., Syndicat des travailleurs et travailleuses du secteur énergétique, Syndicat canadien de la fonction publique, section locale 1000 et Society of Energy Professionals *Intimés*

et

Corporation des services en éducation de l'Ontario *Intervenante*

Indexed as: Ontario (Energy Board) *v.* Ontario Power Generation Inc.

2015 SCC 44

File No.: 35506.

2014: December 3; 2015: September 25.

Present: McLachlin C.J. and Abella, Rothstein, Cromwell, Moldaver, Karakatsanis and Gascon JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Public utilities — Electricity — Rate-setting decision by utilities regulator — Utility seeking to recover incurred or committed compensation costs in utility rates set by Ontario Energy Board — Whether Board bound to apply particular prudence test in evaluating utility costs — Whether Board's decision to disallow $145 million in labour compensation costs related to utility's nuclear operations reasonable — Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B, s. 78.1(5), (6).

Administrative law — Boards and tribunals — Appeals — Standing — Whether Ontario Energy Board acted improperly in pursuing appeal and in arguing in favour of reasonableness of its own decision — Whether

Répertorié : Ontario (Commission de l'énergie) *c.* Ontario Power Generation Inc.

2015 CSC 44

N° du greffe : 35506.

2014 : 3 décembre; 2015 : 25 septembre.

Présents : La juge en chef McLachlin et les juges Abella, Rothstein, Cromwell, Moldaver, Karakatsanis et Gascon.

EN APPEL DE LA COUR D'APPEL DE L'ONTARIO

Services publics — Électricité — Décision d'un organisme de réglementation des services publics relativement à l'établissement de tarifs — Demande d'un service public en vue d'obtenir le recouvrement de dépenses de rémunération faites ou convenues grâce aux tarifs établis par la Commission de l'énergie de l'Ontario — La Commission avait-elle l'obligation d'employer une méthode particulière axée sur la prudence pour apprécier les dépenses du service public? — Le refus de la Commission d'approuver 145 millions de dollars au titre des dépenses de rémunération liées aux installations nucléaires du service public était-il raisonnable? — Loi de 1998 sur la Commission de l'énergie de l'Ontario, L.O. 1998, c. 15, ann. B, art. 78.1(5), (6).

Droit administratif — Organismes et tribunaux administratifs — Appels — Qualité pour agir — La Commission de l'énergie de l'Ontario a-t-elle agi de manière inappropriée en se pourvoyant en appel et en faisant valoir

Board attempted to use appeal to "bootstrap" its original decision by making additional arguments on appeal.

In Ontario, utility rates are regulated through a process by which a utility seeks approval from the Ontario Energy Board for costs the utility has incurred or expects to incur in a specified period of time. Where the Board approves of the costs, they are incorporated into utility rates such that the utility receives payment amounts to cover the approved expenditures. The Board disallowed certain payment amounts applied for by Ontario Power Generation ("OPG") as part of its rate application covering the 2011-2012 operating period. Specifically, the Board disallowed $145 million in labour compensation costs related to OPG's nuclear operations on the grounds that OPG's labour costs were out of step with those of comparable entities in the regulated power generation industry. A majority of the Ontario Divisional Court dismissed OPG's appeal and upheld the decision of the Board. The Court of Appeal set aside the decisions of the Divisional Court and the Board and remitted the matter to the Board for redetermination in accordance with its reasons.

The crux of OPG's argument here is that the Board is legally required to compensate OPG for all of its prudently committed or incurred costs. OPG asserts that prudence in this context has a particular methodological meaning that requires the Board to assess the reasonableness of OPG's decision to incur or commit to costs at the time the decisions to incur or commit to the costs were made and that OPG ought to benefit from a presumption of prudence. The Board on the other hand argues that a particular prudence test methodology is not compelled by law, and that in any case the costs disallowed here were not committed nuclear compensation costs, but are better characterized as forecast costs.

OPG also raises concerns regarding the Board's role in acting as a party on appeal from its own decision, arguing that the Board's aggressive and adversarial defence of its decision was improper, and the Board attempted to use the appeal to bootstrap its original decision by making additional arguments on appeal. The Board argues that the structure of utilities regulation in Ontario makes it necessary and important for it to argue the merits of its decision on appeal.

le caractère raisonnable de sa propre décision? — A-t-elle tenté de se servir de l'appel pour « s'auto-justifier » en formulant de nouveaux arguments à l'appui de sa décision initiale?

En Ontario, la tarification d'un service public est réglementée, de sorte que ce dernier doit obtenir de la Commission de l'énergie de l'Ontario l'approbation des dépenses qu'il a faites ou qu'il prévoit faire pendant une période donnée. Lorsque cette approbation est obtenue, les tarifs sont rajustés de manière que le service public touche des paiements qui correspondent à ses dépenses. La Commission a refusé certains paiements sollicités par Ontario Power Generation (« OPG ») dans sa décision sur la demande d'établissement des tarifs pour la période 2011-2012. Elle a en fait refusé à OPG le recouvrement de 145 millions de dollars au titre des dépenses de rémunération liées aux installations nucléaires du service public au motif que ces dépenses étaient en rupture avec celles d'organismes comparables dans le secteur réglementé de la production d'énergie. Les juges majoritaires de la Cour divisionnaire de l'Ontario ont rejeté l'appel d'OPG et confirmé la décision de la Commission. La Cour d'appel a annulé les décisions de la Cour divisionnaire et de la Commission, puis renvoyé le dossier à la Commission afin qu'elle rende une nouvelle décision conforme à ses motifs.

La thèse d'OPG en l'espèce veut essentiellement que la Commission soit légalement tenue de l'indemniser de la totalité des dépenses faites ou convenues avec prudence. OPG prétend que, dans ce contexte, la prudence se définit selon une méthode particulière qui exige de la Commission qu'elle détermine si, au moment où elles ont été prises, les décisions de faire les dépenses ou de convenir des dépenses étaient raisonnables. Elle soutient en outre qu'une présomption de prudence doit s'appliquer à son bénéfice. La Commission prétend pour sa part que la loi ne l'oblige pas à employer quelque méthode fondée sur le principe de la prudence et que, de toute manière, les dépenses de rémunération des employés du secteur nucléaire refusées en l'espèce n'étaient pas des dépenses convenues, mais bien des dépenses prévues.

OPG exprime en outre des préoccupations sur la participation de la Commission à l'appel de sa propre décision et fait valoir que la manière agressive et conflictuelle dont la Commission a défendu sa décision initiale n'était pas justifiée et que l'organisme a tenté de se servir de l'appel pour s'auto-justifier en formulant de nouveaux arguments à l'appui de sa décision initiale. La Commission soutient que la manière dont les services publics sont réglementés en Ontario fait en sorte qu'il est nécessaire et important qu'elle défende la justesse de ses décisions portées en appel.

Held (Abella J. dissenting): The appeal should be allowed. The decision of the Court of Appeal is set aside and the decision of the Board is reinstated.

Per McLachlin C.J. and Rothstein, Cromwell, Moldaver, Karakatsanis and Gascon JJ.: The first issue is the appropriateness of the Board's participation in the appeal. The concerns with regard to tribunal participation on appeal from the tribunal's own decision should not be read to establish a categorical ban. A discretionary approach provides the best means of ensuring that the principles of finality and impartiality are respected without sacrificing the ability of reviewing courts to hear useful and important information and analysis. Because of their expertise and familiarity with the relevant administrative scheme, tribunals may in many cases be well positioned to help the reviewing court reach a just outcome. Further, some cases may arise in which there is simply no other party to stand in opposition to the party challenging the tribunal decision. In a situation where no other well-informed party stands opposed, the presence of a tribunal as an adversarial party may help the court ensure it has heard the best of both sides of a dispute. The following factors are relevant in informing the court's exercise of its discretion: statutory provisions addressing the structure, processes and role of the particular tribunal and the mandate of the tribunal, that is, whether the function of the tribunal is to adjudicate individual conflicts between parties or whether it serves a policy-making, regulatory or investigative role, or acts on behalf of the public interest. The importance of fairness, real and perceived, weighs more heavily against tribunal standing where the tribunal served an adjudicatory function in the proceeding. Tribunal standing is a matter to be determined by the court conducting the first-instance review in accordance with the principled exercise of that court's discretion. In exercising its discretion, the court is required to balance the need for fully informed adjudication against the importance of maintaining tribunal impartiality.

Consideration of these factors in the context of this case leads to the conclusion that it was not improper for the Board to participate in arguing in favour of the reasonableness of its decision on appeal. The Board was the only respondent in the initial review of its decision. It had no alternative but to step in if the decision was to be defended on the merits. Also, the Board was exercising

Arrêt (la juge Abella est dissidente) : Le pourvoi est accueilli. La décision de la Cour d'appel est annulée et celle de la Commission est rétablie.

La juge en chef McLachlin et les juges Rothstein, Cromwell, Moldaver, Karakatsanis et Gascon : Se pose en premier lieu la question du caractère approprié de la participation de la Commission au pourvoi. Les préoccupations relatives à la participation d'un tribunal administratif à l'appel de sa propre décision ne sauraient fonder l'interdiction absolue d'une telle participation. La démarche discrétionnaire offre le meilleur moyen d'assurer le caractère définitif de la décision et l'impartialité du décideur sans que la cour de révision ne soit alors privée de données et d'analyses à la fois utiles et importantes. Vu ses compétences spécialisées et sa connaissance approfondie du régime administratif en cause, le tribunal administratif peut, dans bien des cas, être bien placé pour aider la cour de révision à rendre une juste décision. Qui plus est, dans certains cas, il n'y a tout simplement personne pour s'opposer à la partie qui conteste la décision du tribunal administratif. Lorsqu'aucune autre partie bien au fait des enjeux ne fait valoir le point de vue opposé, la participation du tribunal administratif à titre de partie adverse peut contribuer à faire en sorte que la cour statue après avoir entendu les arguments les plus convaincants de chacune des deux parties au litige. Les considérations suivantes permettent de délimiter l'exercice du pouvoir discrétionnaire de la cour de révision : les dispositions législatives portant sur la structure, le fonctionnement et la mission du tribunal en cause et le mandat du tribunal, à savoir si sa fonction consiste soit à trancher des différends individuels opposant plusieurs parties, soit à élaborer des politiques, à réglementer ou à enquêter, ou à défendre l'intérêt public. L'importance de l'équité, réelle et perçue, milite davantage contre la reconnaissance de la qualité pour agir du tribunal administratif qui a exercé une fonction juridictionnelle dans l'instance. Il appartient à la cour de première instance chargée du contrôle judiciaire de décider de la qualité pour agir d'un tribunal administratif en exerçant son pouvoir discrétionnaire de manière raisonnée. Dans l'exercice de son pouvoir discrétionnaire, la cour doit établir un équilibre entre la nécessité d'une décision bien éclairée et l'importance d'assurer l'impartialité du tribunal administratif.

L'application de ces principes à la situation considérée en l'espèce mène à la conclusion qu'il n'était pas inapproprié que la Commission participe à l'appel pour défendre le caractère raisonnable de sa décision. La Commission était la seule partie intimée lors du contrôle judiciaire initial de sa décision. Elle n'avait d'autre choix que de prendre part à l'instance pour que sa décision

a regulatory role by setting just and reasonable payment amounts to a utility. In this case, the Board's participation in the instant appeal was not improper.

The issue of tribunal "bootstrapping" is closely related to the question of when it is proper for a tribunal to act as a party on appeal or judicial review of its decision. The standing issue concerns the types of argument a tribunal may make, while the bootstrapping issue concerns the content of those arguments. A tribunal engages in bootstrapping where it seeks to supplement what would otherwise be a deficient decision with new arguments on appeal. A tribunal may not defend its decision on a ground that it did not rely on in the decision under review. The principle of finality dictates that once a tribunal has decided the issues before it and provided reasons for its decision, absent a power to vary its decision or rehear the matter, it cannot use judicial review as a chance to amend, vary, qualify or supplement its reasons. While a permissive stance towards new arguments by tribunals on appeal serves the interests of justice insofar as it ensures that a reviewing court is presented with the strongest arguments in favour of both sides, to permit bootstrapping may undermine the importance of reasoned, well-written original decisions. In this case, the Board did not impermissibly step beyond the bounds of its original decision in its arguments before the Court. The arguments raised by the Board on appeal do not amount to impermissible bootstrapping.

The merits issue concerns whether the appropriate methodology was followed by the Board in its disallowance of $145 million in labour compensation costs sought by OPG. The just-and-reasonable approach to recovery of the cost of services provided by a utility captures the essential balance at the heart of utilities regulation: to encourage investment in a robust utility infrastructure and to protect consumer interests, utilities must be allowed, over the long run, to earn their cost of capital, no more, no less. In order to ensure the balance between utilities' and consumers' interests is struck, just and reasonable rates must be those that ensure consumers are paying what the Board expects it to cost to efficiently provide the services they receive, taking account of both operating and capital costs. In that way, consumers may be assured that, overall, they are paying no more than what is necessary for the service they receive, and

soit défendue au fond. Aussi, la Commission a exercé sa fonction de réglementation en établissant les paiements justes et raisonnables auxquels un service public avait droit. Sa participation au pourvoi n'avait rien d'inapproprié en l'espèce.

La question de l'« autojustification » est étroitement liée à celle de savoir à quelles conditions le tribunal administratif est en droit d'agir comme partie à l'appel ou au contrôle judiciaire de sa décision. Statuer sur la qualité pour agir d'un tribunal c'est décider de ce qu'il peut faire valoir, alors que l'autojustification touche à la teneur des prétentions. Un tribunal s'autojustifie lorsqu'il cherche, par la présentation de nouveaux arguments en appel, à étoffer une décision qui, sinon, serait lacunaire. Un tribunal ne peut défendre sa décision en invoquant un motif qui n'a pas été soulevé dans la décision faisant l'objet du contrôle. Le caractère définitif de la décision veut que, dès lors qu'il a tranché les questions dont il était saisi et qu'il a motivé sa décision, à moins qu'il ne soit investi du pouvoir de modifier sa décision ou d'entendre à nouveau l'affaire, un tribunal ne puisse profiter d'un contrôle judiciaire pour modifier, changer, nuancer ou compléter ses motifs. Même s'il est dans l'intérêt de la justice de permettre au tribunal de présenter de nouveaux arguments en appel, la cour de révision étant alors saisie des arguments les plus convaincants à l'appui de chacune des thèses, autoriser l'autojustification risque de compromettre l'importance de décisions bien étayées et bien rédigées au départ. Dans la présente affaire, la Commission n'a pas indûment outrepassé les limites de sa décision initiale lorsqu'elle a présenté ses arguments devant la Cour. Les arguments qu'elle a invoqués en appel n'équivalent pas à une autojustification inadmissible.

La question de fond est celle de savoir si la Commission a employé une méthode appropriée pour refuser à OPG le recouvrement de 145 millions de dollars au titre des dépenses de rémunération. L'approche fondée sur le caractère juste et raisonnable des dépenses qu'un service public peut recouvrer rend compte de l'équilibre essentiel recherché dans la réglementation des services publics : pour encourager l'investissement dans une infrastructure robuste et protéger l'intérêt des consommateurs, un service public doit pouvoir, à long terme, toucher l'équivalent du coût du capital, ni plus, ni moins. Lorsqu'il s'agit d'assurer l'équilibre entre les intérêts du service public et ceux du consommateur, la tarification juste et raisonnable est celle qui fait en sorte que le consommateur paie ce que la Commission prévoit qu'il en coûtera pour la prestation efficace du service, compte tenu à la fois des dépenses d'exploitation et des coûts en

utilities may be assured of an opportunity to earn a fair return for providing those services.

The *Ontario Energy Board Act, 1998* does not prescribe the methodology the Board must use to weigh utility and consumer interests when deciding what constitutes just and reasonable payment amounts to the utility. However, the *Ontario Energy Board Act, 1998* places the burden on the applicant utility to establish that payment amounts approved by the Board are just and reasonable. It would thus seem inconsistent with the statutory scheme to presume that utility decisions to incur costs were prudent. The Board has broad discretion to determine the methods it may use to examine costs — but it cannot shift the burden of proof contrary to the statutory scheme.

The issue is whether the Board was bound to use a no-hindsight, presumption of prudence test to determine whether labour compensation costs were just and reasonable. The prudent investment test, or prudence review, is a valid and widely accepted tool that regulators may use when assessing whether payments to a utility would be just and reasonable. However, there is no support in the statutory scheme for the notion that the Board should be required as a matter of law, under the *Ontario Energy Board Act, 1998* to apply the prudence test such that the mere decision not to apply it when considering committed costs would render its decision on payment amounts unreasonable. Where a statute requires only that the regulator set "just and reasonable" payments, as the *Ontario Energy Board Act, 1998* does in Ontario, the regulator may make use of a variety of analytical tools in assessing the justness and reasonableness of a utility's proposed payment amounts. This is particularly so where, as here, the regulator has been given express discretion over the methodology to be used in setting payment amounts.

Where the regulator has discretion over its methodological approach, understanding whether the costs at issue are "forecast" or "committed" may be helpful in reviewing the reasonableness of a regulator's choice of methodology. Here, the labour compensation costs which led to the $145 million disallowance are best understood

capital. Ainsi, le consommateur a l'assurance que, globalement, il ne paie pas plus que ce qui est nécessaire pour obtenir le service, et le service public a l'assurance de pouvoir toucher une juste contrepartie pour la prestation du service.

La *Loi de 1998 sur la Commission de l'énergie de l'Ontario* ne prescrit pas la méthode que doit utiliser la Commission pour soupeser les intérêts respectifs du service public et du consommateur lorsqu'elle décide ce qui constitue des paiements justes et raisonnables. Suivant cette loi, il incombe cependant au service public requérant d'établir que les paiements qu'il demande à la Commission d'approuver sont justes et raisonnables. Il semble donc contraire au régime législatif de présumer que la décision du service public de faire les dépenses était prudente. La Commission jouit d'un grand pouvoir discrétionnaire qui lui permet d'arrêter la méthode à employer dans l'examen des dépenses, mais elle ne peut tout simplement pas inverser le fardeau de la preuve qu'établit le régime législatif.

La question à trancher est celle de savoir si la Commission était tenue à l'application d'un critère excluant le recul et présumant la prudence pour décider si les dépenses de rémunération du personnel étaient justes et raisonnables. Le critère de l'investissement prudent — ou contrôle de la prudence — offre aux organismes de réglementation un moyen valable et largement reconnu d'apprécier le caractère juste et raisonnable des paiements sollicités par un service public. Toutefois, aucun élément du régime législatif n'appuie l'idée que la Commission devrait être tenue en droit, suivant la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, d'appliquer le critère de la prudence de sorte que la seule décision de ne pas l'appliquer pour apprécier des dépenses convenues rendrait déraisonnable sa décision sur les paiements. Lorsqu'un texte législatif — telle la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* en Ontario — exige seulement qu'il fixe des paiements « justes et raisonnables », l'organisme de réglementation peut avoir recours à divers moyens d'analyse pour apprécier le caractère juste et raisonnable des paiements sollicités par le service public. Cela est particulièrement vrai lorsque, comme en l'espèce, l'organisme de réglementation se voit accorder expressément un pouvoir discrétionnaire quant à la méthode à appliquer pour fixer les paiements.

Lorsque l'organisme de réglementation possède un pouvoir discrétionnaire quant à la méthode à employer, la qualification des dépenses — « prévues » ou « convenues » — peut constituer une étape importante pour statuer sur le caractère raisonnable de la méthode retenue. Dans la présente affaire, il convient mieux de voir dans

as partly committed costs and partly costs subject to management discretion. They are partly committed because they resulted from collective agreements entered into between OPG and two of its unions, and partly subject to management discretion because OPG retained some flexibility to manage total staffing levels in light of, among other things, projected attrition of the workforce. It is not reasonable to treat these costs as entirely forecast. However, the Board was not bound to apply a particular prudence test in evaluating these costs. It is not necessarily unreasonable, in light of the particular regulatory structure established by the *Ontario Energy Board Act, 1998*, for the Board to evaluate committed costs using a method other than a no-hindsight prudence review. Applying a presumption of prudence would have conflicted with the burden of proof in the *Ontario Energy Board Act, 1998* and would therefore not have been reasonable. The question of whether it was reasonable to assess a particular cost using hindsight should turn instead on the circumstances of that cost.

In this case, the nature of the disputed costs and the environment in which they arose provide a sufficient basis to find that the Board did not act unreasonably in not applying the prudent investment test in determining whether it would be just and reasonable to compensate OPG for these costs and disallowing them. Since the costs at issue are operating costs, there is little danger that a disallowance of these costs will have a chilling effect on OPG's willingness to incur operating costs in the future, because costs of the type disallowed here are an inescapable element of operating a utility. Further, the costs at issue arise in the context of an ongoing repeat-player relationship between OPG and its employees. Such a context supports the reasonableness of a regulator's decision to weigh all evidence it finds relevant in striking a just and reasonable balance between the utility and consumers, rather than confining itself to a no-hindsight approach. There is no dispute that collective agreements are "immutable" between employees and the utility. However, if the legislature had intended for costs under collective agreements to also be inevitably imposed on consumers, it would not have seen fit to grant the Board oversight of utility compensation costs. The Board's decision in no way purports to force OPG to break its contractual commitments to unionized employees. It was not unreasonable

les dépenses de rémunération dont le recouvrement a été refusé à raison de 145 millions de dollars en partie des dépenses convenues et en partie des dépenses relevant du pouvoir discrétionnaire de la direction. Elles sont en partie convenues parce qu'elles résultent de conventions collectives intervenues entre OPG et deux de ses syndicats, et elles relèvent en partie de la discrétion de la direction parce qu'OPG conservait une certaine marge de manœuvre dans la gestion des niveaux de dotation globale compte tenu, entre autres, de l'attrition projetée de l'effectif. Il est déraisonnable de considérer qu'il s'agit en totalité de dépenses prévues. Cependant, la Commission n'était pas tenue d'appliquer un principe de prudence donné pour apprécier ces dépenses. Il n'est pas nécessairement déraisonnable, à la lumière du cadre réglementaire établi par la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, que la Commission se prononce sur les dépenses convenues en employant une autre méthode que l'application d'un critère de prudence qui exclut le recul. Présumer la prudence aurait été incompatible avec le fardeau de la preuve que prévoit la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* et, de ce fait, déraisonnable. Qu'il soit raisonnable ou non d'apprécier certaines dépenses avec recul devrait plutôt dépendre des circonstances de la décision dont s'originent ces dépenses.

Dans la présente affaire, la nature des dépenses litigieuses et le contexte dans lequel elles ont vu le jour permettent de conclure que la Commission n'a pas agi de manière déraisonnable en n'appliquant pas le critère de l'investissement prudent pour décider s'il était juste et raisonnable d'indemniser OPG de ces dépenses et en refusant le recouvrement de celles-ci. Puisque les dépenses en cause sont des dépenses d'exploitation, il est peu probable que le refus essuyé dissuade OPG de faire de telles dépenses à l'avenir, car les dépenses de la nature de celles dont le recouvrement a été refusé sont inhérentes à l'exploitation d'un service public. Aussi, les dépenses en cause découlent d'une relation continue entre OPG et ses employés. Pareil contexte milite en faveur du caractère raisonnable de la décision de l'organisme de réglementation de soupeser toute preuve qu'il juge pertinente aux fins d'établir un équilibre juste et raisonnable entre le service public et les consommateurs, au lieu de s'en tenir à une approche excluant le recul. Nul ne conteste que les conventions collectives intervenues entre le service public et ses employés sont « immuables ». Toutefois, si le législateur avait voulu que les dépenses qui en sont issues se répercutent inévitablement sur les consommateurs, il n'aurait pas jugé opportun d'investir la Commission du pouvoir de surveiller les dépenses de

for the Board to adopt a mixed approach that did not rely on quantifying the exact share of compensation costs that fell into the forecast and committed categories. Such an approach represents an exercise of the Board's methodological discretion in addressing a challenging issue where these costs did not fit easily into one category or the other.

The Board's disallowance may have adversely impacted OPG's ability to earn its cost of capital in the short run. Nevertheless, the disallowance was intended to send a clear signal that OPG must take responsibility for improving its performance. Such a signal may, in the short run, provide the necessary impetus for OPG to bring its compensation costs in line with what, in the Board's opinion, consumers should justly expect to pay for an efficiently provided service. Sending such a signal is consistent with the Board's market proxy role and its objectives under s. 1 of the *Ontario Energy Board Act, 1998*.

Per Abella J. (dissenting): The Board's decision was unreasonable because the Board failed to apply the methodology set out for itself for evaluating just and reasonable payment amounts. It both ignored the legally binding nature of the collective agreements between Ontario Power Generation and the unions and failed to distinguish between committed compensation costs and those that were reducible.

The Board stated in its reasons that it would use two kinds of review in order to determine just and reasonable payment amounts. As to "forecast costs", that is, those over which a utility retains discretion and can still be reduced or avoided, the Board explained that it would review such costs using a wide range of evidence, and that the onus would be on the utility to demonstrate that its forecast costs were reasonable. A different approach, however, would be applied to those costs the company could not "take action to reduce". These costs, sometimes called "committed costs", represent binding commitments that leave a utility with no discretion about whether to make the payment. The Board explained that it would evaluate these costs using a "prudence review". The application of a prudence review does not shield

rémunération d'un service public. La Commission n'entend aucunement, par sa décision, contraindre OPG à se soustraire à ses engagements contractuels envers ses employés syndiqués. Il n'était pas déraisonnable que la Commission opte pour une démarche hybride qui ne se fonde pas sur la répartition exacte des dépenses de rémunération entre celles qui sont prévues et celles qui sont convenues. Pareille démarche correspond à un exercice du pouvoir discrétionnaire de la Commission sur le plan méthodologique lorsqu'elle est appelée à se prononcer sur une question épineuse et que les dépenses en cause ne sont pas aisément assimilables à l'une ou l'autre de ces catégories.

Le refus de la Commission a pu nuire à la possibilité qu'OPG obtienne à court terme l'équivalent de son coût du capital. Toutefois, il visait à signifier clairement à OPG qu'il lui incombe d'accroître sa performance. L'envoi d'un tel message peut, à court terme, donner à OPG l'impulsion nécessaire pour rapprocher ses dépenses de rémunération de ce que, selon la Commission, les consommateurs devraient à bon droit s'attendre à payer pour la prestation efficace du service. L'envoi d'un tel message est conforme au rôle de substitut du marché de la Commission et à ses objectifs selon l'article premier de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*.

La juge Abella (dissidente) : La Commission a rendu une décision déraisonnable en ce qu'elle n'a pas appliqué la méthode qu'elle avait elle-même établie pour déterminer le montant de paiements justes et raisonnables. Elle a à la fois méconnu le caractère contraignant en droit des conventions collectives liant Ontario Power Generation et les syndicats et omis de distinguer les dépenses de rémunération convenues de celles qui étaient réductibles.

Dans ses motifs, la Commission a dit recourir à deux examens pour arrêter le montant de paiements justes et raisonnables. En ce qui concerne les « dépenses prévues », soit celles à l'égard desquelles le service public conserve un pouvoir discrétionnaire et qu'il peut toujours réduire ou éviter, la Commission a expliqué qu'elle examinait ces dépenses au regard d'une vaste gamme d'éléments de preuve et qu'il incombait au service public d'en démontrer le caractère raisonnable. Cependant, une démarche différente était suivie pour les dépenses à l'égard desquelles la société ne pouvait « prendre de mesures de réduction ». Ces dépenses, parfois appelées « dépenses convenues », résultent d'obligations contractuelles qui excluent tout pouvoir discrétionnaire permettant au service public de ne pas les acquitter. La Commission a expliqué

these costs from scrutiny, but it does include a presumption that the costs were prudently incurred.

Rather than apply the methodology it set out for itself, however, the Board assessed *all* compensation costs in Ontario Power Generation's collective agreements as adjustable forecast costs, without determining whether any of them were costs for which there is no opportunity for the company to take action to reduce. The Board's failure to separately assess the compensation costs committed as a result of the collective agreements from other compensation costs, ignored not only its own methodological template, but labour law as well.

The compensation costs for approximately 90 per cent of Ontario Power Generation's regulated workforce were established through legally binding collective agreements which obligated the utility to pay fixed levels of compensation, regulated staffing levels, and provided unionized employees with employment security. The obligations contained in these collective agreements were immutable and legally binding commitments. The agreements therefore did not just leave the utility with limited flexibility regarding overall compensation or staffing levels, they made it *illegal* for the utility to alter the compensation and staffing levels of 90 per cent of its regulated workforce in a manner that was inconsistent with its commitments under the agreements.

The Board, however, applying the methodology it said it would use for the utility's forecast costs, put the onus on Ontario Power Generation to prove the reasonableness of all its compensation costs and concluded that it had failed to provide compelling evidence or documentation or analysis to justify compensation levels. Had the Board used the approach it said it would use for costs the company had no opportunity to reduce, it would have used an after-the-fact prudence review, with a rebuttable presumption that the utility's expenditures were reasonable.

It may well be that Ontario Power Generation has the ability to manage some staffing levels through attrition or other mechanisms that did not breach the utility's commitments under its collective agreements, and that these costs may therefore properly be characterized as forecast

qu'elle appréciait ces dépenses en se livrant à un « contrôle de la prudence ». L'application du principe de la prudence ne soustrait pas ces dépenses à tout examen, mais elle présume que les dépenses ont été faites de manière prudente.

Toutefois, au lieu d'appliquer la méthode qu'elle avait elle-même établie, la Commission a considéré *toutes* les dépenses de rémunération issues des conventions collectives d'Ontario Power Generation comme des dépenses prévues ajustables sans se demander s'il s'agissait en partie de dépenses pour lesquelles la société ne pouvait prendre de mesures de réduction. Par son omission d'apprécier les dépenses de rémunération issues des conventions collectives séparément des autres dépenses de rémunération, la Commission a méconnu à la fois son propre cadre méthodologique et le droit du travail.

Les dépenses de rémunération visant environ 90 p. 100 de l'effectif obligatoire d'Ontario Power Generation étaient établies par des conventions collectives contraignantes en droit qui imposaient des barèmes de rémunération fixes, qui déterminaient les niveaux de dotation et qui garantissaient la sécurité d'emploi des employés syndiqués. Les obligations contractées dans ces conventions collectives constituaient des engagements immuables ayant force obligatoire. Ces conventions ne laissaient pas seulement au service public peu de marge de manœuvre quant aux barèmes de rémunération et aux niveaux de dotation dans leur ensemble, elles rendaient *illégale* la modification par le service public — d'une manière incompatible avec les engagements qu'il y prenait — des barèmes de rémunération et des niveaux de dotation quant à 90 p. 100 de son effectif obligatoire.

Or, en appliquant la méthode qu'elle avait dit qu'elle utiliserait à l'égard des dépenses prévues du service public, la Commission a en fait obligé Ontario Power Generation à prouver le caractère raisonnable de toutes ses dépenses de rémunération et a conclu que l'entreprise n'avait présenté ni preuve convaincante, ni documents ou analyses qui justifiaient les barèmes de rémunération. Si elle avait eu recours à l'approche qu'elle avait dit qu'elle utiliserait pour les dépenses à l'égard desquelles la société ne pouvait « prendre de mesures de réduction », la Commission aurait contrôlé la prudence des dépenses après coup et appliqué la présomption réfutable selon laquelle elles étaient raisonnables.

Il se peut fort bien qu'Ontario Power Generation puisse modifier certains niveaux de dotation par voie d'attrition ou grâce à d'autres mécanismes qui ne vont pas à l'encontre de ses obligations suivant les conventions collectives. Il se peut fort bien aussi que les dépenses puissent

costs. But no factual findings were made by the Board about the extent of any such flexibility. There is in fact no evidence in the record, nor any evidence cited in the Board's decision, setting out what proportion of Ontario Power Generation's compensation costs were fixed and what proportion remained subject to the utility's discretion. Given that collective agreements are legally binding, it was unreasonable for the Board to assume that Ontario Power Generation could reduce the costs fixed by these contracts in the absence of any evidence to that effect.

Selecting a test which is more likely to confirm the Board's assumption that collectively-bargained costs are excessive, misconceives the point of the exercise, namely, to determine whether those costs were in fact excessive. Blaming collective bargaining for what are *assumed* to be excessive costs, imposes the appearance of an ideologically-driven conclusion on what is intended to be a principled methodology based on a distinction between committed and forecast costs, not between costs which are collectively bargained and those which are not. While the Board has wide discretion to fix payment amounts that are just and reasonable and, subject to certain limitations, to establish the methodology used to determine such amounts, once the Board establishes a methodology, it is, at the very least, required to faithfully apply it.

Absent methodological clarity and predictability, Ontario Power Generation would be unable to know how to determine what expenditures and investments to make and how to present them to the Board for review. Wandering sporadically from approach to approach, or failing to apply the methodology it declares itself to be following, creates uncertainty and leads, inevitably, to needlessly wasting public time and resources in constantly having to anticipate and respond to moving regulatory targets. Whether or not one can fault the Board for failing to use a particular methodology, what the Board can unquestionably be analytically faulted for, is evaluating all compensation costs fixed by collective agreements as being amenable to adjustment. Treating these compensation costs as reducible was unreasonable.

donc être assimilées à juste titre à des dépenses prévues. La Commission n'a toutefois tiré aucune conclusion de fait sur l'étendue d'une telle marge de manœuvre. En fait, aucun élément du dossier ou de la preuve invoquée par la Commission n'indique dans quelle proportion les dépenses de rémunération d'Ontario Power Generation étaient fixes et dans quelle proportion elles demeuraient assujetties au pouvoir discrétionnaire du service public. Comme les conventions collectives sont contraignantes en droit, il était déraisonnable que la Commission présume qu'Ontario Power Generation pouvait réduire les dépenses déterminées par ces contrats en l'absence de toute preuve en ce sens.

En choisissant un critère éminemment susceptible de confirmer l'hypothèse de la Commission selon laquelle les dépenses issues de négociations collectives sont excessives, on se méprend sur l'objectif de la démarche, qui est de déterminer si ces dépenses étaient bel et bien excessives. Imputer à la négociation collective ce que l'on *suppose* constituer des dépenses excessives revient à substituer ce qui a l'apparence d'une conclusion idéologique à ce qui est censé résulter d'une méthode d'analyse raisonnée qui distingue entre les dépenses convenues et les dépenses prévues, non entre les dépenses issues de négociations collectives et celles qui ne le sont pas. Même si la Commission jouit d'un vaste pouvoir discrétionnaire lui permettant de déterminer les paiements qui sont justes et raisonnables et, à l'intérieur de certaines limites, de définir la méthode utilisée pour établir le montant de ces paiements, dès lors qu'elle a établi une telle méthode, elle doit à tout le moins l'appliquer avec constance.

En l'absence de clarté et de prévisibilité quant à la méthode à appliquer, Ontario Power Generation ne peut savoir comment déterminer les dépenses et les investissements à faire et de quelle manière les soumettre à l'examen de la Commission. Passer sporadiquement d'une approche à une autre ou ne pas appliquer la méthode que l'on prétend appliquer crée de l'incertitude et mène inévitablement au gaspillage inutile du temps et des ressources publics en ce qu'il faut constamment anticiper un objectif réglementaire fluctuant et s'y ajuster. On peut reprocher ou non à la Commission de ne pas avoir appliqué une certaine méthode, mais on peut assurément lui reprocher, sur le plan analytique, d'avoir considéré toutes les dépenses de rémunération déterminées par des conventions collectives comme des dépenses ajustables. Voir dans ces dépenses des dépenses réductibles est à mon sens déraisonnable.

The appeal should accordingly be dismissed, the Board's decision set aside, and the matter remitted to the Board for reconsideration.

Cases Cited

By Rothstein J.

Considered: *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006), 210 O.A.C. 4; *Northwestern Utilities Ltd. v. City of Edmonton*, [1979] 1 S.C.R. 684; **referred to:** *Toronto Hydro-Electric System Ltd. v. Ontario (Energy Board)*, 2010 ONCA 284, 99 O.R. (3d) 481; *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186; *TransCanada Pipelines Ltd. v. National Energy Board*, 2004 FCA 149, 319 N.R. 171; *Ontario Power Generation Inc. (Re)*, EB-2007-0905, November 3, 2008 (online: http://www.ontarioenergyboard.ca/); *CAIMAW v. Paccar of Canada Ltd.*, [1989] 2 S.C.R. 983; *B.C.G.E.U. v. Indust. Rel. Council* (1988), 26 B.C.L.R. (2d) 145; *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67, [2013] 3 S.C.R. 895; *Ellis-Don Ltd. v. Ontario (Labour Relations Board)*, 2001 SCC 4, [2001] 1 S.C.R. 221; *Tremblay v. Quebec (Commission des affaires sociales)*, [1992] 1 S.C.R. 952; *Ontario (Children's Lawyer) v. Ontario (Information and Privacy Commissioner)* (2005), 75 O.R. (3d) 309; *Canada (Attorney General) v. Quadrini*, 2010 FCA 246, [2012] 2 F.C.R. 3; *Leon's Furniture Ltd. v. Information and Privacy Commissioner (Alta.)*, 2011 ABCA 94, 502 A.R. 110; *Henthorne v. British Columbia Ferry Services Inc.*, 2011 BCCA 476, 344 D.L.R. (4th) 292; *United Brotherhood of Carpenters and Joiners of America, Local 1386 v. Bransen Construction Ltd.*, 2002 NBCA 27, 249 N.B.R. (2d) 93; *Chandler v. Alberta Association of Architects*, [1989] 2 S.C.R. 848; *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190; *Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61, [2011] 3 S.C.R. 654; *Tervita Corp. v. Canada (Commissioner of Competition)*, 2015 SCC 3, [2015] 1 S.C.R. 161; *Bell Canada v. Bell Aliant Regional Communications*, 2009 SCC 40, [2009] 2 S.C.R. 764; *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12; *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140; *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989); *U.S. West Communications, Inc. v. Public Service Commission of Utah*, 901 P.2d 270 (1995); *British Columbia Electric Railway Co. v. Public Utilities Commission of British Columbia*, [1960] S.C.R.

Je serais donc d'avis de rejeter le pourvoi, d'annuler la décision de la Commission et de renvoyer l'affaire à la Commission pour réexamen.

Jurisprudence

Citée par le juge Rothstein

Arrêts examinés : *Enbridge Gas Distribution Inc. c. Ontario Energy Board* (2006), 210 O.A.C. 4; *Northwestern Utilities Ltd. c. Ville d'Edmonton*, [1979] 1 R.C.S. 684; **arrêts mentionnés :** *Toronto Hydro-Electric System Ltd. c. Ontario (Energy Board)*, 2010 ONCA 284, 99 O.R. (3d) 481; *Northwestern Utilities Ltd. c. City of Edmonton*, [1929] R.C.S. 186; *TransCanada Pipelines Ltd. c. Office national de l'Énergie*, 2004 CAF 149; *Ontario Power Generation Inc. (Re)*, EB-2007-0905, November 3, 2008 (en ligne : http://www.ontarioenergyboard.ca/); *CAIMAW c. Paccar of Canada Ltd.*, [1989] 2 R.C.S. 983; *B.C.G.E.U. c. Indust. Rel. Council* (1988), 26 B.C.L.R. (2d) 145; *McLean c. Colombie-Britannique (Securities Commission)*, 2013 CSC 67, [2013] 3 R.C.S. 895; *Ellis-Don Ltd. c. Ontario (Commission des relations de travail)*, 2001 CSC 4, [2001] 1 R.C.S. 221; *Tremblay c. Québec (Commission des affaires sociales)*, [1992] 1 R.C.S. 952; *Ontario (Children's Lawyer) c. Ontario (Information and Privacy Commissioner)* (2005), 75 O.R. (3d) 309; *Canada (Procureur général) c. Quadrini*, 2010 CAF 246, [2012] 2 R.C.F. 3; *Leon's Furniture Ltd. c. Information and Privacy Commissioner (Alta.)*, 2011 ABCA 94, 502 A.R. 110; *Henthorne c. British Columbia Ferry Services Inc.*, 2011 BCCA 476, 344 D.L.R. (4th) 292; *United Brotherhood of Carpenters and Joiners of America, Local 1386 c. Bransen Construction Ltd.*, 2002 NBCA 27, 249 R.N.-B. (2e) 93; *Chandler c. Alberta Association of Architects*, [1989] 2 R.C.S. 848; *Dunsmuir c. Nouveau-Brunswick*, 2008 CSC 9, [2008] 1 R.C.S. 190; *Alberta (Information and Privacy Commissioner) c. Alberta Teachers' Association*, 2011 CSC 61, [2011] 3 R.C.S. 654; *Tervita Corp. c. Canada (Commissaire de la concurrence)*, 2015 CSC 3, [2015] 1 R.C.S. 161; *Bell Canada c. Bell Aliant Communications régionales*, 2009 CSC 40, [2009] 2 R.C.S. 764; *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12; *ATCO Gas and Pipelines Ltd. c. Alberta (Energy and Utilities Board)*, 2006 CSC 4, [2006] 1 R.C.S. 140; *State of Missouri ex rel. Southwestern Bell Telephone Co. c. Public Service Commission of Missouri*, 262 U.S. 276 (1923); *Duquesne Light Co. c. Barasch*, 488 U.S. 299 (1989); *U.S. West Communications, Inc. c. Public Service Commission of Utah*, 901 P.2d 270 (1995); *British Columbia Electric Railway Co. c. Public Utilities Commission of British Columbia*, [1960]

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By Abella J. (dissenting)

Verizon Communications Inc. v. Federal Communications Commission, 535 U.S. 467 (2002); *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186; *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923); *Enersource Hydro Mississauga Inc. (Re)*, 2012 LNONOEB 373 (QL); *Enbridge Gas Distribution Inc. (Re)*, 2002 LNONOEB 4 (QL); *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006), 210 O.A.C. 4; *Ontario Power Generation v. Society of Energy Professionals*, [2011] O.L.A.A. No. 117 (QL); *TransCanada Pipelines Ltd. v. National Energy Board*, 2004 FCA 149, 319 N.R. 171.

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Glenn Zacher, *Patrick Duffy* and *James Wilson*, for the appellant.

John B. Laskin, *Crawford Smith*, *Myriam Seers* and *Carlton Mathias*, for the respondent Ontario Power Generation Inc.

Richard P. Stephenson and *Emily Lawrence*, for the respondent the Power Workers' Union, Canadian Union of Public Employees, Local 1000.

Paul J. J. Cavalluzzo and *Amanda Darrach*, for the respondent the Society of Energy Professionals.

Mark Rubenstein, for the intervener.

Kahn, Jonathan. « Keep *Hope* Alive : Updating the Prudent Investment Standard for Allocating Nuclear Plant Cancellation Costs » (2010), 22 *Fordham Envtl. L. Rev.* 43.

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POURVOI contre un arrêt de la Cour d'appel de l'Ontario (les juges Rosenberg, Goudge et Blair), 2013 ONCA 359, 116 O.R. (3d) 793, 365 D.L.R. (4th) 247, 307 O.A.C. 109, [2013] O.J. No. 3917 (QL), 2013 CarswellOnt 9792 (WL Can.), qui a infirmé une décision de la Cour divisionnaire (les juges Aitken, Swinton et Hoy), 2012 ONSC 729, 109 O.R. (3d) 576, 347 D.L.R. (4th) 355, [2012] O.J. No. 862 (QL), 2012 CarswellOnt 2710 (WL Can.), et une décision de la Commission de l'énergie de l'Ontario, EB-2010-0008, 10 mars 2011 (en ligne : http://www.ontarioenergyboard.ca/), 2011 LNONOEB 57 (QL), 2011 CarswellOnt 3723 (WL Can.). Pourvoi accueilli, la juge Abella est dissidente.

Glenn Zacher, *Patrick Duffy* et *James Wilson*, pour l'appelante.

John B. Laskin, *Crawford Smith*, *Myriam Seers* et *Carlton Mathias*, pour l'intimée Ontario Power Generation Inc.

Richard P. Stephenson et *Emily Lawrence*, pour l'intimé le Syndicat des travailleurs et travailleuses du secteur énergétique, Syndicat canadien de la fonction publique, section locale 1000.

Paul J. J. Cavalluzzo et *Amanda Darrach*, pour l'intimée Society of Energy Professionals.

Mark Rubenstein, pour l'intervenante.

The judgment of McLachlin C.J. and Rothstein, Cromwell, Moldaver, Karakatsanis and Gascon JJ. was delivered by

[1] ROTHSTEIN J. — In Ontario, utility rates are regulated through a process by which a utility seeks approval from the Ontario Energy Board ("Board") for costs the utility has incurred or expects to incur in a specified period of time. Where the Board approves of costs, they are incorporated into utility rates such that the utility receives payment amounts to cover the approved expenditures. This case concerns the decision of the Board to disallow certain payment amounts applied for by Ontario Power Generation Inc. ("OPG") as part of its rate application covering the 2011-2012 operating period. Specifically, the Board disallowed $145 million in labour compensation costs related to OPG's nuclear operations on the grounds that OPG's labour costs were out of step with those of comparable entities in the regulated power generation industry.

[2] OPG appealed the Board's decision to the Ontario Divisional Court. A majority of the court dismissed the appeal and upheld the decision of the Board. OPG then appealed that decision to the Ontario Court of Appeal, which set aside the decisions of the Divisional Court and the Board and remitted the matter to the Board for redetermination in accordance with its reasons. The Board now appeals to this Court.

[3] OPG asserts that the Board's decision to disallow these labour compensation costs was unreasonable. The crux of OPG's argument is that the Board is legally required to compensate OPG for all of its prudently committed or incurred costs. OPG asserts that prudence in this context has a particular methodological meaning that requires the Board to assess the reasonableness of OPG's decisions to incur or commit to costs at the time the decisions to incur or commit to the costs were made and that OPG ought to benefit from a presumption of prudence. Because the Board did not employ this prudence

Version française du jugement de la juge en chef McLachlin et des juges Rothstein, Cromwell, Moldaver, Karakatsanis et Gascon rendu par

[1] LE JUGE ROTHSTEIN — En Ontario, la tarification d'un service public est réglementée, de sorte que ce dernier doit obtenir de la Commission de l'énergie de l'Ontario (« Commission ») l'approbation des dépenses qu'il a faites ou qu'il prévoit faire pendant une période donnée. Lorsque cette approbation est obtenue, les tarifs sont rajustés de manière que l'entreprise touche des paiements qui correspondent à ses dépenses. Le présent pourvoi vise la décision de la Commission de refuser certains paiements à Ontario Power Generation Inc. (« OPG ») par suite de sa demande d'approbation de tarifs pour la période 2011-2012. Plus particulièrement, la Commission a refusé d'approuver des dépenses de 145 millions de dollars au titre de la rémunération du personnel affecté aux installations nucléaires au motif que le coût de la main-d'œuvre d'OPG était en rupture avec celui d'organismes comparables dans le secteur réglementé de la production d'énergie.

[2] OPG en a appelé devant la Cour divisionnaire de l'Ontario, dont les juges majoritaires ont rejeté l'appel et confirmé la décision de la Commission. OPG s'est alors adressée à la Cour d'appel de l'Ontario, qui a annulé les décisions de la Cour divisionnaire et de la Commission, puis renvoyé le dossier à la Commission afin qu'elle rende une nouvelle décision conforme à ses motifs. La Commission interjette aujourd'hui appel devant notre Cour.

[3] OPG soutient que le refus de la Commission d'approuver ces dépenses de rémunération de ses employés est déraisonnable. Sa thèse veut essentiellement que la Commission soit légalement tenue de l'indemniser de la totalité des dépenses faites ou convenues avec prudence. OPG prétend que, dans ce contexte, la prudence se définit selon une méthode particulière qui exige de la Commission qu'elle détermine si, au moment où elles ont été prises, les décisions de faire les dépenses ou de convenir des dépenses étaient raisonnables. Elle soutient en outre qu'une présomption de prudence

methodology, OPG argues that its decision was unreasonable.

[4] The Board argues that a particular "prudence test" methodology is not compelled by law, and that in any case the costs disallowed here were not "committed" nuclear compensation costs, but are better characterized as forecast costs.

[5] OPG also raises concerns regarding the Board's role in acting as a party on appeal from its own decision. OPG argues that in this case, the Board's aggressive and adversarial defence of its original decision was improper, and that the Board attempted to use the appeal to "bootstrap" its original decision by making additional arguments on appeal.

[6] The Board asserts that the scope of its authority to argue on appeal was settled when it was granted full party rights in connection with the granting of leave by this Court. Alternatively, the Board argues that the structure of utilities regulation in Ontario makes it necessary and important for it to argue the merits of its decisions on appeal.

[7] In my opinion, the labour compensation costs which led to the $145 million disallowance are best understood as partly committed costs and partly costs subject to management discretion. They are partly committed because they resulted from collective agreements entered into between OPG and two of its unions, and partly subject to management discretion because OPG retained some flexibility to manage total staffing levels in light of, among other things, projected attrition of the workforce. It is not reasonable to treat these costs as entirely forecast. However, I do not agree with OPG that the Board was bound to apply a particular prudence test in evaluating these costs. The *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B, and associated regulations give the Board broad latitude to determine the methodology it uses in assessing utility

doit s'appliquer à son bénéfice. La Commission n'ayant pas eu recours à pareille méthode pour se prononcer sur la prudence d'OPG, sa décision serait déraisonnable.

[4] La Commission rétorque que la loi ne l'oblige pas à employer quelque méthode pour appliquer le « principe de la prudence » et que, de toute manière, les dépenses de rémunération des employés du secteur nucléaire refusées en l'espèce n'étaient pas des dépenses « convenues », mais bien des dépenses prévues.

[5] OPG déplore par ailleurs que la Commission soit partie à l'appel de sa propre décision. Selon elle, la manière agressive et conflictuelle dont la Commission a défendu sa décision initiale n'était pas justifiée, et la Commission tente de se servir de l'appel pour « s'auto-justifier » en formulant de nouveaux arguments à l'appui de sa décision initiale.

[6] La Commission fait valoir que la Cour a circonscrit la faculté qu'elle avait de plaider en appel lorsqu'elle lui a reconnu tous les droits d'une partie au moment d'autoriser le pourvoi. Subsidiairement, elle soutient que la manière dont les services publics sont réglementés en Ontario fait en sorte qu'il est nécessaire et important qu'elle défende la justesse de ses décisions portées en appel.

[7] Il convient mieux, à mon sens, de voir dans les dépenses de rémunération qui ont été refusées à raison de 145 millions de dollars en partie des dépenses convenues et en partie des dépenses relevant du pouvoir discrétionnaire de la direction. Elles sont en partie convenues parce qu'elles résultent de conventions collectives intervenues entre OPG et deux syndicats, et elles relèvent en partie de la discrétion de la direction parce qu'OPG conserve une certaine marge de manœuvre dans la gestion des niveaux de dotation globale compte tenu, entre autres, de l'attrition projetée de l'effectif. Il est déraisonnable de considérer qu'il s'agit en totalité de dépenses prévues. Je ne crois cependant pas, malgré ce qu'affirme OPG, que la Commission était tenue d'appliquer un principe de prudence donné pour apprécier les dépenses. La *Loi de 1998 sur la*

costs, subject to the Board's ultimate duty to ensure that payment amounts it orders be just and reasonable to both the utility and consumers.

[8] In this case, the nature of the disputed costs and the environment in which they arose provide a sufficient basis to find that the Board did not act unreasonably in disallowing the costs.

[9] Regarding the Board's role on appeal, I do not find that the Board acted improperly in arguing the merits of this case, nor do I find that the arguments raised on appeal amount to impermissible "bootstrapping".

[10] Accordingly, I would allow the appeal, set aside the decision of the Court of Appeal, and reinstate the decision of the Board.

I. Regulatory Framework

[11] The *Ontario Energy Board Act, 1998* establishes the Board as a regulatory body with authority to oversee, among other things, electricity generation in the province of Ontario. Section 1 sets out the objectives of the Board in regulating electricity, which include:

1. (1) . . .

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 generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Accordingly, the Board must ensure that it regulates with an eye to balancing both consumer interests and the efficiency and financial viability of the

Commission de l'énergie de l'Ontario, L.O. 1998, c. 15, ann. B, et ses règlements connexes accordent à la Commission une grande latitude dans le choix d'une méthode pour apprécier les dépenses d'un service public, sous réserve de l'obligation de faire en sorte que, au final, les paiements qu'elle ordonne soient justes et raisonnables vis-à-vis à la fois du service public et du consommateur.

[8] Dans la présente affaire, la nature des dépenses litigieuses et le contexte dans lequel elles ont vu le jour permettent de conclure que la Commission n'a pas agi de manière déraisonnable en refusant de les approuver.

[9] En ce qui concerne la participation de la Commission au pourvoi, je ne crois pas qu'il soit inapproprié qu'elle défende la justesse de sa décision, ni que les arguments qu'elle invoque en appel équivalent à une « autojustification » inadmissible.

[10] Je suis donc d'avis d'accueillir le pourvoi, d'annuler la décision de la Cour d'appel et de rétablir la décision de la Commission.

I. Cadre réglementaire

[11] La *Loi de 1998 sur la Commission de l'énergie de l'Ontario* fait de la Commission un organisme de réglementation investi du pouvoir de surveiller, entre autres choses, la production d'électricité en Ontario. Son article premier énonce les objectifs de la Commission dans la réglementation de l'électricité, dont les suivants :

1. (1) . . .

1. Protéger les intérêts des consommateurs en ce qui concerne les prix, ainsi que la suffisance, la fiabilité et la qualité du service d'électricité.

2. Promouvoir l'efficacité économique et la rentabilité dans les domaines de la production, du transport, de la distribution et de la vente d'électricité ainsi que de la gestion de la demande d'électricité et faciliter le maintien d'une industrie de l'électricité financièrement viable.

La Commission doit donc s'acquitter de sa fonction de réglementation dans le souci d'établir un équilibre entre l'intérêt du consommateur, d'une part,

electricity industry. The Board's role has also been described as that of a "market proxy": 2012 ONSC 729, 109 O.R. (3d) 576, at para. 54; 2013 ONCA 359, 116 O.R. (3d) 793, at para. 38. In this sense, the Board's role is to emulate as best as possible the forces to which a utility would be subject in a competitive landscape: *Toronto Hydro-Electric System Ltd. v. Ontario (Energy Board)*, 2010 ONCA 284, 99 O.R. (3d) 481, at para. 48.

[12] One of the Board's most powerful tools to achieve its objectives is its authority to fix the amount of payments utilities receive in exchange for the provision of service. Section 78.1(5) of the *Ontario Energy Board Act, 1998* provides in relevant part:

(5) The Board may fix such other payment amounts as it finds to be just and reasonable,

(a) on an application for an order under this section, if the Board is not satisfied that the amount applied for is just and reasonable; . . .

[13] Section 78.1(6) provides: ". . . the burden of proof is on the applicant in an application made under this section".

[14] As I read these provisions, the utility applies for payment amounts for a future period (called the "test period"). The Board will accept the payment amounts applied for unless the Board is not satisfied that the amounts are just and reasonable. Where the Board is not satisfied, s. 78.1(5) empowers it to fix other payment amounts which it finds to be just and reasonable.

[15] This Court has had the occasion to consider the meaning of similar statutory language in *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186. In that case, the Court held that "fair and reasonable" rates were those "which, under the circumstances, would be fair to the consumer on

et l'efficacité et la viabilité financière du secteur de l'électricité, d'autre part. On lui attribue aussi un rôle de « substitut du marché » (2012 ONSC 729, 109 O.R. (3d) 576, par. 54; 2013 ONCA 359, 116 O.R. (3d) 793, par. 38). Sa fonction consiste alors à reproduire au mieux les forces auxquelles serait soumis un service public dans un contexte concurrentiel (*Toronto Hydro-Electric System Ltd. c. Ontario (Energy Board)*, 2010 ONCA 284, 99 O.R. (3d) 481, par. 48).

[12] L'un des leviers les plus puissants dont dispose la Commission pour atteindre ses objectifs réside dans son pouvoir de fixer le montant des paiements que touche l'entreprise pour la prestation du service. Voici l'extrait pertinent du par. 78.1(5) de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* :

(5) La Commission peut fixer les autres paiements qu'elle estime justes et raisonnables :

a) dans le cadre d'une requête en vue d'obtenir une ordonnance prévue au présent article, si elle n'est pas convaincue que le montant du paiement qui fait l'objet de la requête est juste et raisonnable; . . .

[13] Le paragraphe 78.1(6) dispose pour sa part : « . . . le fardeau de la preuve incombe au requérant dans une requête présentée en vertu du présent article ».

[14] Suivant mon interprétation de ces dispositions, le service public demande des paiements pour une période à venir (appelée « période de référence »). La Commission fait droit à la demande, sauf lorsqu'elle n'est pas convaincue que les paiements demandés sont justes et raisonnables. Lorsqu'elle n'en est pas convaincue, le par. 78.1(5) lui permet de déterminer les paiements qui lui paraissent justes et raisonnables.

[15] Dans l'arrêt *Northwestern Utilities Ltd. c. City of Edmonton*, [1929] R.C.S. 186, la Cour a eu l'occasion de se prononcer sur le sens d'un libellé législatif semblable. Elle a alors statué que la tarification « juste et raisonnable » était celle [TRADUCTION] « qui, dans les circonstances, était juste pour le

the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested" (pp. 192-93).

[16] This means that the utility must, over the long run, be given the opportunity to recover, through the rates it is permitted to charge, its operating and capital costs ("capital costs" in this sense refers to all costs associated with the utility's invested capital). This case is concerned primarily with operating costs. If recovery of operating costs is not permitted, the utility will not earn its cost of capital, which represents the amount investors require by way of a return on their investment in order to justify an investment in the utility. The required return is one that is equivalent to what they could earn from an investment of comparable risk. Over the long run, unless a regulated utility is allowed to earn its cost of capital, further investment will be discouraged and it will be unable to expand its operations or even maintain existing ones. This will harm not only its shareholders, but also its customers: *TransCanada Pipelines Ltd. v. National Energy Board*, 2004 FCA 149, 319 N.R. 171.

[17] This of course does not mean that the Board must accept every cost that is submitted by the utility, nor does it mean that the rate of return to equity investors is guaranteed. In the short run, return on equity may vary, for example if electricity consumption by the utility's customers is higher or lower than predicted. Similarly, a disallowance of any operating costs to which the utility has committed itself will negatively impact the return to equity investors. I do not intend to enter into a detailed analysis of how the cost of equity capital should be treated by utility regulators, but merely to observe that any disallowance of costs to which a utility has committed itself has an effect on equity investor returns. This effect must be carefully considered in light of the long-run necessity that utilities be able to attract investors and retain earnings in order to survive and operate efficiently and effectively, in accordance with the statutory objectives of the Board in regulating electricity in Ontario.

consommateur, d'une part, et qui permettait à l'entreprise d'obtenir un juste rendement sur les capitaux investis, d'autre part » (p. 192-193).

[16] Dès lors, le service public doit pouvoir à long terme recouvrer, grâce à la tarification approuvée, ses dépenses d'exploitation et ses coûts en capital, ces derniers s'entendant alors de tous les coûts liés aux capitaux investis par le service public. Le pourvoi vise principalement les dépenses d'exploitation. Si leur recouvrement n'est pas autorisé, le service public n'obtient pas l'équivalent du coût du capital, soit le rendement exigé par les investisseurs pour investir dans le service public. Le rendement exigé équivaut à celui qu'ils pourraient réaliser sur un investissement comportant un risque comparable. À long terme, à moins que le service public réglementé ne puisse obtenir l'équivalent du coût du capital, les nouveaux investissements seront découragés et l'entreprise ne pourra accroître ses activités, ni même les poursuivre. Ce sont non seulement ses actionnaires, mais aussi ses clients, qui en souffriront (*TransCanada Pipelines Ltd. c. Office national de l'Énergie*, 2004 CAF 149).

[17] Évidemment, la Commission n'est pas tenue pour autant d'accepter toute dépense avancée par le service public, et le rendement obtenu par les actionnaires n'est pas non plus garanti. À court terme, ce rendement peut fluctuer, notamment lorsque la consommation d'électricité est supérieure ou inférieure à celle prévue. De même, le refus d'approuver des dépenses d'exploitation dont le service public a convenu aura un effet défavorable sur le rendement des actions. Je n'entends pas me livrer à une analyse détaillée de la manière dont le coût du capital-actions devrait être considéré par les organismes qui réglementent les services publics, mais seulement faire observer que tout refus d'approuver une dépense dont un service public a convenu a un effet sur le rendement des actions. Cet effet justifie une grande attention au vu de la nécessité qu'un service public attire les investissements à long terme et réinvestisse ses bénéfices afin de survivre et de fonctionner de manière efficace et rentable, conformément aux objectifs légaux de la Commission applicables à la réglementation de l'électricité en Ontario.

[18] As noted above, the burden is on the utility to satisfy the Board that the payment amounts it applies for are just and reasonable. If it fails to do so, the Board may disallow the portion of the application that it finds is not for amounts that are just and reasonable.

[19] Where applied-for operating costs are disallowed, the utility, if it is able to do so, may forego the expenditure of such costs. Where the expenditure cannot be foregone, the shareholders of the utility will have to absorb the reduction in the form of receiving less than their anticipated rate of return on their investment, i.e. the utility's cost of equity capital. In such circumstances it will be the management of the utility that will be responsible in the future for bringing its costs into line with what the Board considers just and reasonable.

[20] In order to ensure that the balance between utilities' and consumers' interests is struck, just and reasonable rates must be those that ensure consumers are paying what the Board expects it to cost to efficiently provide the services they receive, taking account of both operating and capital costs. In that way, consumers may be assured that, overall, they are paying no more than what is necessary for the service they receive, and utilities may be assured of an opportunity to earn a fair return for providing those services.

II. Facts

[21] OPG is Ontario's largest energy generator, and is subject to rate regulation by the Board. OPG came into being in 1999 as one of the successor corporations to Ontario Hydro. It operates Board-regulated nuclear and hydroelectric facilities that generate approximately half of Ontario's electricity. Its sole shareholder is the Province of Ontario.

[22] It employs approximately 10,000 people in connection with its regulated facilities, 95 percent of whom work in its nuclear business. Approximately 90 percent of its employees in its regulated

[18] Rappelons qu'il incombe au service public de convaincre la Commission du caractère juste et raisonnable des paiements qu'il sollicite. S'il n'y parvient pas, la Commission peut rejeter la demande en partie à raison du montant qui, selon elle, n'est pas juste et raisonnable.

[19] En cas de refus d'approbation, le service public peut renoncer, si cela lui est possible, aux dépenses d'exploitation en cause. S'il ne peut y renoncer, ses actionnaires absorbent le déficit en touchant un rendement inférieur à celui prévu, c'est-à-dire le coût du capital-actions pour le service public. Il appartient dès lors à la direction de ce dernier de faire en sorte que ses dépenses correspondent à celles que la Commission tient pour justes et raisonnables.

[20] Lorsqu'il s'agit d'assurer l'équilibre entre les intérêts du service public et ceux du consommateur, la tarification juste et raisonnable est celle qui fait en sorte que le consommateur paie ce que la Commission prévoit qu'il en coûtera pour la prestation efficace du service, compte tenu à la fois des dépenses d'exploitation et des coûts en capital. Ainsi, le consommateur a l'assurance que, globalement, il ne paie pas plus que ce qui est nécessaire pour obtenir le service, et le service public a l'assurance de pouvoir toucher une juste contrepartie pour la prestation du service.

II. Faits

[21] OPG est le plus grand producteur d'énergie de l'Ontario, et sa tarification est réglementée par la Commission. Elle a vu le jour en 1999 et fait partie des entreprises qui ont succédé à Ontario Hydro. Elle exploite des installations nucléaires et hydroélectriques soumises à la réglementation de la Commission qui produisent environ la moitié de l'électricité consommée dans la province. Son unique actionnaire est la province d'Ontario.

[22] Son effectif se compose d'environ 10 000 personnes pour ses activités réglementées, dont 95 p. 100 travaillent dans le secteur nucléaire. Environ 90 p. 100 des employés affectés à ses activités

businesses are unionized, with approximately two thirds of unionized employees represented by the Power Workers' Union, Canadian Union of Public Employees, Local 1000 ("PWU"), and one third represented by the Society of Energy Professionals ("Society").

[23] Since early in its existence as an independent utility, OPG has been aware of the importance of improving its corporate performance. As part of a general effort to improve its business, OPG undertook efforts to benchmark its nuclear performance against comparable power plants around the world. In a memorandum of agreement ("MOA") with the Province of Ontario dated August 17, 2005, OPG committed to the following:

> OPG will seek continuous improvement in its nuclear generation business and internal services. OPG will benchmark its performance in these areas against CANDU nuclear plants worldwide as well as against the top quartile of private and publicly-owned nuclear electricity generators in North America. OPG's top operational priority will be to improve the operation of its existing nuclear fleet.

(A.R., vol. III, at p. 215)

[24] As part of OPG's first-ever rate application with the Board in 2007, for a test period covering the years 2008 and 2009, OPG sought approval for a $6.4 billion "revenue requirement"; this term refers to "the total revenue that is required by the company to pay all of its allowable expenses and also to recover all costs associated with its invested capital": L. Reid and J. Todd, "New Developments in Rate Design for Electricity Distributors", in G. Kaiser and B. Heggie, eds., *Energy Law and Policy* (2011), 519, at p. 521. This constituted an increase of $1 billion over the revenue requirement that it had sought and was granted under the regulatory scheme in place prior to the Board's assumption of regulatory authority over OPG: EB-2007-0905, Decision with Reasons, November 3, 2008 ("Board 2008-2009 Decision") (online), at pp. 5-6.

réglementées sont syndiqués, dont approximativement les deux tiers sont représentés par le Syndicat des travailleurs et travailleuses du secteur énergétique, Syndicat canadien de la fonction publique, section locale 1000 (« STTSE »), et le tiers par Society of Energy Professionals (« Society »).

[23] Dès ses débuts en tant que service public indépendant, OPG a eu conscience de l'importance d'accroître sa performance d'entreprise. Dans le cadre de mesures générales prises à cette fin, elle a entrepris de comparer le rendement de son secteur nucléaire à celui de centrales comparables dans le monde. Dans un protocole d'accord intervenu avec la province d'Ontario le 17 août 2005, OPG a pris l'engagement suivant :

> [TRADUCTION] OPG visera l'amélioration constante de son secteur nucléaire et de ses services internes. Elle comparera sa performance dans ces domaines à celle de l'exploitation des réacteurs CANDU à travers le monde ainsi qu'à celle des producteurs privés et publics d'électricité d'origine nucléaire appartenant au quartile supérieur en Amérique du Nord. Sa priorité première sera d'améliorer l'exploitation de son parc nucléaire actuel.

(d.a., vol. III, p. 215)

[24] Dans la toute première demande qu'elle a présentée à la Commission en 2007 pour la période de référence 2008-2009, OPG a sollicité l'approbation de « recettes nécessaires » se chiffrant à 6,4 milliards de dollars; ce poste correspond [TRADUCTION] « aux recettes dont l'entreprise a besoin au total pour le paiement de toutes ses dépenses susceptibles d'approbation et, également, pour recouvrer tous les coûts liés aux capitaux investis » (L. Reid et J. Todd, « New Developments in Rate Design for Electricity Distributors », dans G. Kaiser et B. Heggie, dir., *Energy Law and Policy* (2011), 519, p. 521). Il s'agissait d'une majoration d'un milliard de dollars par rapport à ce qu'OPG avait demandé et obtenu en application du régime de réglementation en vigueur avant que la Commission ne soit investie de son pouvoir de réglementation vis-à-vis d'elle (EB-2007-0905, décision motivée, 3 novembre 2008 (« décision 2008-2009 de la Commission ») (en ligne), p. 5-6).

[25] The Board found that OPG was not meeting the nuclear performance expectations of its sole shareholder and that it had done little to conduct benchmarking of its performance against that of its peers, despite its commitment to do so dating back to 2005. Indeed, the only evidence of benchmarking that OPG submitted as part of its rate application was a 2006 report from Navigant Consulting, Inc. ("Navigant Report"), which found that OPG was overstaffed by 12 percent in comparison to its peers. The Board found that OPG had not acted on the recommendations of the Navigant Report and had not commissioned subsequent benchmarking studies to assess its performance (Board 2008-2009 Decision, at pp. 27 and 30). The Board also found that operating costs at OPG's Pickering nuclear facilities were "far above industry averages" (p. 29). The Board thus disallowed $35 million of OPG's proposed revenue requirement and directed OPG to prepare benchmarking studies for use in future applications (p. 31).

[26] In explaining the importance of benchmarking, the Board stated: "The reason why the MOA emphasized benchmarking was because such studies can and do shine a light on inefficiencies and lack of productivity improvement" (Board 2008-2009 Decision, at p. 30).

[27] On May 5, 2010, shortly before OPG was set to file its second rate application, which is the subject of this appeal, the Ontario Minister of Energy and Infrastructure wrote to the President and CEO of OPG to ensure that OPG would demonstrate in its upcoming rate application "concerted efforts to identify cost saving opportunities and focus [its] forthcoming rate application on those items that are essential to the safe and reliable operation of [its] existing assets and projects already under development" (A.R., vol. IV, at p. 38).

[25] La Commission a estimé qu'OPG ne satisfaisait pas aux attentes de son unique actionnaire quant à la performance de son secteur nucléaire et qu'elle avait peu fait pour comparer sa performance à celle de ses pairs, alors qu'elle s'y était engagée dès 2005. De fait, la seule preuve d'une démarche en ce sens présentée par OPG dans le cadre de sa demande d'approbation de tarifs était un rapport établi par Navigant Consulting Inc. en 2006 (« rapport Navigant ») et selon lequel l'effectif d'OPG dépassait de 12 p. 100 celui de ses pairs. La Commission a conclu qu'OPG n'avait pas donné suite aux recommandations du rapport Navigant, ni commandé d'études comparatives ultérieures pour évaluer sa performance (décision 2008-2009 de la Commission, p. 27 et 30). Elle a aussi jugé les coûts d'exploitation d'OPG aux installations nucléaires de Pickering [TRADUCTION] « bien supérieurs à la moyenne du secteur » (p. 29). Elle a donc refusé d'approuver 35 millions de dollars au chapitre des recettes nécessaires et enjoint à OPG de réaliser des études comparatives pour étayer ses demandes ultérieures (p. 31).

[26] Pour expliquer l'importance de la comparaison, la Commission dit ce qui suit : [TRADUCTION] « La raison pour laquelle le protocole d'accord insiste sur la conduite d'une étude comparative est qu'une telle étude peut faire et fait ressortir toute inefficacité ou absence d'accroissement de la productivité » (décision 2008-2009 de la Commission, p. 30).

[27] Le 5 mai 2010, peu avant qu'OPG ne dépose sa deuxième demande d'approbation de tarifs — qui est l'objet du pourvoi —, le ministre de l'Énergie et de l'Infrastructure de l'Ontario a écrit au président-directeur général du service public afin que ce dernier fasse état, dans sa demande, [TRADUCTION] « d'efforts concertés pour trouver des moyens de réaliser des économies et mette l'accent sur les postes de dépense qui sont essentiels à l'exploitation sûre et fiable de ses actifs existants et de ses installations projetées déjà en cours de réalisation » (d.a., vol. IV, p. 38).

[28] On May 26, 2010, OPG filed its payment amounts application for the 2011-2012 test period. As part of its evidence before the Board, OPG submitted two reports by ScottMadden Inc., a general management consulting firm specializing in benchmarking and business planning for nuclear facilities. The Phase 1 report compared OPG's nuclear operational and financial performance against that of external peers using industry performance metrics. The Phase 2 final report discussed performance improvement targets with the intent of improving OPG's nuclear business. OPG collaborated with ScottMadden on the Phase 1 and 2 reports, which were released on July 2, 2009 and September 11, 2009, respectively.

[29] OPG's rate application pertained to a test period beginning on January 1, 2011 and ending on December 31, 2012. OPG sought approval of a $6.9 billion revenue requirement, which represented an increase of 6.2 percent over OPG's then-current revenue based on the preceding year's approved utility rates. Of the $6.9 billion revenue requirement sought by OPG, $2.8 billion pertained to compensation costs, of which approximately $2.4 billion concerned OPG's nuclear business.

[30] A substantial portion of OPG's wage and compensation expenses was fixed by OPG's collective agreements with the unions, PWU and the Society. At the time of its application, OPG was party to a collective agreement with PWU, effective from April 2009 through March 2012, while its collective agreement with the Society expired on December 31, 2010. These collective agreements provided annual wage increases between 2 percent and 3 percent. OPG forecast an additional 1 percent increase for step progressions and promotions of unionized staff. Following the Board's hearing in this case, an interest arbitrator ordered a new collective agreement between OPG and the Society, effective February 3, 2011. This collective agreement provided wage increases that varied between 1 percent and 3 percent.

[28] Le 26 mai 2010, OPG a déposé sa demande de paiements pour la période de référence 2011-2012. Elle a présenté à l'appui deux rapports de ScottMadden Inc., un cabinet-conseil en gestion générale spécialisé dans la comparaison et la planification opérationnelle d'installations nucléaires. Le rapport de la phase 1 compare la performance opérationnelle et financière d'OPG à celle d'autres entreprises à partir de mesures de la performance dans le secteur d'activité. Le rapport final de la phase 2 porte sur les objectifs d'accroissement de la performance dans l'optique d'une amélioration de l'exploitation du secteur nucléaire. OPG a collaboré avec ScottMadden pour l'établissement des rapports des phases 1 et 2, qui ont respectivement été publiés les 2 juillet et 11 septembre 2009.

[29] La demande visait la période allant du 1er janvier 2011 au 31 décembre 2012. OPG y demandait l'approbation de recettes nécessaires de 6,9 milliards de dollars, soit une augmentation de 6,2 p. 100 par rapport aux recettes d'alors compte tenu des tarifs approuvés pour la période précédente. Des 6,9 milliards de dollars sollicités au titre des recettes nécessaires, 2,8 milliards auraient été affectés à la rémunération, dont environ 2,4 milliards dans le secteur nucléaire.

[30] Une grande partie des dépenses d'OPG au chapitre des salaires et de la rémunération était déterminée par des conventions collectives intervenues avec les syndicats (STTSE et Society). Lors du dépôt de la demande, OPG était liée par une convention collective conclue avec le STTSE en vigueur d'avril 2009 à mars 2012, alors que la convention collective qui la liait à Society avait expiré le 31 décembre 2010. Ces conventions collectives prévoyaient des augmentations annuelles de salaires se situant entre 2 et 3 p. 100, auxquelles s'ajoutait 1 p. 100 pour les changements d'échelon et l'avancement. Après l'audition de la demande par la Commission dans la présente affaire, un arbitre a ordonné l'application d'une nouvelle convention collective liant OPG et Society à compter du 3 février 2011. La convention collective prévoyait des augmentations de salaires de 1 à 3 p. 100.

III. Judicial History

A. *Ontario Energy Board: 2011 LNONOEB 57 (QL) ("Board Decision")*

[31] In its decision concerning OPG's rate application for the 2011-2012 test period, the Board stated that it enjoyed broad discretion pursuant to Ontario Regulation 53/05 (*Payments Under Section 78.1 of the Act*) and s. 78.1 of the *Ontario Energy Board Act, 1998* to "adopt the mechanisms it judges appropriate in setting just and reasonable rates" (para. 73). The Board recognized that different tests could apply depending on whether its analysis concerned the recovery of forecast costs or an after-the-fact review of costs already incurred. In this rate application, it was appropriate to take into consideration all evidence that the Board deemed relevant to assess the reasonableness of OPG's revenue requirement.

[32] The Board rejected OPG's proposed revenue requirement of $6.9 billion, reducing it by $145 million over the test period "to send a clear signal that OPG must take responsibility for improving its performance" (para. 350). Key to its disallowance was the Board's finding that OPG was overstaffed and that its compensation levels were excessive.

[33] Regarding the number of staff, the Board pointed out that a benchmarking study commissioned by OPG itself, the ScottMadden Phase 2 final report, suggested that certain staff positions could be reduced or eliminated altogether. The Board suggested that OPG could review its organizational structure and reassign or eliminate positions in the coming years, as 20 percent to 25 percent of its staff were set to retire between 2010 and 2014 and it was possible to make greater use of external contractors. Regarding compensation, the Board found that OPG had not submitted compelling evidence justifying the benchmarking of its salaries of non-management employees to the 75th percentile of a survey of

III. Historique judiciaire

A. *Commission de l'énergie de l'Ontario (2011 LNONOEB 57 (QL) (« décision de la Commission »))*

[31] Dans sa décision relative à la demande d'approbation de tarifs d'OPG pour la période de référence 2011-2012, la Commission dit que le règlement 53/05 de l'Ontario (*Payments Under Section 78.1 of the Act*) (« règlement 53/05 ») et l'art. 78.1 de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* lui confèrent un vaste pouvoir discrétionnaire quant [TRADUCTION] « au choix d'une méthode indiquée pour fixer des tarifs justes et raisonnables » (para. 73). Elle reconnaît que différents principes peuvent s'appliquer selon qu'il s'agit du recouvrement de dépenses prévues ou de l'examen après coup de dépenses déjà faites. Pour statuer sur la demande dont elle était saisie, il convenait de tenir compte de tout élément de preuve que la Commission jugeait pertinent pour apprécier le caractère raisonnable des recettes nécessaires d'OPG.

[32] La Commission refuse d'approuver les 6,9 milliards de dollars demandés par OPG au titre des recettes nécessaires, les réduisant de 145 millions de dollars pour la période référence [TRADUCTION] « afin de signifier clairement à OPG qu'il lui incombe d'accroître sa performance » (par. 350). Cette décision défavorable tient surtout à l'opinion de la Commission selon laquelle OPG compte trop d'employés et ses niveaux de rémunération sont excessifs.

[33] Au sujet de la taille de l'effectif, la Commission relève que, selon une étude comparative qu'OPG a elle-même commandée (le rapport final de la phase 2 de ScottMadden), la dotation de certains postes peut être réduite, voire supprimée. Elle recommande à OPG de revoir sa structure organisationnelle et de réaffecter du personnel ou de supprimer des postes au cours des années suivantes. Vingt à vingt-cinq pour cent du personnel d'OPG devait en effet partir à la retraite entre 2010 et 2014 et il était possible de recourir davantage à la sous-traitance. Au chapitre de la rémunération, elle estime qu'OPG n'a pas présenté d'éléments convaincants pour justifier que les salaires de son personnel opérationnel

industry salaries conducted by Towers Perrin. Instead, the Board considered the proper benchmark to be the 50th percentile, the same percentile against which OPG benchmarks management compensation. In determining the appropriate disallowance, the Board acknowledged that OPG may not have been able to achieve the full $145 million in savings for the test period through the reduction of compensation levels alone because of its collective agreements with the unions.

B. *Ontario Superior Court of Justice, Divisional Court: 2012 ONSC 729, 109 O.R. (3d) 576*

[34] OPG appealed the Board Decision on the basis that it was unreasonable and that the reasons provided were inadequate. OPG argued that the Board should have conducted a prudent investment test — that is, it should have restricted its review of compensation costs to a consideration of whether the collective agreements that prescribed the compensation costs were prudent at the time they were entered into. OPG also argued that the Board should have presumed that the costs were prudent.

[35] The panel of three Divisional Court judges was split. Justice Hoy (as she then was), for the majority, found the Board Decision reasonable because management had the ability to reduce total compensation costs in the future within the framework of the collective agreement. Applying a strict prudent investment test would not permit the Board to fulfill its statutory objective of promoting cost effectiveness in the generation of electricity. It was particularly important for the Board to exercise its authority to set just and reasonable rates given the "double monopoly" dynamic at play:

> The collective agreements were concluded between a regulated monopoly, which passes costs on to consumers, not a competitive enterprise, and two unions which account for approximately 90 per cent of the employees and amount to a near, second monopoly, based on terms

se situent au 75e percentile des salaires versés dans le secteur selon une étude de Towers Perrin. Selon la Commission, ils devraient se situer au 50e percentile, soit le même que pour le personnel de direction. Pour décider de la réduction qui s'impose, elle reconnaît qu'OPG pourrait ne pas être en mesure, pendant la période de référence, de réaliser des économies de 145 millions de dollars par la réduction de sa seule masse salariale à cause des conventions collectives en vigueur.

B. *Cour supérieure de Justice de l'Ontario, Cour divisionnaire (2012 ONSC 729, 109 O.R. (3d) 576)*

[34] OPG a fait appel de la décision au motif que celle-ci était déraisonnable et mal motivée. Elle a soutenu que la Commission aurait dû appliquer le principe de l'investissement prudent, c'est-à-dire que, dans son examen des dépenses de rémunération, elle aurait dû seulement s'interroger sur la prudence de conclure, à l'époque, les conventions collectives qui commandaient ces dépenses. Elle a ajouté que la Commission aurait dû présumer que les dépenses étaient prudentes.

[35] La décision de la formation de trois juges de la Cour divisionnaire est partagée. Au nom des juges majoritaires, la juge Hoy (aujourd'hui Juge en chef adjointe de l'Ontario) conclut que la décision de la Commission est raisonnable, car il était possible à la direction d'OPG de réduire ultérieurement ses dépenses globales de rémunération dans le respect des conventions collectives. L'application stricte du principe de l'investissement prudent n'aurait pas permis à la Commission d'atteindre son objectif, d'origine législative, de favoriser la rentabilité de la production d'électricité. Vu la présence de « deux monopoles », il importait particulièrement que la Commission exerce son pouvoir de fixer des tarifs justes et raisonnables :

> [TRADUCTION] Les conventions collectives sont intervenues entre un monopole réglementé qui refile ses coûts au consommateur et qui n'est pas soumis à la concurrence, et deux syndicats qui représentent environ 90 p. 100 des salariés et qui constituent presque un second monopole

inherited from Ontario Hydro and in face of the reality that running a nuclear operation without the employees would be extremely difficult. [para. 54]

[36] Justice Aitken dissented, finding that,

to the extent that [nuclear compensation] costs were predetermined, in the sense that they were locked in as a result of collective agreements entered prior to the date of the application and the test period, OPG only had to prove their prudence or reasonableness based on the circumstances that were known or that reasonably could have been anticipated at the time the decision to enter those collective agreements was made. [para. 83]

She would have held that the Board's failure to undertake a separate and explicit prudence review for the committed portion of nuclear compensation costs, coupled with its consideration of hindsight factors in assessing the reasonableness of these costs, rendered the Board Decision unreasonable.

C. *Ontario Court of Appeal: 2013 ONCA 359, 116 O.R. (3d) 793*

[37] The Ontario Court of Appeal reversed the Divisional Court's decision and remitted the case to the Board. The court drew a distinction between forecast costs and committed costs, with committed costs being those that the utility "is committed to pay in [the test period]" and that "cannot be managed or reduced by the utility in that time frame, usually because of contractual obligations" (para. 29). Although costs may not require actual payment until the future, as in this case, costs that have been "contractually incurred to be paid over the time frame are nonetheless committed even though they have not yet been paid" (para. 29). When reviewing such costs, the court held that the Board must undertake a prudence review as described in *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006), 210 O.A.C. 4 (paras. 15-16). By failing to follow this jurisprudence and by requiring that OPG "manage costs that, by law, it cannot manage", the Board acted unreasonably (para. 37).

étant donné les conditions héritées d'Ontario Hydro et le fait qu'il serait extrêmement difficile d'exploiter des installations nucléaires sans les salariés. [par. 54]

[36] Dissidente, la juge Aitken opine que,

[TRADUCTION] dans la mesure où les coûts [de rémunération des employés du secteur nucléaire] étaient déterminés à l'avance, c'est-à-dire qu'ils étaient arrêtés par des conventions collectives conclues avant la demande et la période de référence, OPG devait seulement prouver la prudence ou le caractère raisonnable de la décision de conclure ces conventions au vu des circonstances connues ou qui auraient pu raisonnablement être prévues au moment de prendre la décision. [par. 83]

Elle aurait statué que l'omission de la Commission d'appliquer séparément et expressément le principe de la prudence à la partie des dépenses de rémunération du secteur nucléaire dont elle avait convenu, jumelée à son appréciation avec le recul du caractère raisonnable de ces dépenses, a rendu la décision de la Commission déraisonnable.

C. *Cour d'appel de l'Ontario (2013 ONCA 359, 116 O.R. (3d) 793)*

[37] La Cour d'appel de l'Ontario infirme le jugement de la Cour divisionnaire et renvoie le dossier à la Commission. Elle établit une distinction entre les dépenses prévues et les dépenses convenues, ces dernières correspondant à celles que le service public [TRADUCTION] « a convenu d'acquitter pendant [la période de référence] » et qu'il « ne peut modifier ou réduire pendant cette période, généralement à cause d'obligations contractuelles » (par. 29). Même si les dépenses n'ont pas à être acquittées dans l'immédiat, comme en l'espèce, celles qui, « par contrat, doivent être acquittées pendant la période de référence constituent néanmoins des dépenses convenues, même si elles n'ont pas encore été acquittées » (par. 29). La Cour d'appel statue que la Commission doit, dans son examen de ces dépenses, appliquer le principe de la prudence énoncé dans *Enbridge Gas Distribution Inc. c. Ontario Energy Board* (2006), 210 O.A.C. 4 (par. 15-16). En ne respectant pas ce précédent et en obligeant OPG à « modifier des dépenses qu'elle ne peut juridiquement modifier », la Commission a agi déraisonnablement (par. 37).

IV. Issues

[38] The Board raises two issues on appeal:

1. What is the appropriate standard of review?

2. Was the Board's decision to disallow $145 million of OPG's revenue requirement reasonable?

[39] Before this Court, OPG has argued that the Board stepped beyond the appropriate role of a tribunal in an appeal from its own decision, which raises the following additional issue:

3. Did the Board act impermissibly in pursuing its appeal in this case?

V. Analysis

[40] It is logical to begin by considering the appropriateness of the Board's participation in the appeal. I will next consider the appropriate standard of review, and then the merits issue of whether the Board's decision in this case was reasonable.

A. *The Appropriate Role of the Board in This Appeal*

(1) Tribunal Standing

[41] In *Northwestern Utilities Ltd. v. City of Edmonton*, [1979] 1 S.C.R. 684 ("*Northwestern Utilities*"), per Estey J., this Court first discussed how an administrative decision-maker's participation in the appeal or review of its own decisions may give rise to concerns over tribunal impartiality. Estey J. noted that "active and even aggressive participation can have no other effect than to discredit the impartiality of an administrative tribunal either in the case where the matter is referred back to it, or in future proceedings involving similar interests and

IV. Questions en litige

[38] La Commission soulève deux questions dans le cadre du pourvoi :

1. Quelle est la norme de contrôle applicable?

2. Sa décision de retrancher 145 millions de dollars des recettes nécessaires d'OPG est-elle raisonnable?

[39] Devant notre Cour, OPG fait valoir que la Commission outrepasse le rôle qui sied à un tribunal administratif dans le cadre d'un appel de sa propre décision, ce qui soulève la question supplémentaire suivante :

3. La Commission a-t-elle agi de manière inacceptable en se pourvoyant en tant que partie à l'appel en l'espèce?

V. Analyse

[40] Il convient en toute logique d'examiner d'abord le caractère approprié de la participation de la Commission au pourvoi. J'examinerai ensuite la norme de contrôle applicable, puis la question de fond de savoir si la décision de la Commission est raisonnable.

A. *Le rôle qui sied à la Commission dans le cadre du pourvoi*

(1) La qualité pour agir d'un tribunal administratif

[41] Dans *Northwestern Utilities Ltd. c. Ville d'Edmonton*, [1979] 1 R.C.S. 684 (« *Northwestern Utilities* »), sous la plume du juge Estey, notre Cour se demande pour la première fois en quoi la participation d'un décideur administratif à l'appel ou au contrôle de sa propre décision peut soulever des doutes sur son impartialité. Pour reprendre les propos du juge Estey, « [u]ne participation aussi active ne peut que jeter le discrédit sur l'impartialité d'un tribunal administratif lorsque l'affaire lui est renvoyée ou lorsqu'il est saisi d'autres procédures

issues or the same parties" (p. 709). He further observed that tribunals already receive an opportunity to make their views clear in their original decisions: ". . . it abuses one's notion of propriety to countenance its participation as a full-fledged litigant in this Court" (p. 709).

[42] The Court in *Northwestern Utilities* ultimately held that the Alberta Public Utilities Board — which, like the Ontario Energy Board, had a statutory right to be heard on judicial appeal (see *Ontario Energy Board Act, 1998*, s. 33(3)) — was limited in the scope of the submissions it could make. Specifically, Estey J. observed that

> [i]t has been the policy in this Court to limit the role of an administrative tribunal whose decision is at issue before the Court, even where the right to appear is given by statute, to an explanatory role with reference to the record before the Board and to the making of representations relating to jurisdiction. [p. 709]

[43] This Court further considered the issue of agency standing in *CAIMAW v. Paccar of Canada Ltd.*, [1989] 2 S.C.R. 983, which involved judicial review of a British Columbia Labour Relations Board decision. Though a majority of the judges hearing the case did not endorse a particular approach to the issue, La Forest J., Dickson C.J. concurring, accepted that a tribunal had standing to explain the record and advance its view of the appropriate standard of review and, additionally, to argue that its decision was reasonable.

[44] This finding was supported by the need to make sure the Court's decision on review of the tribunal's decision was fully informed. La Forest J. cited *B.C.G.E.U. v. Indust. Rel. Council* (1988), 26 B.C.L.R. (2d) 145 (C.A.), at p. 153, for the proposition that the tribunal is the party best equipped to draw the Court's attention to

concernant des intérêts et des questions semblables ou impliquant les mêmes parties » (p. 709). Il ajoute que le tribunal administratif avait déjà le loisir de s'expliquer clairement dans sa décision initiale et « [qu'il] enfreint de façon inacceptable la réserve dont [il doit] faire preuve lorsqu'[il] particip[e] aux procédures comme partie à part entière » (p. 709).

[42] Dans *Northwestern Utilities*, notre Cour statue finalement que la portée des observations que pouvait présenter l'Alberta Public Utilities Board — qui, à l'instar de la Commission de l'énergie de l'Ontario, jouissait légalement du droit d'être entendue en appel devant une cour de justice (voir la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, par. 33(3)) — était limitée. Le juge Estey fait remarquer ce qui suit :

> Cette Cour, à cet égard, a toujours voulu limiter le rôle du tribunal administratif dont la décision est contestée à la présentation d'explications sur le dossier dont il était saisi et d'observations sur la question de sa compétence, même lorsque la loi lui confère le droit de comparaître. [p. 709]

[43] Dans *CAIMAW c. Paccar of Canada Ltd.*, [1989] 2 R.C.S. 983, qui porte sur le contrôle judiciaire d'une décision de la commission des relations de travail de la Colombie-Britannique, notre Cour approfondit la question de la qualité pour agir d'un organisme administratif. Même si les juges majoritaires qui ont entendu le pourvoi n'adoptent pas d'approche particulière pour se prononcer, le juge La Forest, avec l'appui du juge en chef Dickson, reconnaît qu'un tribunal administratif a qualité non seulement pour expliquer le dossier et faire valoir son point de vue sur la norme de contrôle applicable, mais aussi pour soutenir que sa décision est raisonnable.

[44] Cette conclusion repose sur la nécessité de faire en sorte que la cour de révision rende un jugement parfaitement éclairé sur la décision du tribunal administratif. Le juge La Forest invoque l'arrêt *B.C.G.E.U. c. Indust. Rel. Council* (1988), 26 B.C.L.R. (2d) 145 (C.A.), p. 153, pour avancer que le tribunal administratif est le mieux placé pour attirer l'attention de la cour

those considerations, rooted in the specialized jurisdiction or expertise of the tribunal, which may render reasonable what would otherwise appear unreasonable to someone not versed in the intricacies of the specialized area.

(*Paccar*, at p. 1016)

La Forest J. found, however, that the tribunal could not go so far as to argue that its decision was correct (p. 1017). Though La Forest J. did not command a majority, L'Heureux-Dubé J. also commented on tribunal standing in her dissent, and agreed with the substance of La Forest J.'s analysis (p. 1026).

[45] Trial and appellate courts have struggled to reconcile this Court's statements in *Northwestern Utilities* and *Paccar*. Indeed, while this Court has never expressly overturned *Northwestern Utilities*, on some occasions, it has permitted tribunals to participate as full parties without comment: see, e.g., *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67, [2013] 3 S.C.R. 895; *Ellis-Don Ltd. v. Ontario (Labour Relations Board)*, 2001 SCC 4, [2001] 1 S.C.R. 221; *Tremblay v. Quebec (Commission des affaires sociales)*, [1992] 1 S.C.R. 952; see also *Ontario (Children's Lawyer) v. Ontario (Information and Privacy Commissioner)* (2005), 75 O.R. (3d) 309 (C.A.) ("*Goodis*"), at para. 24.

[46] A number of appellate decisions have grappled with this issue and "for the most part now display a more relaxed attitude in allowing tribunals to participate in judicial review proceedings or statutory appeals in which their decisions were subject to attack": D. Mullan, "Administrative Law and Energy Regulation", in G. Kaiser and B. Heggie, 35, at p. 51. A review of three appellate decisions suffices to establish the rationale behind this shift.

[47] In *Goodis*, the Children's Lawyer urged the court to refuse or limit the standing of the Information and Privacy Commissioner, whose decision

sur les considérations, enracinées dans la compétence ou les connaissances spécialisées du tribunal, qui peuvent rendre raisonnable ce qui autrement paraîtrait déraisonnable à quelqu'un qui n'est pas versé dans les complexités de ce domaine spécialisé.

(*Paccar*, p. 1016)

Toutefois, le juge La Forest conclut que le tribunal administratif ne peut aller jusqu'à défendre le bien-fondé de sa décision (p. 1017). Sa thèse ne convainc pas une majorité de ses collègues, mais la juge L'Heureux-Dubé, dissidente, qui se prononce elle aussi sur la qualité pour agir du tribunal administratif, souscrit à son analyse sur le fond (p. 1026).

[45] Juridictions de première instance et d'appel ont tenté tant bien que mal de concilier les opinions exprimées par les juges de la Cour dans les arrêts *Northwestern Utilities* et *Paccar*. De fait, même si notre Cour n'est jamais expressément revenue sur *Northwestern Utilities*, elle a parfois autorisé un tribunal administratif à participer à l'instance à titre de partie à part entière sans expliquer sa décision (voir p. ex. *McLean c. Colombie-Britannique (Securities Commission)*, 2013 CSC 67, [2013] 3 R.C.S. 895; *Ellis-Don Ltd. c. Ontario (Commission des relations de travail)*, 2001 CSC 4, [2001] 1 R.C.S. 221; *Tremblay c. Québec (Commission des affaires sociales)*, [1992] 1 R.C.S. 952; voir également *Ontario (Children's Lawyer) c. Ontario (Information and Privacy Commissioner)* (2005), 75 O.R. (3d) 309 (C.A.) (« *Goodis* »), par. 24).

[46] Dans un certain nombre de décisions, les cours d'appel se sont attaquées à la question et, [TRADUCTION] « pour la plupart, elles sont désormais plus enclines à autoriser un tribunal administratif à participer au contrôle judiciaire ou à l'appel, prévu par la loi, de sa propre décision » (D. Mullan, « Administrative Law and Energy Regulation », dans G. Kaiser et B. Heggie, 35, p. 51). Le survol de trois arrêts de juridictions d'appel suffit à établir la raison d'être de ce revirement.

[47] Dans *Goodis*, le Bureau de l'avocate des enfants demandait à la cour de ne pas reconnaître ou de restreindre la qualité pour agir du Commissaire

was under review. The Ontario Court of Appeal declined to apply any formal, fixed rule that would limit the tribunal to certain categories of submissions and instead adopted a contextual, discretionary approach: *Goodis*, at paras. 32-34. The court found no principled basis for the categorical approach, and observed that such an approach may lead to undesirable consequences:

> For example, a categorical rule denying standing if the attack asserts a denial of natural justice could deprive the court of vital submissions if the attack is based on alleged deficiencies in the structure or operation of the tribunal, since these are submissions that the tribunal is uniquely placed to make. Similarly, a rule that would permit a tribunal standing to defend its decision against the standard of reasonableness but not against one of correctness, would allow unnecessary and prevent useful argument. Because the best argument that a decision is reasonable may be that it is correct, a rule based on this distinction seems tenuously founded at best as Robertson J.A. said in *United Brotherhood of Carpenters and Joiners of America, Local 1386 v. Bransen Construction Ltd.*, [2002] N.B.J. No. 114, 249 N.B.R. (2d) 93 (C.A.), at para. 32.

(*Goodis*, at para. 34)

[48] The court held that *Northwestern Utilities* and *Paccar* should be read as the source of "fundamental considerations" that should guide the court's exercise of discretion in the context of the case: *Goodis*, at para. 35. The two most important considerations, drawn from those cases, were the "importance of having a fully informed adjudication of the issues before the court" (para. 37), and "the importance of maintaining tribunal impartiality": para. 38. The court should limit tribunal participation if it will undermine future confidence in its objectivity. The court identified a list of factors, discussed further below, that may aid in determining whether and

à l'information et à la protection de la vie privée dont la décision faisait l'objet d'une demande de contrôle. La Cour d'appel de l'Ontario a refusé de se montrer formaliste et d'appliquer une règle fixe qui aurait obligé le tribunal administratif à s'en tenir à des observations d'un certain type et elle a adopté plutôt une approche contextuelle et discrétionnaire (*Goodis*, par. 32-34). Elle a conclu que l'approche catégorique n'avait pas de fondement rationnel et a fait remarquer qu'une telle approche pouvait avoir des conséquences fâcheuses :

> [TRADUCTION] Par exemple, la règle catégorique qui refuse au tribunal administratif la qualité pour agir lorsque la contestation allègue le déni de justice naturelle peut priver la cour d'observations capitales lorsque la contestation se fonde des défaillances alléguées de la structure ou du fonctionnement du tribunal administratif, car ce sont des sujets sur lesquels ce dernier est particulièrement bien placé pour formuler des observations. De même, la règle qui reconnaît à un tribunal administratif la qualité pour défendre sa décision au regard du critère de la raisonnabilité, mais non du critère de la décision correcte, permet le débat inutile et empêche le débat utile. Parce que le meilleur moyen d'établir la raisonnabilité d'une décision peut être de démontrer qu'elle est correcte, une règle fondée sur cette distinction semble au mieux ténue, comme l'affirme le juge Robertson dans *Fraternité unie des charpentiers et menuisiers d'Amérique, section locale 1386 c. Bransen Construction Ltd.*, [2002] A.N.-B. nº 114, 249 R.N.-B. (2e) 93 (C.A.), par. 32.

(*Goodis*, par. 34)

[48] La Cour d'appel statue qu'il faut voir dans les arrêts *Northwestern Utilities* et *Paccar* la source de [TRADUCTION] « considérations fondamentales » qui doivent guider l'exercice de son pouvoir discrétionnaire eu égard au contexte de l'affaire (*Goodis*, par. 35). Les deux considérations les plus importantes, selon ces arrêts, sont « la nécessité de faire en sorte que la cour rende une décision parfaitement éclairée sur les questions en litige » (par. 37) et « celle d'assurer l'impartialité du tribunal administratif » (par. 38). La cour doit limiter la participation du tribunal administratif lorsque cette participation est de nature à miner la confiance

to what extent the tribunal should be permitted to make submissions: paras. 36-38.

[49] In *Canada (Attorney General) v. Quadrini*, 2010 FCA 246, [2012] 2 F.C.R. 3, Stratas J.A. identified two common law restrictions that, in his view, restricted the scope of a tribunal's participation on appeal from its own decision: finality and impartiality. Finality, the principle whereby a tribunal may not speak on a matter again once it has decided upon it and provided reasons for its decision, is discussed in greater detail below, as it is more directly related to concerns surrounding "bootstrapping" rather than agency standing itself.

[50] The principle of impartiality is implicated by tribunal argument on appeal, because decisions may in some cases be remitted to the tribunal for further consideration. Stratas J.A. found that "[s]ubmissions by the tribunal in a judicial review proceeding that descend too far, too intensely, or too aggressively into the merits of the matter before the tribunal may disable the tribunal from conducting an impartial redetermination of the merits later": *Quadrini*, at para. 16. However, he ultimately found that these principles did not mandate "hard and fast rules", and endorsed the discretionary approach set out by the Ontario Court of Appeal in *Goodis*: *Quadrini*, at paras. 19-20.

[51] A third example of recent judicial consideration of this issue may be found in *Leon's Furniture Ltd. v. Information and Privacy Commissioner (Alta.)*, 2011 ABCA 94, 502 A.R. 110. In this case, Leon's Furniture challenged the Commissioner's standing to make submissions on the merits of the appeal (para. 16). The Alberta Court of Appeal, too, adopted the position that the law should respond to the fundamental concerns raised in *Northwestern*

ultérieure des citoyens dans son objectivité. La Cour d'appel énumère les considérations — sur lesquelles je reviendrai — qui jouent dans la décision d'autoriser ou non le tribunal administratif à présenter des observations et dans la détermination de la mesure dans laquelle il lui est permis de le faire, le cas échéant (par. 36-38).

[49] Dans *Canada (Procureur général) c. Quadrini*, 2010 CAF 246, [2012] 2 R.C.F. 3, le juge Stratas relève deux considérations qui, en common law, limitent selon lui la participation éventuelle d'un tribunal administratif à l'appel de sa propre décision : le caractère définitif et l'impartialité. Le principe du caractère définitif veut qu'un tribunal ne puisse se prononcer de nouveau dans une affaire une fois qu'il a rendu sa décision, motifs à l'appui. J'y reviendrai plus en détail, car j'estime que ce principe se rapporte plus directement à l'« autojustification » de sa décision par le tribunal administratif qu'à sa qualité pour agir comme telle.

[50] Le principe de l'impartialité entre en jeu lorsque le tribunal administratif défend une thèse en appel car, dans certains cas, sa décision peut lui être renvoyée pour réexamen. Le juge Stratas conclut que « [l]es observations que le tribunal administratif présente dans une instance en contrôle judiciaire et qui plongent trop loin, trop intensément ou trop énergiquement dans le bien-fondé de l'affaire soumise au tribunal administratif risquent d'empêcher celui-ci de procéder par la suite à un réexamen impartial du bien-fondé de l'affaire » (*Quadrini*, par. 16). Il conclut toutefois au final que les principes applicables n'imposaient pas de « règles absolues », et il souscrit à l'approche discrétionnaire de la Cour d'appel de l'Ontario dans *Goodis* (*Quadrini*, par. 19-20).

[51] L'arrêt *Leon's Furniture Ltd. c. Information and Privacy Commissioner (Alta.)*, 2011 ABCA 94, 502 A.R. 110, constitue un troisième exemple récent où une cour de justice est appelée à se pencher sur le sujet. Leon's Furniture a contesté la qualité du commissaire intimé de plaider sur le fond en appel (par. 16). La Cour d'appel de l'Alberta estime elle aussi que le droit applicable doit donner suite aux considérations fondamentales soulevées dans

Utilities but should nonetheless approach the question of tribunal standing with discretion, to be exercised in view of relevant contextual considerations: paras. 28-29.

[52] The considerations set forth by this Court in *Northwestern Utilities* reflect fundamental concerns with regard to tribunal participation on appeal from the tribunal's own decision. However, these concerns should not be read to establish a categorical ban on tribunal participation on appeal. A discretionary approach, as discussed by the courts in *Goodis*, *Leon's Furniture*, and *Quadrini*, provides the best means of ensuring that the principles of finality and impartiality are respected without sacrificing the ability of reviewing courts to hear useful and important information and analysis: see N. Semple, "The Case for Tribunal Standing in Canada" (2007), 20 *C.J.A.L.P.* 305; L. A. Jacobs and T. S. Kuttner, "Discovering What Tribunals Do: Tribunal Standing Before the Courts" (2002), 81 *Can. Bar Rev.* 616; F. A. V. Falzon, "Tribunal Standing on Judicial Review" (2008), 21 *C.J.A.L.P.* 21.

[53] Several considerations argue in favour of a discretionary approach. Notably, because of their expertise and familiarity with the relevant administrative scheme, tribunals may in many cases be well positioned to help the reviewing court reach a just outcome. For example, a tribunal may be able to explain how one interpretation of a statutory provision might impact other provisions within the regulatory scheme, or the factual and legal realities of the specialized field in which they work. Submissions of this type may be harder for other parties to present.

[54] Some cases may arise in which there is simply no other party to stand in opposition to the party challenging the tribunal decision. Our judicial review processes are designed to function best when both sides of a dispute are argued vigorously before the reviewing court. In a situation where no other well-informed party stands opposed, the presence of a tribunal as an adversarial party may help the court

l'arrêt *Northwestern Utilities*, mais que la question de la qualité pour agir d'un tribunal administratif relève néanmoins d'un pouvoir discrétionnaire qu'il faut exercer eu égard aux éléments contextuels applicables (par. 28-29).

[52] Les considérations énoncées par notre Cour dans *Northwestern Utilities* témoignent de préoccupations fondamentales quant à la participation d'un tribunal administratif à l'appel de sa propre décision. Or, ces préoccupations ne sauraient fonder l'interdiction absolue d'une telle participation. La démarche discrétionnaire préconisée dans *Goodis*, *Leon's Furniture* et *Quadrini* offre le meilleur moyen d'assurer le caractère définitif de la décision et l'impartialité du décideur sans que la cour de révision ne soit alors privée de données et d'analyses à la fois utiles et importantes (voir N. Semple, « The Case for Tribunal Standing in Canada » (2007), 20 *R.C.D.A.P.* 305; L. A. Jacobs et T. S. Kuttner, « Discovering What Tribunals Do : Tribunal Standing Before the Courts » (2002), 81 *R. du B. can*. 616; F. A. V. Falzon, « Tribunal Standing on Judicial Review » (2008), 21 *R.C.D.A.P.* 21).

[53] Plusieurs considérations militent en faveur d'une démarche discrétionnaire. En particulier, vu ses compétences spécialisées et sa connaissance approfondie du régime administratif en cause, le tribunal administratif peut, dans bien des cas, être bien placé pour aider la cour de révision à rendre une juste décision. Par exemple, il peut être en mesure d'expliquer en quoi une certaine interprétation de la disposition législative en cause peut avoir une incidence sur d'autres dispositions du régime de réglementation ou sur les réalités factuelles et juridiques de son domaine de spécialisation. Il pourrait être plus difficile d'obtenir de tels éléments d'information d'autres parties.

[54] Dans certains cas, il n'y a tout simplement personne pour s'opposer à la partie qui conteste la décision du tribunal administratif. Le contrôle judiciaire se révèle optimal lorsque les deux facettes du litige sont vigoureusement défendues devant la cour de révision. Lorsqu'aucune autre partie bien au fait des enjeux ne fait valoir le point de vue opposé, la participation du tribunal administratif à titre de

ensure it has heard the best of both sides of a dispute.

[55] Canadian tribunals occupy many different roles in the various contexts in which they operate. This variation means that concerns regarding tribunal partiality may be more or less salient depending on the case at issue and the tribunal's structure and statutory mandate. As such, statutory provisions addressing the structure, processes and role of the particular tribunal are key aspects of the analysis.

[56] The mandate of the Board, and similarly situated regulatory tribunals, sets them apart from those tribunals whose function it is to adjudicate individual conflicts between two or more parties. For tribunals tasked with this latter responsibility, "the importance of fairness, real and perceived, weighs more heavily" against tribunal standing: *Henthorne v. British Columbia Ferry Services Inc.*, 2011 BCCA 476, 344 D.L.R. (4th) 292, at para. 42.

[57] I am thus of the opinion that tribunal standing is a matter to be determined by the court conducting the first-instance review in accordance with the principled exercise of that court's discretion. In exercising its discretion, the court is required to balance the need for fully informed adjudication against the importance of maintaining tribunal impartiality.

[58] In this case, as an initial matter, the *Ontario Energy Board Act, 1998* expressly provides that "[t]he Board is entitled to be heard by counsel upon the argument of an appeal" to the Divisional Court: s. 33(3). This provision neither expressly grants the Board standing to argue the merits of the decision on appeal, nor does it expressly limit the Board to jurisdictional or standard-of-review arguments as was the case for the relevant statutory provision in *Quadrini*: see para. 2.

partie adverse peut contribuer à faire en sorte que la cour statue après avoir entendu les arguments les plus convaincants de chacune des deux parties au litige.

[55] Les tribunaux administratifs canadiens tiennent nombre de rôles différents dans les contextes variés où ils évoluent, de sorte que la crainte d'une partialité de leur part peut être plus ou moins grande selon l'affaire en cause, ainsi que la structure du tribunal et son mandat légal. Dès lors, les dispositions législatives portant sur la structure, le fonctionnement et la mission d'un tribunal en particulier sont cruciales aux fins de l'analyse.

[56] Le mandat de la Commission, comme celui des tribunaux administratifs qui lui sont apparentés, la différencie des tribunaux administratifs appelés à trancher des différends individuels opposant plusieurs parties. Dans le cas de ces derniers, [TRADUCTION] « l'importance de l'équité, réelle et perçue, milite davantage » contre la reconnaissance de leur qualité pour agir (*Henthorne c. British Columbia Ferry Services Inc.*, 2011 BCCA 476, 344 D.L.R. (4th) 292, par. 42).

[57] Par conséquent, je suis d'avis qu'il appartient à la cour de première instance chargée du contrôle judiciaire de décider de la qualité pour agir d'un tribunal administratif en exerçant son pouvoir discrétionnaire de manière raisonnée. Dans l'exercice de son pouvoir discrétionnaire, la cour doit établir un équilibre entre la nécessité d'une décision bien éclairée et l'importance d'assurer l'impartialité du tribunal administratif.

[58] Dans la présente affaire, le par. 33(3) de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* prévoit à titre préliminaire que « [l]a Commission a le droit d'être représentée par un avocat lors de l'audition de l'appel » devant la Cour divisionnaire. Cette disposition ne confère pas expressément à la Commission une qualité pour agir qui permet de faire valoir le bien-fondé de sa décision en appel, ni ne limite expressément la thèse qu'elle peut défendre à la présentation d'arguments relatifs à la compétence ou à la norme de contrôle comme le fait la disposition en cause dans l'affaire *Quadrini* (voir par. 2).

[59] In accordance with the foregoing discussion of tribunal standing, where the statute does not clearly resolve the issue, the reviewing court must rely on its discretion to define the tribunal's role on appeal. While not exhaustive, I would find the following factors, identified by the courts and academic commentators cited above, are relevant in informing the court's exercise of this discretion:

(1) If an appeal or review were to be otherwise unopposed, a reviewing court may benefit by exercising its discretion to grant tribunal standing.

(2) If there are other parties available to oppose an appeal or review, and those parties have the necessary knowledge and expertise to fully make and respond to arguments on appeal or review, tribunal standing may be less important in ensuring just outcomes.

(3) Whether the tribunal adjudicates individual conflicts between two adversarial parties, or whether it instead serves a policy-making, regulatory or investigative role, or acts on behalf of the public interest, bears on the degree to which impartiality concerns are raised. Such concerns may weigh more heavily where the tribunal served an adjudicatory function in the proceeding that is the subject of the appeal, while a proceeding in which the tribunal adopts a more regulatory role may not raise such concerns.

[60] Consideration of these factors in the context of this case leads me to conclude that it was not improper for the Board to participate in arguing in favour of the reasonableness of its decision on appeal. First, the Board was the only respondent in the initial review of its decision. Thus, it had no alternative but to step in if the decision was to be defended on the merits. Unlike some other provinces, Ontario has no designated utility consumer advocate, which left the Board — tasked by statute

[59] Au vu de cette analyse de la qualité pour agir d'un tribunal administratif, lorsque le texte législatif applicable n'est pas clair sur ce point, la cour de révision s'en remet à son pouvoir discrétionnaire pour délimiter les attributs du tribunal administratif en appel. Voici quelles sont, entre autres, les considérations — relevées par les juridictions et les auteurs précités — qui délimitent l'exercice de ce pouvoir discrétionnaire :

(1) lorsque, autrement, l'appel ou la demande de contrôle serait non contesté, il peut être avantageux que la cour de révision exerce le pouvoir discrétionnaire qui lui permet de reconnaître la qualité pour agir du tribunal administratif;

(2) lorsque d'autres parties sont susceptibles de contester l'appel ou la demande de contrôle et qu'elles ont les connaissances et les compétences spécialisées nécessaires pour bien avancer une thèse ou la réfuter, la qualité pour agir du tribunal administratif peut revêtir une importance moindre pour l'obtention d'une issue juste;

(3) le fait que la fonction du tribunal administratif consiste soit à trancher des différends individuels opposant deux parties, soit à élaborer des politiques, à réglementer ou enquêter ou à défendre l'intérêt public influe sur la mesure dans laquelle l'impartialité soulève des craintes ou non. Ces craintes peuvent jouer davantage lorsque le tribunal a exercé une fonction juridictionnelle dans l'instance visée par l'appel, et moins lorsque son rôle s'est révélé d'ordre plutôt réglementaire.

[60] Au vu de ces considérations, je conclus qu'il n'était pas inapproprié que la Commission participe à l'appel pour défendre le caractère raisonnable de sa décision. Premièrement, la Commission était la seule partie intimée lors du contrôle judiciaire initial de sa décision. Elle n'avait donc d'autre choix que de prendre part à l'instance pour que sa décision soit défendue au fond. Contrairement à d'autres provinces, l'Ontario n'a nommé aucun défenseur des droits des clients des services publics,

with acting to safeguard the public interest — with few alternatives but to participate as a party.

[61] Second, the Board is tasked with regulating the activities of utilities, including those in the electricity market. Its regulatory mandate is broad. Among its many roles: it licenses market participants, approves the development of new transmission and distribution facilities, and authorizes rates to be charged to consumers. In this case, the Board was exercising a regulatory role by setting just and reasonable payment amounts to a utility. This is unlike situations in which a tribunal may adjudicate disputes between two parties, in which case the interests of impartiality may weigh more heavily against full party standing.

[62] The nature of utilities regulation further argues in favour of full party status for the Board here, as concerns about the appearance of partiality are muted in this context. As noted by Doherty J.A., "[l]ike all regulated bodies, I am sure Enbridge wins some and loses some before the [Board]. I am confident that Enbridge fully understands the role of the regulator and appreciates that each application is decided on its own merits by the [Board]": *Enbridge*, at para. 28. Accordingly, I do not find that the Board's participation in the instant appeal was improper. It remains to consider whether the content of the Board's arguments was appropriate.

(2) Bootstrapping

[63] The issue of tribunal "bootstrapping" is closely related to the question of when it is proper for a tribunal to act as a party on appeal or judicial review of its decision. The standing issue concerns what types of argument a tribunal may make, i.e.

si bien que la Commission — qui est légalement garante de l'intérêt public — n'avait pas vraiment d'autre avenue que celle de se constituer partie à l'instance.

[61] Deuxièmement, la Commission a pour mandat de réglementer les activités de services publics, y compris ceux qui appartiennent au domaine de l'électricité. Son mandat de réglementation est large. Au nombre de ses nombreuses fonctions, mentionnons l'octroi de permis aux participants du marché, l'approbation de nouvelles installations de transport et de distribution et l'autorisation des tarifs exigés des consommateurs. Dans la présente affaire, la Commission a exercé sa fonction de réglementation en établissant les paiements justes et raisonnables auxquels un service public avait droit. Il s'agit d'une situation différente de celle où le tribunal administratif est habilité à trancher un différend entre deux parties, le souci d'impartialité pouvant alors militer davantage contre la qualité d'agir comme partie à part entière.

[62] L'objet de la réglementation est un autre élément qui milite en faveur de la pleine reconnaissance de la qualité pour agir de la Commission, puisque la crainte d'apparence de partialité est faible en l'espèce. Pour reprendre les propos du juge Doherty dans *Enbridge*, par. 28, [TRADUCTION] « [à] l'instar de tout organisme réglementé, je suis certain que [la Commission] donne parfois raison à Enbridge et lui donne parfois tort. J'ose croire qu'Enbridge comprend parfaitement le rôle de l'organisme de réglementation et sait que [la Commission] statue sur chaque demande en fonction des faits qui lui sont propres ». Je conclus donc que la participation de la Commission au pourvoi n'a rien d'inapproprié. Reste à savoir si les arguments de la Commission sont appropriés.

(2) L'autojustification

[63] La question de l'« autojustification » est étroitement liée à celle de savoir à quelles conditions le tribunal administratif (ci-après le « tribunal ») est en droit d'agir comme partie à l'appel ou au contrôle judiciaire de sa décision. Statuer sur la

jurisdictional or merits arguments, while the bootstrapping issue concerns the content of those arguments.

[64] As the term has been understood by the courts who have considered it in the context of tribunal standing, a tribunal engages in bootstrapping where it seeks to supplement what would otherwise be a deficient decision with new arguments on appeal: see, e.g., *United Brotherhood of Carpenters and Joiners of America, Local 1386 v. Bransen Construction Ltd.*, 2002 NBCA 27, 249 N.B.R. (2d) 93. Put differently, it has been stated that a tribunal may not "defen[d] its decision on a ground that it did not rely on in the decision under review": *Goodis*, at para. 42.

[65] The principle of finality dictates that once a tribunal has decided the issues before it and provided reasons for its decision, "absent a power to vary its decision or rehear the matter, it has spoken finally on the matter and its job is done": *Quadrini*, at para. 16, citing *Chandler v. Alberta Association of Architects*, [1989] 2 S.C.R. 848. Under this principle, the court found that tribunals could not use judicial review as a chance to "amend, vary, qualify or supplement its reasons": *Quadrini*, at para. 16. In *Leon's Furniture*, Slatter J.A. reasoned that a tribunal could "offer interpretations of its reasons or conclusion, [but] cannot attempt to reconfigure those reasons, add arguments not previously given, or make submissions about matters of fact not already engaged by the record": para. 29.

[66] By contrast, in *Goodis*, Goudge J.A. found on behalf of a unanimous court that while the Commissioner had relied on an argument not expressly set out in her original decision, this argument was available for the Commissioner to make on appeal. Though he recognized that "[t]he importance of reasoned decision making may be undermined if, when attacked in court, a tribunal can simply offer different, better, or even contrary reasons to

qualité pour agir d'un tribunal c'est décider de ce qu'il peut faire valoir (p. ex. des prétentions relatives à sa compétence ou à la justesse de sa décision), alors que l'« autojustification » touche à la teneur des prétentions.

[64] Suivant le sens attribué à cette notion par les cours de justice qui l'ont examinée dans le contexte de la qualité pour agir, un tribunal « s'autojustifie » lorsqu'il cherche, par la présentation de nouveaux arguments en appel, à étoffer une décision qui, sinon, serait lacunaire (voir p. ex. *United Brotherhood of Carpenters and Joiners of America, Local 1386 c. Bransen Construction Ltd.*, 2002 NBCA 27, 249 R.N.-B. (2e) 93). Autrement dit, un tribunal ne pourrait [TRADUCTION] « défendre sa décision en invoquant un motif qui n'a pas été soulevé dans la décision faisant l'objet du contrôle » (*Goodis*, par. 42).

[65] Le caractère définitif de la décision veut que, dès lors qu'il a tranché les questions dont il était saisi et qu'il a motivé sa décision, le tribunal ait statué définitivement et que son travail soit terminé, « à moins qu'il ne soit investi du pouvoir de modifier sa décision ou d'entendre à nouveau l'affaire » (*Quadrini*, par. 16, citant *Chandler c. Alberta Association of Architects*, [1989] 2 R.C.S. 848). Partant, la cour a conclu qu'un tribunal ne peut profiter d'un contrôle judiciaire pour « modifier, changer, nuancer ou compléter ses motifs » (*Quadrini*, par. 16). Dans l'arrêt *Leon's Furniture*, le juge Slatter affirme qu'un tribunal peut [TRADUCTION] « offrir différentes interprétations de ses motifs ou de sa conclusion, [mais] non tenter de remanier ses motifs, invoquer de nouveaux arguments ou se prononcer sur des questions de fait que ne soulève pas déjà le dossier » (par. 29).

[66] En revanche, le juge Goudge conclut, dans l'arrêt *Goodis*, avec l'accord de tous ses collègues, que même si la commissaire invoque un argument qui ne figure pas expressément dans sa décision initiale, elle peut le soulever en appel. Il reconnaît que [TRADUCTION] « [l']importance de décisions bien étayées pourrait être compromise si un tribunal pouvait simplement offrir, à l'appui de sa décision attaquée devant une cour de justice,

support its decision" (para. 42), Goudge J.A. ultimately found that the Commissioner was permitted to raise a new argument on judicial review. The new argument presented was "not inconsistent with the reason offered in the decision. Indeed it could be said to be implicit in it": para. 55. "It was therefore proper for the Commissioner to be permitted to raise this argument before the Divisional Court and equally proper for the court to decide on that basis": para. 58.

[67] There is merit in both positions on the issue of bootstrapping. On the one hand, a permissive stance toward new arguments by tribunals on appeal serves the interests of justice insofar as it ensures that a reviewing court is presented with the strongest arguments in favour of both sides: Semple, at p. 315. This remains true even if those arguments were not included in the tribunal's original reasons. On the other hand, to permit bootstrapping may undermine the importance of reasoned, well-written original decisions. There is also the possibility that a tribunal, surprising the parties with new arguments in an appeal or judicial review after its initial decision, may lead the parties to see the process as unfair. This may be particularly true where a tribunal is tasked with adjudicating matters between two private litigants, as the introduction of new arguments by the tribunal on appeal may give the appearance that it is "ganging up" on one party. As discussed, however, it may be less appropriate in general for a tribunal sitting in this type of role to participate as a party on appeal.

[68] I am not persuaded that the introduction of arguments by a tribunal on appeal that interpret or were implicit but not expressly articulated in its original decision offends the principle of finality. Similarly, it does not offend finality to permit a tribunal to explain its established policies and practices to the reviewing court, even if those were not described in the reasons under review. Tribunals need not repeat explanations of such practices in every decision merely to guard against charges of bootstrapping should they be called upon to explain them on appeal or review. A tribunal may also

des motifs différents, plus convaincants, voire opposés » (par. 42), mais il conclut finalement que la commissaire peut présenter un nouvel argument dans le cadre d'un contrôle judiciaire. Le nouvel argument n'est toutefois « pas incompatible avec les motifs formulés dans la décision, car on peut en effet affirmer qu'il en fait implicitement partie » (par. 55). « La commissaire pouvait donc soulever l'argument devant la Cour divisionnaire, et celle-ci pouvait en tenir compte pour se prononcer » (par. 58).

[67] Les deux thèses avancées sur l'autojustification se défendent. D'une part, il est dans l'intérêt de la justice de permettre au tribunal de présenter de nouveaux arguments en appel, car la cour de révision est alors saisie des arguments les plus convaincants à l'appui de chacune des thèses (Semple, p. 315). Cela demeure vrai même si ces arguments ne figurent pas dans la décision initiale. D'autre part, autoriser l'autojustification risque de compromettre l'importance de décisions bien étayées et bien rédigées au départ. Permettre au tribunal de présenter de nouveaux arguments en appel ou dans le cadre du contrôle judiciaire de sa décision initiale peut aussi amener les parties à conclure que le processus n'est pas équitable. Il peut surtout en être ainsi lorsque le tribunal est appelé à trancher des différends opposant deux personnes privées, puisque la présentation de nouveaux arguments en appel peut donner l'impression que le tribunal « se ligue » contre l'une des parties. Or, je le rappelle, il ne convient généralement pas que le tribunal doté d'un tel mandat participe en tant que partie à l'appel.

[68] Je ne suis pas convaincu que la formulation en appel de nouveaux arguments qui interprètent la décision initiale ou qui l'étayaient implicitement, mais non expressément, va à l'encontre du principe du caractère définitif. De même, il n'est pas contraire à ce principe de permettre au tribunal d'expliquer à la cour de révision quelles sont ses politiques et pratiques établies, même lorsque les motifs contestés n'en font pas mention. Le tribunal n'a pas à les expliquer systématiquement dans chaque décision à la seule fin de se prémunir contre une allégation d'autojustification advenant qu'il

respond to arguments raised by a counterparty. A tribunal raising arguments of these types on review of its decision does so in order to uphold the initial decision; it is not reopening the case and issuing a new or modified decision. The result of the original decision remains the same even if a tribunal seeks to uphold that effect by providing an interpretation of it or on grounds implicit in the original decision.

[69] I am not, however, of the opinion that tribunals should have the unfettered ability to raise entirely new arguments on judicial review. To do so may raise concerns about the appearance of unfairness and the need for tribunal decisions to be well reasoned in the first instance. I would find that the proper balancing of these interests against the reviewing courts' interests in hearing the strongest possible arguments in favour of each side of a dispute is struck when tribunals do retain the ability to offer interpretations of their reasons or conclusions and to make arguments implicit within their original reasons: see *Leon's Furniture*, at para. 29; *Goodis*, at para. 55.

[70] In this case, I do not find that the Board impermissibly stepped beyond the bounds of its original decision in its arguments before this Court. In its reply factum, the Board pointed out — correctly, in my view — that its submissions before this Court simply highlight what is apparent on the face of the record, or respond to arguments raised by the respondents.

[71] I would, however, urge the Board, and tribunal parties in general, to be cognizant of the tone they adopt on review of their decisions. As Goudge J.A. noted in *Goodis*:

> . . . if an administrative tribunal seeks to make submissions on a judicial review of its decision, it [should] pay careful attention to the tone with which it does so. Although this is not a discrete basis upon which its standing might be limited, there is no doubt that the tone

soit appelé à les préciser en appel ou en contrôle judiciaire. Il peut aussi répondre aux arguments de la partie adverse dans le cadre du contrôle judiciaire de sa décision car il le fait dans le but de faire confirmer sa décision initiale, non de rouvrir le dossier et de rendre une nouvelle décision ou de modifier la décision initiale. L'effet de la décision initiale demeure inchangé même lorsque le tribunal demande sa confirmation en offrant une interprétation de cette décision ou en invoquant des motifs qui la sous-tendent implicitement.

[69] Cependant, je ne crois pas qu'un tribunal devrait avoir la possibilité inconditionnelle de présenter une thèse entièrement nouvelle dans le cadre d'un contrôle judiciaire, car lui reconnaître cette faculté pourrait l'exposer à des allégations d'iniquité et nuire au prononcé de décisions bien motivées au départ. Je suis d'avis qu'il y a un juste équilibre entre ces considérations et celles voulant que la cour de révision entende les arguments les plus convaincants de chacune des parties lorsqu'il est permis au tribunal d'offrir différentes interprétations de ses motifs ou de ses conclusions ou de présenter des arguments qui sous-tendent implicitement ses motifs initiaux (voir *Leon's Furniture*, par. 29; *Goodis*, par. 55).

[70] Je ne crois pas que, dans la présente affaire, la Commission a indûment outrepassé les limites de sa décision initiale lorsqu'elle a présenté ses arguments devant notre Cour. Dans son mémoire en réplique, la Commission signale — à juste titre, selon moi — que ses observations mettent simplement en évidence ce qui ressort du dossier ou répondent aux arguments des intimées.

[71] J'exhorte toutefois la Commission et, de façon générale, tout tribunal qui se constitue partie à une instance à se soucier du ton qu'il adopte lors du contrôle judiciaire de sa décision. Comme le fait remarquer le juge Goudge dans l'arrêt *Goodis*,

> [TRADUCTION] le tribunal administratif qui veut faire valoir son point de vue lors du contrôle judiciaire de sa décision [doit] porte[r] une attention particulière au ton qu'il adopte. Bien qu'il ne s'agisse pas d'un motif précis pour lequel sa qualité pourrait être restreinte, il ne

of the proposed submissions provides the background for the determination of that issue. A tribunal that seeks to resist a judicial review application will be of assistance to the court to the degree its submissions are characterized by the helpful elucidation of the issues, informed by its specialized position, rather than by the aggressive partisanship of an adversary. [para. 61]

[72] In this case, the Board generally acted in such a way as to present helpful argument in an adversarial but respectful manner. However, I would sound a note of caution about the Board's assertion that the imposition of the prudent investment test "would in all likelihood not change the result" if the decision were remitted for reconsideration (A.F., at para. 99). This type of statement may, if carried too far, raise concerns about the principle of impartiality such that a court would be justified in exercising its discretion to limit tribunal standing so as to safeguard this principle.

B. *Standard of Review*

[73] The parties do not dispute that reasonableness is the appropriate standard of review for the Board's actions in applying its expertise to set rates and approve payment amounts under the *Ontario Energy Board Act, 1998*. I agree. In addition, to the extent that the resolution of this appeal turns on the interpretation of the *Ontario Energy Board Act, 1998*, the Board's home statute, a standard of reasonableness presumptively applies: *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190, at para. 54; *Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61, [2011] 3 S.C.R. 654, at para. 30; *Tervita Corp. v. Canada (Commissioner of Competition)*, 2015 SCC 3, [2015] 1 S.C.R. 161, at para. 35. Nothing in this case suggests the presumption should be rebutted.

[74] This appeal involves two distinct uses of the term "reasonable". One concerns the standard of review: on appeal, this Court is charged with evaluating the "justification, transparency and intelligibility" of the Board's reasoning, and "whether the

fait aucun doute que le ton des observations proposées offre une toile de fond à cet égard. Le tribunal qui désire contester une demande de contrôle judiciaire sera utile à la cour dans la mesure où ses observations permettront d'éclaircir les questions et où elles seront fondées sur ses connaissances spécialisées, au lieu d'être empreintes d'un parti pris agressif contre la partie adverse. [par. 61]

[72] En l'espèce, la Commission a généralement présenté des arguments utiles dans le cadre d'un débat contradictoire, mais respectueux. Une mise en garde s'impose toutefois selon moi en ce qui concerne l'affirmation de la Commission selon laquelle l'application du critère de l'investissement prudent [TRADUCTION] « ne changerait vraisemblablement pas l'issue de l'affaire » si la décision lui était renvoyée pour réexamen (m.a., par. 99). Une telle affirmation peut, si elle est poussée trop loin, faire douter de l'impartialité du tribunal au point où une cour de justice serait justifiée d'exercer son pouvoir discrétionnaire et de limiter la qualité pour agir du tribunal de manière à préserver son impartialité.

B. *Norme de contrôle*

[73] Les parties conviennent que la norme de contrôle qui s'applique aux actes de la Commission lorsqu'elle fait appel à son expertise pour fixer les tarifs et approuver des paiements sur le fondement de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* est celle de la décision raisonnable. Je suis d'accord. En outre, dans la mesure où l'issue du pourvoi repose sur l'interprétation de cette loi — la loi constitutive de la Commission —, l'application de la norme de la décision raisonnable doit être présumée (*Dunsmuir c. Nouveau-Brunswick*, 2008 CSC 9, [2008] 1 R.C.S. 190, par. 54; *Alberta (Information and Privacy Commissioner) c. Alberta Teachers' Association*, 2011 CSC 61, [2011] 3 R.C.S. 654, par. 30; *Tervita Corp. c. Canada (Commissaire de la concurrence)*, 2015 CSC 3, [2015] 1 R.C.S. 161, par. 35). Rien ne donne à penser en l'espèce que la présomption soit réfutée.

[74] Le pourvoi fait intervenir deux notions distinctes de ce qui est « raisonnable ». L'une est liée à la norme de contrôle : en appel, la Cour doit apprécier la « justification [. . .], [. . .] la transparence et [. . .] l'intelligibilité » du raisonnement de la

decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law" (*Dunsmuir*, at para. 47). The other is statutory: the Board's rate-setting powers are to be used to ensure that, in its view, a just and reasonable balance is struck between utility and consumer interests. These reasons will attempt to keep the two uses of the term distinct.

C. *Choice of Methodology Under the Ontario Energy Board Act, 1998*

[75] The question of whether the Board's decision to disallow recovery of certain costs was reasonable turns on how that decision relates to the Board's statutory and regulatory powers to approve payments to utilities and to have these payments reflected in the rates paid by consumers. The Board's general rate- and payment-setting powers are described above under the "Regulatory Framework" heading.

[76] The just-and-reasonable approach to recovery of the cost of services provided by a utility captures the essential balance at the heart of utilities regulation: to encourage investment in a robust utility infrastructure and to protect consumer interests, utilities must be allowed, over the long run, to earn their cost of capital, no more, no less.

[77] The *Ontario Energy Board Act, 1998* does not, however, either in s. 78.1 or elsewhere, prescribe the methodology the Board must use to weigh utility and consumer interests when deciding what constitutes just and reasonable payment amounts to the utility. Indeed, s. 6(1) of O. Reg. 53/05 expressly permits the Board, subject to certain exceptions set out in s. 6(2), to "establish the form, methodology, assumptions and calculations used in making an order that determines payment amounts for the purpose of section 78.1 of the Act".

Commission et se demander si la décision appartient « aux issues possibles acceptables pouvant se justifier au regard des faits et du droit » (*Dunsmuir*, par. 47). L'autre est d'origine législative : la Commission doit utiliser son pouvoir de fixation des tarifs de manière à établir un équilibre qu'elle considère juste et raisonnable entre les intérêts du service public et ceux des consommateurs. Je m'efforce ci-après de respecter cette distinction.

C. *Choix de la méthode suivant la Loi de 1998 sur la Commission de l'énergie de l'Ontario*

[75] La question de savoir si le refus de la Commission d'approuver le recouvrement de certaines dépenses est raisonnable ou non dépend du lien de ce refus avec les pouvoirs légaux et réglementaires de la Commission d'approuver des paiements au service public et de répercuter ces paiements sur les tarifs exigés des consommateurs. Les pouvoirs généraux de la Commission en matière de fixation des tarifs et des paiements sont énoncés précédemment à la rubrique « Cadre réglementaire ».

[76] L'approche fondée sur le caractère juste et raisonnable des dépenses qu'un service public peut recouvrer rend compte de l'équilibre essentiel recherché dans la réglementation des services publics : pour encourager l'investissement dans une infrastructure robuste et protéger l'intérêt des consommateurs, un service public doit pouvoir, à long terme, toucher l'équivalent du coût du capital, ni plus, ni moins.

[77] Or, la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* ne prévoit ni à l'art. 78.1 ni à quelque autre article la méthode que doit utiliser la Commission pour soupeser les intérêts respectifs du service public et des consommateurs lorsqu'elle décide ce qui constitue des paiements justes et raisonnables. Certes, sous réserve de certaines exceptions prévues au par. 6(2), le par. 6(1) du règlement 53/05 permet expressément à la Commission de [TRADUCTION] « définir la forme, la méthode, les hypothèses et les calculs utilisés pour rendre une ordonnance qui établit le montant du paiement aux fins de l'article 78.1 de la Loi ».

[78] As a contrasting example, para. 4.1 of s. 6(2) of O. Reg. 53/05 establishes a specific methodology for use when the Board reviews "costs incurred and firm financial commitments made in the course of planning and preparation for the development of proposed new nuclear generation facilities". When reviewing such costs, the Board must be satisfied that "the costs were prudently incurred" and that "the financial commitments were prudently made": para. 4.1 of s. 6(2). The provision thus establishes a specific context in which the Board's analysis is focused on the prudence of the decision to incur or commit to certain costs. The absence of such language in the more general s. 6(1) provides further reason to read the regulation as providing broad methodological discretion to the Board in making orders for payment amounts where the specific provisions of s. 6(2) do not apply.

[78] En revanche, la disposition 4.1 du par. 6(2) du règlement 53/05 prescrit le recours à une méthode particulière lorsque la Commission examine [TRADUCTION] « les dépenses faites et les engagements financiers fermes pris dans le cadre de la planification et de la préparation relatives à la réalisation d'installations nucléaires projetées ». La Commission doit être convaincue que « les dépenses ont été faites de manière prudente » et que « les engagements financiers ont été pris de manière prudente » (la disposition 4.1 du par. 6(2)). La disposition établit donc un cadre précis où l'analyse de la Commission est axée sur la prudence de la décision de faire certaines dépenses ou de convenir de certaines dépenses. L'absence d'un libellé en ce sens dans la disposition générale qu'est le par. 6(1) constitue un autre motif de considérer que le règlement confère à la Commission un large pouvoir discrétionnaire quant à la méthode à employer pour ordonner un paiement lorsque les dispositions particulières du par. 6(2) ne s'appliquent pas.

[79] Regarding whether a presumption of prudence must be applied to OPG's decisions to incur costs, neither the *Ontario Energy Board Act, 1998* nor O. Reg. 53/05 expressly establishes such a presumption. Indeed, the *Ontario Energy Board Act, 1998* places the burden on the applicant utility to establish that payment amounts approved by the Board are just and reasonable: s. 78.1(6) and (7). It would thus seem inconsistent with the statutory scheme to presume that utility decisions to incur costs were prudent.

[79] Pour ce qui concerne la question de savoir si la présomption de prudence doit s'appliquer aux décisions d'OPG de faire des dépenses, ni la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, ni le règlement 53/05 n'établissent expressément une telle présomption. D'ailleurs, suivant cette loi, il incombe au service public requérant d'établir que les paiements qu'il demande à la Commission d'approuver sont justes et raisonnables (par. 78.1(6) et (7)). Il semble donc contraire au régime législatif de présumer que la décision de faire des dépenses est prudente.

[80] Justice Abella concludes that the Board's review of OPG's costs should have consisted of "an after-the-fact prudence review, with a rebuttable presumption that the utility's expenditures were reasonable": para. 150. Such an approach is contrary to the statutory scheme. While the Board has considerable methodological discretion, it does not have the freedom to displace the burden of proof established by s. 78.1(6) of the *Ontario Energy Board Act, 1998*: ". . . the burden of proof is on the applicant in an application made under this section". Of course, this does not imply that the applicant must systematically prove that every single cost is just

[80] La juge Abella conclut que l'examen des dépenses d'OPG par la Commission aurait dû consister à « contrôl[er] la prudence des dépenses après coup et [à] appliqu[er] la présomption réfutable selon laquelle elles étaient raisonnables » (par. 150). Or, une telle approche est contraire au régime législatif. La Commission jouit certes d'une grande marge de manœuvre quant au choix d'une méthode, mais elle n'a pas la faculté d'inverser le fardeau de la preuve établi au par. 78.1(6) de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* : « . . . le fardeau de la preuve incombe au requérant dans une requête présentée en vertu du

and reasonable. The Board has broad discretion to determine the methods it may use to examine costs — it just cannot shift the burden of proof contrary to the statutory scheme.

[81] In judicially reviewing a decision of the Board to allow or disallow payments to a utility, the court's role is to assess whether the Board reasonably determined that a certain payment amount was "just and reasonable" for both the utility and the consumers. Such an approach is consistent with this Court's rate-setting jurisprudence in other regulatory domains in which the regulator is given methodological discretion, where it has been observed that "[t]he obligation to act is a question of law, but the choice of the method to be adopted is a question of discretion with which, under the statute, no Court of law may interfere": *Bell Canada v. Bell Aliant Regional Communications*, 2009 SCC 40, [2009] 2 S.C.R. 764, at para. 40 (concerning telecommunication rate-setting), quoting *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12 (S.C.C.), at p. 13 (concerning railway freight rates). Of course, today this statement must be understood to permit intervention by a court where the exercise of discretion rendered a decision unreasonable. Accordingly, it remains to determine whether the Board's analytical approach to disallowing the costs at issue in this case rendered the Board's decision unreasonable under the "just and reasonable" standard.

D. *Characterization of Costs at Issue*

[82] Forecast costs are costs which the utility has not yet paid, and over which the utility still retains discretion as to whether the disbursement will be

présent article ». Il ne s'ensuit pas, bien sûr, que le requérant doit systématiquement prouver le caractère juste et raisonnable de chacune de ses dépenses, individuellement. La Commission jouit d'un grand pouvoir discrétionnaire qui lui permet d'arrêter les méthodes à employer dans l'examen des dépenses, mais elle ne peut tout simplement pas inverser le fardeau de la preuve qu'établit le régime législatif.

[81] La cour de justice appelée à contrôler la décision de la Commission d'approuver ou non des paiements à un service public doit se demander si la conclusion de la Commission selon laquelle un paiement d'un certain montant est « juste et raisonnable » tant pour le service public que pour le consommateur est raisonnable ou non. Cette approche concorde avec les décisions de notre Cour sur l'établissement de tarifs dans d'autres secteurs réglementés où l'organisme de réglementation dispose d'un pouvoir discrétionnaire qui lui permet de recourir à une méthode ou à une autre. Dans ces décisions, la Cour signale que « [l]'obligation d'agir est une question de droit, mais le choix de la méthode est une question relevant de l'exercice du pouvoir discrétionnaire et à l'égard de laquelle, selon le texte de loi, aucun tribunal judiciaire ne peut intervenir » (*Bell Canada c. Bell Aliant Communications régionales*, 2009 CSC 40, [2009] 2 R.C.S. 764, par. 40 (tarification des télécommunications), citant *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12 (C.S.C.), p. 13 (tarification du transport ferroviaire des marchandises)). Certes, de nos jours, il faut voir dans ces propos la reconnaissance du pouvoir d'une cour de justice d'intervenir lorsqu'elle estime que l'exercice du pouvoir discrétionnaire a débouché sur une décision déraisonnable. Reste donc à décider si la méthode d'analyse retenue par la Commission pour refuser d'approuver les dépenses en l'espèce a rendu sa décision déraisonnable selon la norme du paiement « juste et raisonnable ».

D. *Qualification des dépenses en cause*

[82] Les dépenses prévues sont celles que le service public n'a pas encore acquittées et qu'un pouvoir discrétionnaire lui permet de renoncer à faire.

made. A disallowance of such costs presents a utility with a choice: it may change its plans and avoid the disallowed costs, or it may incur the costs regardless of the disallowance with the knowledge that the costs will ultimately be borne by the utility's shareholders rather than its ratepayers. By contrast, committed costs are those for which, if a regulatory board disallows recovery of the costs in approved payments, the utility and its shareholders will have no choice but to bear the burden of those costs themselves. This result may occur because the utility has already spent the funds, or because the utility entered into a binding commitment or was subject to other legal obligations that leave it with no discretion as to whether to make the payment in the future.

Lorsque leur approbation est refusée, le service public peut soit modifier ses plans et renoncer aux dépenses, soit les faire malgré le refus étant entendu qu'elles seront assumées par les actionnaires plutôt que par les consommateurs. À l'opposé, les dépenses convenues sont celles que ses actionnaires et lui n'auront d'autre choix que d'assumer si l'organisme de réglementation refuse de permettre leur recouvrement et d'approuver les paiements sollicités. Cela peut advenir lorsque le service public a déjà déboursé la somme en cause ou qu'il a pris un engagement contraignant ou était assujetti à d'autres obligations qui écartent tout pouvoir discrétionnaire lui permettant de ne pas acquitter la somme ultérieurement.

[83] There is disagreement between the parties as to how the costs disallowed by the Board in this matter should be characterized. The Board asserts that compensation costs for the test period are forecast insofar as they have not yet been disbursed, while OPG asserts that the costs should be characterized as committed, because OPG is under a contractual obligation to pay those amounts when they become due. This disagreement is important because a "no hind-sight" prudence review, which is discussed in detail below, has developed in the context of "committed" costs. Indeed, it makes no sense to apply such a test where a utility still retains discretion over whether the costs will ultimately be incurred; the decision to commit the utility to such costs has not yet been made. Accordingly, where the regulator has discretion over its methodological approach, understanding whether the costs at issue are "forecast" or "committed" may be helpful in reviewing the reasonableness of a regulator's choice of methodology.

[83] Les parties ne s'entendent pas sur la qualification des dépenses que la Commission a refusé d'approuver. Selon cette dernière, les dépenses de rémunération pour la période de référence sont des dépenses prévues dans la mesure où elles n'ont pas encore été acquittées. OPG soutient plutôt qu'il s'agit de dépenses convenues puisqu'elle est tenue par contrat de verser les sommes en cause au moment où elles deviennent exigibles. Ce désaccord est important car le contrôle de la prudence « sans recul », sur lequel je reviendrai plus en détail, a vu le jour dans le contexte de dépenses « convenues ». Il est en effet absurde d'appliquer ce critère lorsque le service public peut encore décider, en fin de compte, de faire ou non les dépenses; la décision de convenir de ces dépenses n'a pas encore été prise. Par conséquent, lorsque l'organisme de réglementation possède un pouvoir discrétionnaire quant à la méthode à employer, la qualification des dépenses — « prévues » ou « convenues » — peut constituer une étape importante pour statuer sur le caractère raisonnable de la méthode retenue.

[84] In this case, at least some of the compensation costs that the Board found to be excessive were driven by collective agreements to which OPG had committed before the application at issue, and which established compensation costs that were, in aggregate, above the 75th percentile for comparable positions at other utilities. The collective agreements left OPG with limited flexibility

[84] En l'espèce, au moins une partie des dépenses de rémunération jugées excessives par la Commission était imputable à des conventions collectives qu'OPG avait conclues avant la présentation de sa demande et qui faisaient en sorte que sa masse salariale globale dépasse le 75e percentile pour des emplois comparables dans d'autres services publics. Les conventions collectives laissaient

regarding overall compensation rates or staffing levels — OPG was required to abide by wage and staffing levels established by collective agreements, and retained flexibility only over terms outside the bounds of those agreements — and thus those portions of OPG's compensation rates and staffing levels that were dictated by the terms of the collective agreements were committed costs.

[85] However, the Board found that OPG's compensation costs for the test period were not entirely driven by the collective agreements, and thus were not entirely committed, because OPG retained some flexibility to manage total staffing levels in light of projected attrition of a mature workforce. The Board Decision did not, however, include detailed forecasts regarding exactly how much of the $145 million in disallowed compensation costs could be recovered through natural reduction in employee numbers or other adjustments, and how much would necessarily be borne by the utility and its shareholder. Accordingly, the disallowed costs at issue must be understood as being at least partially committed. It is unreasonable to characterize them as entirely forecast in view of the constraints placed on OPG by the collective agreements.

[86] Having established that the disallowed costs are at least partially committed, it is necessary to consider whether the Board acted reasonably in not applying a no-hindsight prudent investment test in assessing those costs. Accordingly, I now turn to the jurisprudential history and methodological details of the prudent investment test.

E. *The Prudent Investment Test*

[87] In order to assess whether the Board's methodology was reasonable in this case, it is necessary to provide some background on the prudent investment test (sometimes referred to as "prudence review" or the "prudence test") in order to identify its origins, place it in context, and explore how it has

peu de marge de manœuvre quant aux barèmes de rémunération et aux niveaux de dotation dans leur ensemble, OPG devait respecter ceux établis par les conventions collectives et elle ne jouissait d'une marge de manœuvre que pour les conditions qui n'étaient pas ainsi régies. Par conséquent, les dépenses liées aux barèmes de rémunération et aux niveaux de dotation imposés par les conventions collectives étaient des dépenses convenues.

[85] La Commission conclut cependant que les dépenses de rémunération pour la période de référence ne sont pas toutes déterminées par les conventions collectives et qu'elles ne sont donc pas toutes convenues, car OPG dispose d'une certaine marge de manœuvre pour gérer globalement les niveaux de dotation en fonction du départ prévu d'employés d'âge mûr. Toutefois, la décision de la Commission ne précise pas quel pourcentage exact des 145 millions de dollars refusés au chapitre de la rémunération pourrait être recouvré grâce à la réduction naturelle du nombre d'employés ou à d'autres ajustements, ni quel pourcentage serait nécessairement assumé par le service public et son actionnaire. Par conséquent, les dépenses refusées en l'espèce doivent être considérées comme des dépenses convenues, du moins en partie. Il est déraisonnable d'y voir en totalité des dépenses prévues étant donné l'effet contraignant des conventions collectives sur OPG.

[86] Après avoir établi que les dépenses refusées sont, du moins partiellement, des dépenses convenues, il faut déterminer si la Commission a agi de façon raisonnable en appliquant le critère de l'investissement prudent sans exclure le recul. J'examine donc maintenant l'historique jurisprudentiel du critère de l'investissement prudent et les données méthodologiques y afférentes.

E. *Le critère de l'investissement prudent*

[87] Décider si la méthode de la Commission était raisonnable en l'espèce exige de se pencher sur l'historique du critère de l'investissement prudent (parfois appelé « contrôle de la prudence » ou « critère de la prudence ») pour déterminer ses origines, le situer dans le contexte et savoir quelle portée lui

been understood by utilities, regulators, and legislators.

(1) American Jurisprudence

[88] American jurisprudence has played a significant role in the history of the prudent investment test in utilities regulation. In discussing this history, I would first reiterate this Court's observation that "[w]hile the American jurisprudence and texts in this area should be considered with caution given that Canada and the United States have very different political and constitutional-legal regimes, they do shed some light on the issue": *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140, at para. 54.

[89] The origins of the prudent investment test in the context of utilities regulation may be traced to Justice Brandeis of the Supreme Court of the United States, who wrote a concurring opinion in 1923 to observe that utilities should receive deference in seeking to recover "investments which, under ordinary circumstances, would be deemed reasonable": *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923), at p. 289, fn.1.

[90] In the decades that followed, American utility regulators tasked with reviewing past-incurred utility costs generally employed one of two standards: the "used and useful" test or the "prudent investment" test (J. Kahn, "Keep *Hope* Alive: Updating the Prudent Investment Standard for Allocating Nuclear Plant Cancellation Costs" (2010), 22 *Fordham Envtl. L. Rev.* 43, at p. 49). These tests took different approaches to determining what costs could justly and reasonably be passed on to ratepayers. The used and useful test allowed utilities to earn returns only on those investments that were actually used and useful to the utility's operations, on the principle that ratepayers should not be compelled to pay for investments that do not benefit them.

ont attribué les services publics, les organismes de réglementation et les rédacteurs législatifs.

(1) Jurisprudence américaine

[88] La jurisprudence américaine a joué un rôle important dans l'application du critère de l'investissement prudent aux services publics réglementés. Rappelons d'abord l'observation de notre Cour selon laquelle, « [b]ien qu'il faille aborder avec circonspection la jurisprudence et la doctrine américaines dans ce domaine — les régimes politiques des États-Unis et du Canada étant fort différents, tout comme leurs régimes de droit constitutionnel —, elles éclairent la question » (*ATCO Gas and Pipelines Ltd. c. Alberta (Energy and Utilities Board)*, 2006 CSC 4, [2006] 1 R.C.S. 140, par. 54).

[89] L'application du critère de l'investissement prudent aux services publics réglementés s'origine de l'opinion concordante du juge Brandeis, de la Cour suprême des États-Unis, datant de 1923 et selon laquelle les services publics ont droit à la déférence lorsqu'ils cherchent à recouvrer [TRADUCTION] « un investissement qui, normalement, serait considéré comme raisonnable » (*State of Missouri ex rel. Southwestern Bell Telephone Co. c. Public Service Commission of Missouri*, 262 U.S. 276 (1923), p. 289, note 1).

[90] Dans les décennies qui ont suivi, les organismes de réglementation américains chargés de l'examen de dépenses déjà faites par les services publics ont généralement appliqué soit le critère axé sur [TRADUCTION] « l'emploi et l'utilité », soit le critère de « l'investissement prudent » (J. Kahn, « Keep *Hope* Alive : Updating the Prudent Investment Standard for Allocating Nuclear Plant Cancellation Costs » (2010), 22 *Fordham Envtl. L. Rev.* 43, p. 49). À chacun de ces critères correspond une approche différente pour déterminer quelles dépenses peuvent équitablement et raisonnablement être refilées aux consommateurs. Le critère de l'emploi et de l'utilité permet au service public d'obtenir un rendement, mais seulement sur l'investissement qui est réellement employé et qui se révèle utile à l'exploitation de l'entreprise, étant entendu que les consommateurs ne doivent pas être tenus de payer pour un investissement dont ils ne bénéficient pas.

[91] By contrast, the prudent investment test followed Justice Brandeis's preferred approach by allowing for recovery of costs provided they were not imprudent based on what was known at the time the investment or expense was incurred: Kahn, at pp. 49-50. Though it may seem problematic from the perspective of consumer interests to adopt the prudent investment test — a test that allows for payments related to investments that may not be used or useful — it gives regulators a tool to soften the potentially harsh effects of the used and useful test, which may place onerous burdens on utilities. Disallowing recovery of the cost of failed investments that appeared reasonable at the time, for example, may imperil the financial health of utilities, and may chill the incentive to make such investments in the first place. This effect may then have negative implications for consumers, whose long-run interests will be best served by a dynamically efficient and viable electricity industry. Thus, the prudent investment test may be employed by regulators to strike the appropriate balance between consumer and utility interests: see Kahn, at pp. 53-54.

[92] The states differed in their approaches to setting the statutory foundation for utility regulation. Regulators in some states were free to apply the prudent investment test, while other states enacted statutory provisions disallowing compensation in respect of capital investments that were not "used and useful in service to the public": *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989), at p. 302. Notably, when asked in *Duquesne* to consider whether "just and reasonable" payments to utilities required, as a constitutional matter, that the prudent investment test be applied to past-incurred costs, the U.S. Supreme Court held that "[t]he designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors": p. 316.

[91] Au critère de l'investissement prudent correspond l'approche retenue par le juge Brandeis et selon laquelle des dépenses peuvent être recouvrées si elles ne sont pas imprudentes compte tenu de ce qu'on sait au moment où est fait l'investissement ou la dépense (Kahn, p. 49-50). Bien qu'il puisse sembler problématique du point de vue de la protection des intérêts des consommateurs d'adopter le critère de l'investissement prudent — dans la mesure où il autorise un paiement pour un investissement qui n'a été ni employé ni utile —, ce critère permet aux organismes de réglementation d'atténuer les possibles effets draconiens du critère de l'emploi et de l'utilité, lequel impose un lourd fardeau au service public. Par exemple, refuser le recouvrement d'un mauvais investissement qui paraissait raisonnable au moment où il a été fait risque de compromettre la santé financière du service public et d'avoir un effet dissuasif sur l'investissement ultérieur de capitaux par ce dernier. Pareil résultat peut ensuite entraîner des conséquences négatives pour les consommateurs, dont les intérêts à long terme sont mieux servis si le secteur de l'électricité est à la fois dynamique, efficace et viable. Par conséquent, un organisme de réglementation peut recourir au critère de l'investissement prudent afin d'établir un juste équilibre entre les intérêts des consommateurs et ceux du service public (voir Kahn, p. 53-54).

[92] Les États ont eu recours à des approches différentes pour établir le fondement légal de la réglementation des services publics. Certains ont permis aux organismes de réglementation d'appliquer le critère de l'investissement prudent, alors que d'autres ont légiféré pour écarter le recouvrement de capitaux investis qui n'étaient [TRADUCTION] « ni employés ni utiles au public » (*Duquesne Light Co. c. Barasch*, 488 U.S. 299 (1989), p. 302). Fait à signaler, dans cette affaire où on lui demandait si des paiements « justes et raisonnables » à un service public nécessitaient, sur le plan constitutionnel, que le critère de l'investissement prudent s'applique aux dépenses déjà faites, la Cour suprême des É.-U. a conclu que « [l']élévation d'une seule méthode de tarification au rang de norme constitutionnelle écarterait inutilement d'autres avenues dont pourraient bénéficier à la fois consommateurs et investisseurs » (p. 316).

[93] American courts have also recognized that there may exist some contexts in which certain features of the prudent investment test may be less justifiable. For example, the Supreme Court of Utah considered whether a presumption of reasonableness was justified when reviewing costs passed to a utility by an unregulated affiliate entity, and concluded that it was not appropriate:

> . . . we do not think an affiliate expense should carry a presumption of reasonableness. While the pressures of a competitive market might allow us to assume, in the absence of a showing to the contrary, that nonaffiliate expenses are reasonable, the same cannot be said of affiliate expenses not incurred in an arm's length transaction.

(*U.S. West Communications, Inc. v. Public Service Commission of Utah*, 901 P.2d 270 (Utah 1995), at p. 274)

[94] Treatment of the prudent investment test in American jurisprudence thus indicates that the test has been employed as a tool that may be useful in arriving at just and reasonable outcomes, rather than a mandatory feature of utilities regulation that must be applied regardless of whether there is statutory language to that effect.

(2) Canadian Jurisprudence

[95] Following its emergence in American jurisprudence, several Canadian utility regulators and courts have also considered the role of prudence review and, in some cases, applied a form of the prudent investment test. I provide a review of some of these cases here not in an attempt to exhaustively catalogue all uses of the test, but rather to set out the way in which the test has been invoked in various contexts.

[96] In *British Columbia Electric Railway Co. v. Public Utilities Commission of British Columbia*, [1960] S.C.R. 837, Martland J. observed that the statute at issue in that case directed that the regulator, in fixing rates,

[93] Les cours de justice américaines ont aussi reconnu que, dans certains contextes, des aspects du critère de l'investissement prudent peuvent se révéler moins justifiables. Par exemple, saisie du contrôle judiciaire de coûts transférés à un service public par une entreprise affiliée non réglementée, la Cour suprême de l'Utah s'est demandé s'il était justifié de présumer que les coûts étaient raisonnables et elle a conclu par la négative :

> [TRADUCTION] . . . nous ne pensons pas que les dépenses de l'affiliée devraient être présumées raisonnables. Bien que la pression exercée par un marché concurrentiel puisse nous permettre de présumer, faute d'une preuve contraire, que les dépenses d'une entreprise non affiliée sont raisonnables, on ne peut en dire autant des dépenses d'une affiliée qui ne sont pas faites dans le cadre d'une opération sans lien de dépendance.

(*U.S. West Communications, Inc. c. Public Service Commission of Utah*, 901 P.2d 270 (Utah 1995), p. 274)

[94] Il appert donc de la jurisprudence américaine que le critère de l'investissement prudent s'est révélé utile pour arriver à un résultat juste et raisonnable, mais qu'il ne saurait constituer un élément obligatoire de la réglementation des services publics dont l'application s'impose même lorsqu'aucune disposition législative ne le prévoit.

(2) Jurisprudence canadienne

[95] Sous l'impulsion de la jurisprudence américaine, plusieurs organismes de réglementation et cours de justice du Canada se sont aussi penchés sur le rôle du contrôle de la prudence et ont parfois appliqué une variante du critère de l'investissement prudent. Je passerai en revue certaines de leurs décisions dans le but non pas de répertorier toutes les applications du critère, mais bien de faire état de la manière dont on l'a appliqué dans différents contextes.

[96] Dans l'arrêt *British Columbia Electric Railway Co. c. Public Utilities Commission of British Columbia*, [1960] R.C.S. 837, le juge Martland relève que, suivant la loi en cause, l'organisme de réglementation est tenu à ce qui suit lorsqu'il fixe des tarifs :

(*a*) . . . shall consider all matters which it deems proper as affecting the rate: [and]

(*b*) . . . shall have due regard, among other things, to the protection of the public from rates that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the public utility; and to giving to the public utility a fair and reasonable return upon the appraised value of the property of the public utility used, or prudently and reasonably acquired, to enable the public utility to furnish the service. [p. 852]

(Quoting *Public Utilities Act*, R.S.B.C. 1948, c. 277, s. 16(1)(*b*) (repealed S.B.C. 1973, c. 29, s. 187).)

The consequence of this statutory language, Martland J. held, was that the regulator, "when dealing with a rate case, has unlimited discretion as to the matters which it may consider as affecting the rate, but that it must, when actually setting the rate, meet the two requirements specifically mentioned in clause (*b*)": p. 856. That is, the regulator, under this statute, must ensure that the public pays only fair and reasonable charges, and that the utility secures a fair and reasonable return upon its property used *or prudently and reasonably acquired*. This express statutory protection for the recovery of prudently made property acquisition costs thus provides an example of statutory language under which this Court found a non-discretionary obligation to provide a fair return to utilities for capital expenditures that were either used or prudently acquired.

[97] In 2005, the Nova Scotia Utility and Review Board ("NSUARB") considered and adopted a definition of the prudent investment test articulated by the Illinois Commerce Commission:

. . . prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. . . . Hindsight is not applied in assessing prudence. . . . A utility's decision is

[TRADUCTION]

(*a*) . . . considérer tout élément qu'il juge susceptible d'influer sur les tarifs; [et]

(*b*) . . . tenir dûment compte, notamment, de la protection du public contre les tarifs excessifs qui excèdent ce qui est juste et raisonnable en contrepartie du service de la nature et de la qualité de celui fourni et de l'obtention par le service public d'un rendement juste et raisonnable sur les biens qu'il affecte à la prestation du service ou qu'il acquiert à cette fin de manière prudente et raisonnable, selon leur valeur d'expertise. [p. 852]

(Citant *Public Utilities Act*, R.S.B.C. 1948, c. 227, al. 16(1)*b*) (abrogé S.B.C. 1973, c. 29, art. 187).)

Le juge Martland conclut de ce libellé que l'organisme de réglementation [TRADUCTION] « appelé à se prononcer sur la fixation de tarifs jouit d'un pouvoir discrétionnaire absolu quant aux éléments qu'il juge susceptibles d'influer sur les tarifs, mais qu'il doit, lorsqu'il établit la tarification, satisfaire aux deux exigences expressément prévues à l'al. (*b*) » (p. 856). Ainsi, l'organisme de réglementation est tenu par cette loi de faire en sorte que le public ne paie que ce qui est juste et raisonnable et que le service public obtienne un rendement juste et raisonnable sur la valeur des biens qu'il a utilisés *ou acquis de manière prudente et raisonnable*. Cette protection légale expresse du recouvrement du coût des biens acquis avec prudence offre un exemple de libellé législatif sur le fondement duquel notre Cour a conclu à l'existence d'une obligation non discrétionnaire d'assurer au service public un rendement juste sur les immobilisations qu'il a utilisées ou acquises avec prudence.

[97] En 2005, la Nova Scotia Utility and Review Board (« NSUARB ») a examiné puis adopté la définition du critère de l'investissement prudent proposée par l'Illinois Commerce Commission :

[TRADUCTION] . . . la prudence est la norme de diligence qu'une personne raisonnable aurait respectée dans la situation rencontrée par la direction du service public au moment où elle a dû prendre les décisions. [. . .] Le recul est exclu lorsqu'il s'agit d'apprécier la prudence. [. . .]

prudent if it was within the range of decisions reasonable persons might have made. . . . The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being imprudent.

(*Nova Scotia Power Inc., Re*, 2005 NSUARB 27 ("*Nova Scotia Power 2005*"), at para. 84 (CanLII))

The NSUARB then wrote that "[f]ollowing a review of the cases, the Board finds that the definition of imprudence as set out by the Illinois Commerce Commission is a reasonable test to be applied in Nova Scotia": para. 90. The NSUARB then considered, among other things, whether the utility's recent fuel procurement strategy had been prudent, and found that it had not: para. 94. It did not, however, indicate that it believed itself to be compelled to apply the prudent investment test.

[98] The NSUARB reaffirmed its endorsement of the prudent investment test in 2012: *Nova Scotia Power Inc. (Re)*, 2012 NSUARB 227 ("*Nova Scotia Power 2012*"), at paras. 143-46 (CanLII). In that case, the utility whose submissions were under review "confirmed that from its perspective this is the test the Board should apply": para. 146. The NSUARB then applied the prudence test in evaluating whether several of the utility's operational decisions were prudent, and found that some were not: para. 188.

[99] In 2006, the Ontario Court of Appeal considered the meaning of the prudent investment test in *Enbridge*. This case is of particular interest for two reasons. First, the Ontario Court of Appeal endorsed in its reasons a specific formulation of the prudent investment test framework:

– Decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds.

La décision du service public est prudente si elle fait partie des décisions qu'une personne raisonnable aurait pu prendre. [. . .] La norme de la prudence reconnaît que des personnes raisonnables peuvent sincèrement différer d'opinions sans pour autant que l'une ou l'autre soit imprudente.

(*Nova Scotia Power Inc., Re*, 2005 NSUARB 27 (« *Nova Scotia Power 2005* »), par. 84 (CanLII))

La NSUARB conclut alors que, [TRADUCTION] « [a]près examen de la jurisprudence, [. . .] la définition d'imprudence proposée par l'Illinois Commerce Commission constitue un critère raisonnable susceptible d'application en Nouvelle-Écosse » (par. 90). Elle se demande notamment si la stratégie récente d'achat de carburant du service public a été prudente, et elle répond par la négative (par. 94). Elle ne se dit cependant pas tenue d'appliquer le critère de l'investissement prudent.

[98] En 2012, la NSUARB a renouvelé son adhésion au critère de l'investissement prudent (*Nova Scotia Power Inc. (Re)*, 2012 NSUARB 227 (« *Nova Scotia Power 2012* »), par. 143-146 (CanLII)). Dans cette affaire, le service public dont les arguments faisaient l'objet de l'examen [TRADUCTION] « a confirmé que, selon lui, il s'agit du critère que la commission devrait appliquer » (par. 146). La NSUARB a ensuite appliqué le critère de la prudence pour décider si plusieurs décisions opérationnelles du service public avaient été prudentes ou non, et elle a conclu que certaines d'entre elles ne l'avaient pas été (par. 188).

[99] En 2006, dans l'arrêt *Enbridge*, la Cour d'appel de l'Ontario se penche sur la teneur du critère de l'investissement prudent. Cet arrêt revêt un intérêt particulier pour deux raisons. Premièrement, la Cour d'appel y circonscrit précisément l'application du critère :

[TRADUCTION]

– La décision de la direction du service public est généralement présumée prudente, sauf contestation pour motifs valables.

– To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.

– Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.

– Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on facts about the elements that could or did enter into the decision at the time. [para. 10]

[100] Second, the Court of Appeal in *Enbridge* made certain statements that suggest that the prudent investment test was a necessary approach to reviewing committed costs. Specifically, it noted that in deciding whether Enbridge's requested rate increase was just and reasonable,

the [Board] was required to balance the competing interests of Enbridge and its consumers. That balancing process is achieved by the application of what is known in the utility rate regulation field as the "prudence" test. Enbridge was entitled to recover its costs by way of a rate increase only if those costs were "prudently" incurred. [para. 8]

The Court of Appeal also noted that the Board had applied the "proper test": para. 18. These statements tend to suggest that the Court of Appeal was of the opinion that prudence review is an inherent and necessary part of ensuring just and reasonable payments.

[101] However, the question of whether the prudence test was a required feature of just-and-reasonable analysis in this context was not squarely before the Court of Appeal in *Enbridge*. Rather, the parties in that case "were in substantial agreement on the general approach the Board should take to reviewing the prudence of a utility's decision" (para. 10), and the question at issue was whether

– Pour qu'elle soit prudente, la décision doit être raisonnable eu égard aux circonstances que connaissait ou qu'aurait dû connaître le service public au moment où il l'a prise.

– Le recul est exclu de l'appréciation de la prudence, même lorsque les conséquences de la décision peuvent légitimement servir à réfuter la présomption de prudence.

– La prudence est appréciée dans le cadre d'une analyse factuelle rétrospective en ce que la preuve doit porter sur le moment où la décision a été prise et reposer sur des faits quant aux éléments qui ont pu entrer en ligne de compte ou qui sont effectivement entrés en ligne de compte dans la décision. [par. 10]

[100] Deuxièmement, elle donne plusieurs fois à entendre que le recours au critère de l'investissement prudent est nécessaire pour se prononcer sur les dépenses convenues. Plus précisément, elle signale que pour décider du caractère juste et raisonnable de l'augmentation des tarifs demandée par Enbridge,

[TRADUCTION] la [Commission] était tenue de soupeser les intérêts opposés d'Enbridge et des consommateurs. Pour ce faire, elle devait appliquer ce qu'on appelle dans le domaine de la réglementation des tarifs des services publics le critère de la « prudence ». Enbridge était en droit de recouvrer ses coûts au moyen d'une augmentation de ses tarifs, mais seulement si la décision derrière ces coûts était « prudente ». [par. 8]

La Cour d'appel ajoute que la Commission a appliqué le [TRADUCTION] « bon critère » (par. 18). Ces affirmations tendent à indiquer que, selon la Cour d'appel, le contrôle de la prudence est fondamental et nécessaire afin que les paiements soient justes et raisonnables.

[101] Or, dans cette affaire, la Cour d'appel n'était pas directement saisie de la question de savoir si, dans ce contexte, l'application du critère de la prudence était nécessaire à l'appréciation du caractère juste et raisonnable des paiements. En fait, les parties s'entendaient [TRADUCTION] « pour l'essentiel sur la démarche qui devait être celle de la Commission pour apprécier la prudence d'une décision d'un

the Board had reasonably applied that agreed-upon approach. In this sense, *Enbridge* is similar to *Nova Scotia Power 2012*: both cases involved the application of prudence analysis in contexts where there was no dispute over whether an alternative methodology could reasonably have been applied.

(3) Conclusion Regarding the Prudent Investment Test

[102] The prudent investment test, or prudence review, is a valid and widely accepted tool that regulators may use when assessing whether payments to a utility would be just and reasonable. While there exist different articulations of prudence review, *Enbridge* presents one express statement of how a regulatory board might structure its review to assess the prudence of utility expenditures at the time they were incurred or committed. A no-hindsight prudence review has most frequently been applied in the context of capital costs, but *Enbridge* and *Nova Scotia Power* (both *2005* and *2012*) provide examples of its application to decisions regarding operating costs as well. I see no reason in principle why a regulatory board should be barred from applying the prudence test to operating costs.

[103] However, I do not find support in the statutory scheme or the relevant jurisprudence for the notion that the Board should be *required* as a matter of law, under the *Ontario Energy Board Act, 1998*, to apply the prudence test as outlined in *Enbridge* such that the mere decision not to apply it when considering committed costs would render its decision on payment amounts unreasonable. Nor is the creation of such an obligation by this Court justified. As discussed above, where a statute requires only that the regulator set "just and reasonable" payments, as the *Ontario Energy Board Act, 1998* does in Ontario, the regulator may make use of a variety of analytical tools in assessing the justness and reasonableness of a utility's proposed payment

service public » (par. 10). La question en litige était celle de savoir si la Commission avait eu recours à cette démarche de manière raisonnable. En ce sens, l'affaire *Enbridge* s'apparente à *Nova Scotia Power 2012* : les deux concernent l'application du critère de la prudence lorsqu'aucune des parties ne soutient qu'une autre démarche aurait pu raisonnablement s'appliquer.

(3) Conclusion sur le critère de l'investissement prudent

[102] Le critère de l'investissement prudent — ou contrôle de la prudence — offre aux organismes de réglementation un moyen valable et largement reconnu d'apprécier le caractère juste et raisonnable des paiements sollicités par un service public. Il existe certes des formulations différentes du contrôle de la prudence, mais l'arrêt *Enbridge* précise en détail quelle peut être la démarche d'un organisme de réglementation appelé à décider si, au moment où le service public les a faites ou en a convenu, les dépenses étaient prudentes ou non. Le plus souvent, le contrôle de la prudence excluant le recul s'applique aux coûts en capital, mais l'arrêt *Enbridge* et les décisions *Nova Scotia Power* (*2005* et *2012*) montrent qu'il s'applique aussi aux dépenses d'exploitation. Je ne vois aucune raison de principe d'interdire à un organisme de réglementation d'appliquer le critère de la prudence aux dépenses d'exploitation.

[103] Toutefois, aucun élément du régime législatif ou de la jurisprudence applicable ne me paraît appuyer l'idée que la Commission devrait être *tenue* en droit, suivant la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, d'appliquer le critère de la prudence énoncé dans l'arrêt *Enbridge*, de sorte que la seule décision de ne pas l'appliquer pour apprécier la prudence de dépenses convenues rendrait déraisonnable sa décision sur les paiements. Notre Cour n'est pas non plus justifiée de créer pareille obligation. Je le répète, lorsqu'un texte législatif — telle la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* en Ontario — exige seulement qu'il fixe des paiements « justes et raisonnables », l'organisme de réglementation peut avoir recours à divers

amounts. This is particularly so where, as here, the regulator has been given express discretion over the methodology to be used in setting payment amounts: O. Reg. 53/05, s. 6(1).

[104] To summarize, it is not necessarily unreasonable, in light of the particular regulatory structure established by the *Ontario Energy Board Act, 1998*, for the Board to evaluate committed costs using a method other than a no-hindsight prudence review. As noted above, applying a presumption of prudence would have conflicted with the burden of proof in the *Ontario Energy Board Act, 1998* and would therefore not have been reasonable. The question of whether it was reasonable to assess a particular cost using hindsight should turn instead on the circumstances of that cost. I emphasize, however, that this decision should not be read to give regulators *carte blanche* to disallow a utility's committed costs at will. Prudence review of committed costs may in many cases be a sound way of ensuring that utilities are treated fairly and remain able to secure required levels of investment capital. As will be explained, particularly with regard to committed capital costs, prudence review will often provide a reasonable means of striking the balance of fairness between consumers and utilities.

[105] This conclusion regarding the Board's ability to select its methodology rests on the particulars of the statutory scheme under which the Board operates. There exist other statutory schemes in which regulators are expressly required to compensate utilities for certain costs prudently incurred: see *British Columbia Electric Railway Co*. Under such a framework, the regulator's methodological discretion may be more constrained.

moyens d'analyse pour apprécier le caractère juste et raisonnable des paiements sollicités par le service public. Cela est particulièrement vrai lorsque, comme en l'espèce, l'organisme de réglementation se voit accorder expressément un pouvoir discrétionnaire quant à la méthode à appliquer pour fixer les paiements (règlement 53/05, par. 6(1)).

[104] En résumé, il n'est pas nécessairement déraisonnable, à la lumière du cadre réglementaire établi par la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, que la Commission se prononce sur les dépenses convenues en employant une autre méthode que l'application d'un critère de prudence qui exclut le recul. Comme nous l'avons vu, présumer la prudence serait incompatible avec le fardeau de preuve que prévoit la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* et, de ce fait, déraisonnable. Qu'il soit raisonnable ou non d'apprécier certaines dépenses avec le recul devrait plutôt dépendre des circonstances de la décision dont s'originent ces dépenses. Je précise toutefois que la présente décision ne doit pas être interprétée de façon à permettre aux organismes de réglementation de refuser à leur guise d'approuver des dépenses convenues. Le contrôle de la prudence de dépenses convenues peut, dans bien des cas, constituer un bon moyen de faire en sorte que les services publics soient traités équitablement et demeurent aptes à obtenir les investissements de capitaux requis. Comme je l'explique plus loin, en ce qui a trait plus particulièrement aux coûts en capital convenus, le contrôle de la prudence offre le plus souvent un moyen raisonnable d'établir un équilibre entre les intérêts du consommateur et ceux du service public.

[105] Cette conclusion sur le pouvoir de la Commission de décider de sa démarche découle du régime législatif qui régit son fonctionnement. D'autres régimes législatifs prévoient expressément que l'organisme de réglementation en cause est tenu d'indemniser le service public de certaines dépenses découlant de décisions prudentes (voir l'arrêt *British Columbia Electric Railway Co.*). Selon ces autres cadres législatifs, le pouvoir discrétionnaire qui permet à l'organisme de réglementation de décider de sa démarche peut être plus restreint.

(4) Application to the Board's Decision

[106] In this case, the Board disallowed a total of $145 million in compensation costs associated with OPG's nuclear operations, over two years. As discussed above, these costs are best understood as at least partly committed. In view of the nature of these particular costs and the circumstances in which they became committed, I do not find that the Board acted unreasonably in not applying the prudent investment test in determining whether it would be just and reasonable to compensate OPG for these costs.

[107] First, the costs at issue are operating costs, rather than capital costs. Capital costs, particularly those pertaining to areas such as capacity expansion or upgrades to existing facilities, often entail some amount of risk, and may not always be strictly necessary to the short-term ongoing production of the utility. Nevertheless, such costs may often be a wise investment in the utility's future health and viability. As such, prudence review, including a no-hindsight approach (with or without a presumption of prudence, depending on the applicable statutory context), may play a particularly important role in ensuring that utilities are not discouraged from making the optimal level of investment in the development of their facilities.

[108] Operating costs, like those at issue here, are different in kind from capital costs. There is little danger in this case that a disallowance of these costs will have a chilling effect on OPG's willingness to incur operating costs in the future, because costs of the type disallowed here are an inescapable element of operating a utility. It is true that a decision such as the Board's in this case may have the effect of making OPG more hesitant about committing to relatively high compensation costs, but that was precisely the intended effect of the Board's decision.

(4) Application à la décision de la Commission

[106] En l'espèce, la Commission refuse à OPG le recouvrement au total de 145 millions de dollars au titre des dépenses de rémunération dans le secteur nucléaire, sur deux ans. Rappelons qu'il faut considérer que ces dépenses constituent, du moins en partie, des dépenses convenues. Compte tenu de la nature de ces dépenses en particulier et des circonstances dans lesquelles le service public en a convenu, je ne saurais conclure que la Commission a agi déraisonnablement en n'appliquant pas le critère de l'investissement prudent pour décider s'il était juste et raisonnable d'indemniser OPG à leur égard.

[107] Premièrement, il s'agit de dépenses d'exploitation, et non de coûts en capital. Les coûts en capital, en particulier ceux qui se rapportent par exemple à l'accroissement de la capacité ou à l'amélioration des installations actuelles, comportent souvent un risque et peuvent ne pas être nécessaires, à strictement parler, à la production à court terme du service public. Ces coûts peuvent néanmoins constituer un investissement judicieux pour le bon fonctionnement et la viabilité ultérieurs de ce dernier. Dès lors, le contrôle de la prudence, qui exclut le recul (et présume ou non la prudence, selon les dispositions législatives applicables), peut jouer un rôle particulièrement important pour faire en sorte que le service public ne soit pas dissuadé d'investir de manière optimale dans le développement de ses installations.

[108] Les dépenses d'exploitation, comme celles visées en l'espèce, diffèrent des coûts en capital. Il est peu probable que le refus de les approuver dissuade OPG d'en faire à l'avenir, car les dépenses de la nature de celles qui ont été refusées sont inhérentes à l'exploitation d'un service public. Certes, une décision comme celle rendue par la Commission en l'espèce peut faire hésiter OPG à convenir de dépenses relativement élevées au chapitre de la rémunération, mais tel était précisément l'effet voulu par la Commission.

[109] Second, the costs at issue arise in the context of an ongoing, "repeat-player" relationship between OPG and its employees. Prudence review has its origins in the examination of decisions to pursue particular investments, such as a decision to invest in capacity expansion; these are often one-time decisions made in view of a particular set of circumstances known or assumed at the time the decision was made.

[110] By contrast, OPG's committed compensation costs arise in the context of an ongoing relationship in which OPG will have to negotiate compensation costs with the same parties in the future. Such a context supports the reasonableness of a regulator's decision to weigh all evidence it finds relevant in striking a just and reasonable balance between the utility and consumers, rather than confining itself to a no-hindsight approach. Prudence review is simply less relevant when the Board's focus is not solely on compensating for past commitments, but on regulating costs to be incurred in the future as well. As will be discussed further, the Board's ultimate disallowance was not targeted exclusively at committed costs, but rather was made with respect to the total compensation costs it evaluated in aggregate. Though the Board acknowledged that OPG may not have had the discretion to reduce spending by the entire amount of the disallowance, the disallowance was animated by the Board's efforts to get OPG's ongoing compensation costs under control.

[111] Having already given OPG a warning that the Board found its operational costs to be of concern (see Board 2008-2009 Decision, at pp. 28-32), it was not unreasonable for the Board to be more forceful in considering compensation costs to ensure effective regulation of such costs going forward. The Board's statement that its disallowance was intended "to send a clear signal that OPG must take responsibility for improving its performance" (Board Decision, at para. 350) shows that it had the ongoing effects of its disallowance squarely in mind in issuing its decision in this case.

[109] Deuxièmement, les dépenses en cause découlent d'une relation continue entre OPG et ses employés. Le contrôle de la prudence tire son origine de l'examen de décisions d'effectuer certains investissements, notamment pour accroître la capacité; il s'agit souvent de décisions isolées prises à la lumière d'un ensemble de données alors connues ou supposées.

[110] À l'opposé de celles issues de telles décisions, les dépenses de rémunération convenues d'OPG découlent d'une relation continue dans le cadre de laquelle OPG devra négocier ultérieurement les barèmes de rémunération avec les mêmes parties. Pareil contexte milite en faveur du caractère raisonnable de la décision de l'organisme de réglementation de soupeser toute preuve qu'il juge pertinente aux fins d'établir un équilibre juste et raisonnable entre le service public et les consommateurs, au lieu de s'en tenir à une approche excluant le recul. Le contrôle de la prudence se révèle tout simplement moins indiqué lorsque la Commission n'entend pas seulement indemniser le service public des engagements déjà pris, mais aussi réguler les dépenses qui seront faites dans l'avenir. En fin de compte, le refus de la Commission ne vise pas que des dépenses convenues, mais bien la totalité des dépenses de rémunération considérées globalement. Même si la Commission reconnaît qu'OPG n'avait peut-être pas de pouvoir discrétionnaire lui permettant de réduire ses dépenses à raison du montant total refusé, le refus de la Commission vise à inciter OPG à la maîtrise constante de ses dépenses de rémunération.

[111] Après que la Commission eut signifié à OPG que ses dépenses d'exploitation lui paraissaient préoccupantes (voir la décision 2008-2009 de la Commission, p. 28-32), il n'était pas déraisonnable qu'elle se montre plus stricte dans l'examen des dépenses de rémunération du service public afin d'en assurer la régulation réelle à l'avenir. Le fait que la Commission dit refuser l'approbation [TRADUCTION] « afin de signifier clairement à OPG qu'il lui incombe d'accroître sa performance » (décision de la Commission, par. 350) montre qu'elle a bel et bien conscience des répercussions actuelles de son refus.

[112] The reasonableness of the Board's decision to disallow $145 million in compensation costs is supported by the Board's recognition of the fact that OPG was bound to a certain extent by the collective agreements in making staffing decisions and setting compensation rates, and its consideration of this factor in setting the total disallowance: Board Decision, at para. 350. The Board's methodological flexibility ensures that its decision need not be "all or nothing". Where appropriate, to the extent that the utility was unable to reduce its costs, the total burden of such costs may be moderated or shared as between the utility's shareholders and the consumers. The Board's moderation in this case shows that, in choosing to disallow costs without applying a formal no-hindsight prudence review, it remained mindful of the need to ensure that any disallowance was not unfair to OPG and certainly did not impair the viability of the utility.

[112] Le caractère raisonnable du refus de la Commission d'approuver des dépenses de 145 millions de dollars au titre de la rémunération tient à ce qu'elle reconnaît qu'OPG était liée dans une certaine mesure par les conventions collectives dans sa prise de décisions en matière de personnel et dans la fixation des barèmes de rémunération, et à ce qu'elle en tient compte pour déterminer la somme totale refusée (décision de la Commission, par. 350). La souplesse méthodologique dont bénéficie la Commission lui permet d'éviter les extrêmes. Lorsque le service public ne peut réduire ses dépenses, la prise en charge de celles-ci peut, si le dossier s'y prête, être modérée ou répartie entre les actionnaires du service public et les consommateurs. La modération opérée par la Commission en l'espèce montre que, en refusant d'approuver les dépenses sans recourir formellement à un contrôle de la prudence excluant le recul, elle ne perd pas de vue la nécessité de veiller à ce que tout refus ne soit pas injuste envers OPG ni, assurément, à ce qu'il ne nuise pas à sa viabilité.

[113] Justice Abella, in her dissent, acknowledges that the Board has the power under prudence review to disallow committed costs in at least some circumstances: para. 152. However, she speculates that any such disallowance could "imperil the assurance of reliable electricity service": para. 156. A large or indiscriminate disallowance might create such peril, but it is also possible for the Board to do as it did here, and temper its disallowance to recognize the realities facing the utility.

[113] Dans ses motifs de dissidence, la juge Abella reconnaît que, lors du contrôle de la prudence, la Commission peut, du moins dans certaines circonstances, refuser des dépenses convenues (par. 152). Elle dit toutefois craindre qu'un tel refus puisse « mettre en péril la garantie d'un service d'électricité fiable » (par. 156). Le refus d'une somme importante ou opposé sans discernement pourrait exposer à un tel risque, mais il se peut aussi que l'organisme de réglementation fasse ce que la Commission fait en l'espèce, c'est-à-dire modérer son refus en tenant compte des réalités auxquelles fait face le service public.

[114] There is no dispute that collective agreements are "immutable" between employees and the utility. However, if the legislature had intended for costs under collective agreements to also be inevitably imposed on consumers, it would not have seen fit to grant the Board oversight of utility compensation costs. The existence both of collective bargaining for utility employees and of the Board's power to fix payment amounts covering compensation costs indicates neither regime can trump the other. The Board cannot interfere with the collective agreement by ordering that a utility break its

[114] Nul ne conteste que les conventions collectives intervenues entre le service public et ses employés sont « immuables ». Toutefois, si le législateur avait voulu que les dépenses qui en sont issues se répercutent inévitablement sur les consommateurs, il n'aurait pas jugé opportun d'investir la Commission du pouvoir de surveiller les dépenses de rémunération d'un service public. La coexistence du droit à la négociation collective des employés du service public et du pouvoir de la Commission de fixer le montant des paiements pour les dépenses de rémunération indique que ni l'un ni l'autre n'a

obligations thereunder, but nor can the collective agreement supersede the Board's duty to ensure a just and reasonable balance between utility and consumer interests.

préséance. La Commission ne peut empiéter sur les conventions collectives en ordonnant au service public de manquer aux obligations qu'elles lui imposent, mais les conventions collectives ne priment pas l'obligation de la Commission d'assurer un équilibre juste et raisonnable entre le service public et les consommateurs.

[115] Justice Abella says that the Board's review of committed costs using hindsight evidence appears to contradict statements made earlier in its decision. The Board wrote that it would use all relevant evidence in assessing forecast costs but that it would limit itself to a no-hindsight approach in reviewing costs that OPG could not "take action to reduce": Board Decision, at para. 75. In my view, these statements can be read as setting out a reasonable approach for analyzing costs that could reliably be fit into forecast or committed categories. However, not all costs are amenable to such clean categorization by the Board in assessing payment amounts for a test period.

[115] La juge Abella affirme que l'examen des dépenses convenues auquel se livre la Commission à partir d'éléments de recul paraît contredire ce que l'organisme affirme précédemment dans sa décision. La Commission écrit en effet qu'elle prendra en compte tout élément de preuve pertinent pour apprécier les dépenses prévues, mais qu'elle s'en tiendra à un examen sans recul pour ce qui concerne les dépenses à l'égard desquelles OPG [TRADUCTION] « ne pouvait prendre de mesures de réduction » (décision de la Commission, par. 75). À mon sens, on peut en conclure qu'elle recourt à une démarche raisonnable pour l'analyse de dépenses que l'on peut assimiler avec assurance soit à des dépenses prévues, soit à des dépenses convenues. Cependant, toutes les dépenses ne sont pas susceptibles d'une distinction aussi nette par la Commission lorsqu'il s'agit d'apprécier le montant des paiements pour une période de référence.

[116] With regard to the compensation costs at issue here, the Board declined to split the total cost disallowance into forecast and committed components in conducting its analysis. As Hoy J. observed, "[g]iven the complexity of OPG's business, and respecting its management's autonomy, [the Board] did not try to quantify precisely the amount by which OPG could reduce its forecast compensation costs within the framework of the existing collective bargaining agreements": Div. Ct. reasons, at para. 53. That is, the Board did not split all compensation costs into either "forecast" or "committed", but analyzed the disallowance of compensation costs as a mix of forecast and committed expenditures over which management retained some, but not total, control.

[116] En ce qui a trait aux dépenses de rémunération en cause, la Commission refuse de préciser quelle partie de la somme totale refusée correspond à des dépenses prévues et quelle partie correspond à des dépenses convenues pour les besoins de son analyse. Le juge Hoy fait observer que, [TRADUCTION] « [v]u la complexité de l'activité d'OPG et l'autonomie de gestion dont elle jouit, [la Commission] n'a pas tenté de déterminer avec précision le montant dont les dépenses de rémunération prévues d'OPG auraient pu être réduites dans le contexte des conventions collectives en vigueur » (motifs de la C. div., par. 53). En somme, la Commission ne départage pas les dépenses de rémunération totales entre celles qui sont « prévues » et celles qui sont « convenues ». Elle considère plutôt que les dépenses de rémunération refusées se composent à la fois de dépenses prévues et de dépenses convenues sur lesquelles la direction conservait une certaine maîtrise, mais non une maîtrise totale.

[117] It was not unreasonable for the Board to proceed on the basis that predicting staff attrition rates is an inherently uncertain exercise, and that it is not equipped to micromanage business decisions within the purview of OPG management. These considerations mean that any attempt to predict the exact degree to which OPG would be able to reduce compensation costs (in other words, what share of the costs were forecast) would be fraught with uncertainty. Accordingly, it was not unreasonable for the Board to adopt a mixed approach that did not rely on quantifying the exact share of compensation costs that fell into the forecast and committed categories. Such an approach is not inconsistent with the Board's discussion at paras. 73-75, but rather represents an exercise of the Board's methodological discretion in addressing a challenging issue where these costs did not fit easily into the categories discussed in that passage.

[118] Justice Abella emphasizes throughout her reasons that the costs established by the collective agreements were not adjustable. I do not dispute this point. However, to the extent that she relies on the observation that the collective agreements "made it *illegal* for the utility to alter the compensation and staffing levels" of the unionized workforce (para. 149 (emphasis in original)), one might conclude that the Board was in some way trying to interfere with OPG's obligations under its collective agreements. It is important not to lose sight of the fact that the Board decision in no way purports to force OPG to break its contractual commitments to unionized employees.

[119] Finally, her observation that the Canadian Nuclear Safety Commission ("CNSC") "has . . . imposed staffing levels on Ontario Power Generation to ensure safe and reliable operation of its nuclear stations" (para. 127) is irrelevant to the issues raised in this case. While the regime put in place by the CNSC surely imposes operational and staffing restraints on nuclear utilities (see OPG record, at

[117] Il n'est pas déraisonnable que la Commission considère que la prévision du taux d'attrition du personnel constitue en soi une entreprise incertaine et qu'elle n'est pas en mesure de microgérer les décisions d'affaires qui relèvent des dirigeants d'OPG. Dès lors, toute tentative de prédire la mesure exacte dans laquelle OPG pourrait abaisser ses dépenses de rémunération (autrement dit, quelle partie de ces dépenses est prévue) serait empreinte d'incertitude. Il n'est donc pas déraisonnable que la Commission opte pour une démarche hybride qui ne se fonde pas sur la répartition exacte des dépenses de rémunération entre celles qui sont prévues et celles qui sont convenues. Pareille démarche est compatible avec l'analyse de la Commission figurant aux par. 73-75 de sa décision et correspond à un exercice du pouvoir discrétionnaire de la Commission sur le plan méthodologique lorsqu'elle est appelée à se prononcer sur une question épineuse et que les dépenses en cause ne sont pas aisément assimilables à l'une ou l'autre des catégories mentionnées dans cette analyse.

[118] Tout au long de ses motifs, la juge Abella rappelle que les dépenses découlant des conventions collectives ne peuvent être rajustées. Je n'en disconviens pas. Cependant, lorsqu'elle opine que les conventions collectives « rend[ent] *illégale* la modification par le service public [. . .] des barèmes de rémunération et des niveaux de dotation » à l'égard de son personnel syndiqué (par. 149 (en italique dans l'original)), d'aucuns pourraient en conclure que la Commission tente de quelque manière de s'immiscer dans l'exécution des obligations d'OPG suivant les conventions collectives. Il importe de ne pas oublier que la Commission n'entend pas, par sa décision, contraindre OPG à se soustraire à ses engagements contractuels envers ses employés.

[119] Enfin, la remarque de ma collègue selon laquelle la Commission canadienne de sûreté nucléaire (« CCSN ») « [a] impos[é] [. . .] des niveaux de dotation à Ontario Power Generation afin de garantir l'exploitation sûre et fiable de ses installations nucléaires » (par. 127) importe peu quant aux questions soulevées en l'espèce. Bien que le régime établi par la CCSN impose sûrement des conditions

pp. 43-46), there is nothing in the Board's reasons, and no argument presented before this Court, suggesting that the Board's disallowance will result in a violation of the provisions of the *Nuclear Safety and Control Act*, S.C. 1997, c. 9.

[120] I have noted above that it is essential for a utility to earn its cost of capital in the long run. The Board's disallowance may have adversely impacted OPG's ability to earn its cost of capital in the short run. Nevertheless, the disallowance was intended "to send a clear signal that OPG must take responsibility for improving its performance" (Board Decision, at para. 350). Such a signal may, in the short run, provide the necessary impetus for OPG to bring its compensation costs in line with what, in the Board's opinion, consumers should justly expect to pay for an efficiently provided service. Sending such a signal is consistent with the Board's market proxy role and its objectives under s. 1 of the *Ontario Energy Board Act, 1998*.

VI. Conclusion

[121] I do not find that the Board acted improperly in pursuing this matter on appeal; nor do I find that it acted unreasonably in disallowing the compensation costs at issue. Accordingly, I would allow the appeal, set aside the decision of the Court of Appeal, and reinstate the decision of the Board.

The following are the reasons delivered by

[122] Abella J. (dissenting) — The Ontario Energy Board was established in 1960 to set rates for the sale and storage of natural gas and to approve pipeline construction projects. Over time, its powers and responsibilities evolved. In 1973, the Board became responsible for reviewing and reporting to the Minister of Energy on electricity rates. During this period, Ontario's electricity market was lightly regulated, dominated by the government-owned

d'exploitation et de dotation aux installations nucléaires (voir dossier OPG, p. 43-46), nul élément des motifs de la Commission et nulle plaidoirie devant notre Cour n'indiquent que le refus de la Commission entraînera le non-respect des dispositions de la *Loi sur la sûreté et la réglementation nucléaires*, L.C. 1997, c. 9.

[120] Je rappelle qu'il est essentiel qu'un service public obtienne à long terme l'équivalent du coût du capital. Le refus de la Commission a pu nuire à la possibilité qu'OPG obtienne à court terme l'équivalent de son coût du capital. Toutefois, il vise à [TRADUCTION] « signifier clairement à OPG qu'il lui incombe d'accroître sa performance » (décision de la Commission, par. 350). L'envoi d'un tel message peut, à court terme, donner à OPG l'impulsion nécessaire pour rapprocher ses dépenses de rémunération de ce que, selon la Commission, les consommateurs devraient à bon droit s'attendre à payer pour la prestation efficace du service. L'envoi d'un tel message est conforme au rôle de substitut du marché de la Commission et à ses objectifs selon l'article premier de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*.

VI. Conclusion

[121] Je conclus que la Commission n'a pas agi de manière inappropriée en se pourvoyant en tant que partie en appel; elle n'a pas non plus agi déraisonnablement en refusant d'approuver les dépenses de rémunération en cause. Par conséquent, je suis d'avis d'accueillir le pourvoi, d'annuler la décision de la Cour d'appel et de rétablir celle de la Commission.

Version française des motifs rendus par

[122] La juge Abella (dissidente) — La Commission de l'énergie de l'Ontario a été mise sur pied en 1960. Son mandat était alors d'établir les tarifs applicables à la vente et au stockage de gaz naturel et d'autoriser les projets de construction de pipelines. Au fil du temps, ses compétences et ses fonctions ont évolué. En 1973, le législateur lui a confié la responsabilité d'examiner les tarifs d'électricité puis de faire rapport au ministre de l'Énergie. Pendant cette

Ontario Hydro, which owned power generation assets responsible for about 90 per cent of electricity production in the province: Ron W. Clark, Scott A. Stoll and Fred D. Cass, *Ontario Energy Law: Electricity* (2012), at p. 134; *2011 Annual Report* of the Office of the Auditor General of Ontario, at pp. 5 and 67.

[123] A series of legislative measures in the late 1990s were adopted to transform the electricity industry into a market-based one driven by competition. Ontario Hydro was unbundled into five entities. One of them was Ontario Power Generation Inc., which was given responsibility for controlling the power generation assets of the former Ontario Hydro. It was set up as a commercial corporation with one shareholder — the Province of Ontario: Clark, Stoll and Cass, at pp. 5-7 and 134.

[124] As of April 1, 2008, the Board was given the authority by statute to set payments for the electricity generated by a prescribed list of assets held by Ontario Power Generation: *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B, s. 78.1(2); O. Reg. 53/05, *Payments Under Section 78.1 of the Act*, s. 3. Under the legislative scheme, Ontario Power Generation is required to apply to the Board for the approval of "just and reasonable" payment amounts: *Ontario Energy Board Act, 1998*, s. 78.1(5). The Board sets its own methodology to determine what "just and reasonable" payment amounts are, guided by the statutory objectives to maintain a "financially viable electricity industry" and to "protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service": O. Reg. 53/05, s. 6(1); *Ontario Energy Board Act, 1998*, paras. 1 and 2 of s. 1(1).

[125] Ontario Power Generation remains the province's largest electricity generator. It was unionized by the Ontario Hydro Employees' Union (the predecessor to the Power Workers' Union) in

période, en Ontario, le marché de l'électricité était peu réglementé. Il était dominé par la société d'État Ontario Hydro, qui possédait des installations de production d'énergie fournissant plus de 90 p. 100 de l'électricité dans la province (Ron W. Clark, Scott A. Stoll et Fred D. Cass, *Ontario Energy Law : Electricity* (2012), p. 134; *Rapport annuel 2011*, Bureau du vérificateur général de l'Ontario, p. 1 et 72).

[123] À la fin des années 1990, une série de mesures législatives a été adoptée en vue d'axer le secteur de l'électricité sur le marché et de le soumettre à la concurrence. Ontario Hydro a été scindée en cinq entités. L'une d'elles, Ontario Power Generation Inc., s'est vu confier l'actif de production d'électricité de l'ancienne société Ontario Hydro. Elle a été constituée en société commerciale dont le seul actionnaire est la province d'Ontario (Clark, Stoll et Cass, p. 5-7 et 134).

[124] Depuis le 1er avril 2008, la Commission est légalement investie du pouvoir de fixer les paiements pour l'électricité produite par les installations prescrites que possède Ontario Power Generation (*Loi de 1998 sur la Commission de l'énergie de l'Ontario*, L.O. 1998, c. 15, ann. B, par. 78.1(2); règlement 53/05 de l'Ontario (*Payments Under Section 78.1 of the Act*) (« règlement 53/05 », art. 3). Suivant le régime législatif, Ontario Power Generation est tenue de faire une demande à la Commission pour obtenir l'approbation de paiements « justes et raisonnables » (*Loi de 1998 sur la Commission de l'énergie de l'Ontario*, par. 78.1(5)). La Commission établit sa propre méthode pour déterminer ce qui constitue des paiements « justes et raisonnables » au regard des objectifs législatifs qui consistent à maintenir une « industrie de l'électricité financièrement viable » et à « protéger les intérêts des consommateurs en ce qui concerne les prix, ainsi que la suffisance, la fiabilité et la qualité du service d'électricité » (règlement 53/05, par. 6(1); *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, dispositions 1 et 2 du par. 1(1).

[125] Ontario Power Generation demeure le plus grand producteur d'électricité de la province. L'Ontario Hydro Employees' Union (auquel a succédé le Syndicat des travailleurs et travailleuses du secteur

the 1950s, and by the Society of Energy Professionals in 1992: Richard P. Chaykowski, *An Assessment of the Industrial Relations Context and Outcomes at OPG* (2013) (online), at s. 6.2. Today, Ontario Power Generation employs approximately 10,000 people in its regulated businesses, 90 per cent of whom are unionized. Two thirds of these unionized employees are represented by the Power Workers' Union, and the rest by the Society of Energy Professionals.

[126] Both the Power Workers' Union and the Society of Energy Professionals had collective agreements with Ontario Hydro before Ontario Power Generation was established. As a successor company to Ontario Hydro, Ontario Power Generation inherited the full range of these labour relations obligations: Ontario *Labour Relations Act, 1995*, S.O. 1995, c. 1, Sch. A, s. 69. Ontario Power Generation's collective agreements with its unions prevent the utility from unilaterally reducing staffing or compensation levels.

[127] The Canadian Nuclear Safety Commission, an independent federal government agency responsible for ensuring compliance with the *Nuclear Safety and Control Act*, S.C. 1997, c. 9, has also imposed staffing levels on Ontario Power Generation to ensure safe and reliable operation of its nuclear stations.

[128] On May 26, 2010, Ontario Power Generation applied to the Board for a total revenue requirement of $6,909.6 million, including $2,783.9 million in compensation costs — wages, benefits, pension servicing, and annual incentives — to cover the period from January 1, 2011 to December 31, 2012: EB-2010-0008, at pp. 8, 49 and 80.

[129] In its decision, the Board explained that it would use "two types of examination" to assess the utility's expenditures. When evaluating forecast costs — costs that the utility has estimated for

énergétique) a été accrédité comme agent négociateur auprès de l'entreprise dans les années 1950, alors que Society of Energy Professionals l'a été à son tour en 1992 (Richard P. Chaykowski, *An Assessment of the Industrial Relations Context and Outcomes at OPG* (2013) (en ligne), art. 6.2). Le personnel d'Ontario Power Generation affecté à ses activités réglementées se compose aujourd'hui d'environ 10 000 personnes, dont 90 p. 100 sont syndiquées. Deux tiers de ces employés syndiqués sont représentés par le Syndicat des travailleurs et travailleuses du secteur énergétique, un tiers par Society of Energy Professionals.

[126] Le syndicat des travailleurs et travailleuses du secteur énergétique et Society of Energy Professionals avaient tous deux conclu des conventions collectives avec Ontario Hydro avant la création d'Ontario Power Generation. Lorsqu'elle a succédé à Ontario Hydro, Ontario Power Generation a hérité de la totalité des obligations issues de ces conventions (*Loi de 1995 sur les relations de travail* de l'Ontario, L.O. 1995, c. 1, ann. A, art. 69), qui la lient et l'empêchent de réduire unilatéralement les niveaux de dotation ou les barèmes de rémunération.

[127] La Commission canadienne de sûreté nucléaire, un organisme fédéral indépendant chargé de faire respecter la *Loi sur la sûreté et la réglementation nucléaires*, L.C. 1997, c. 9, impose également des niveaux de dotation à Ontario Power Generation afin de garantir l'exploitation sûre et fiable de ses installations nucléaires.

[128] Le 26 mai 2010, Ontario Power Generation a demandé à la Commission d'approuver des recettes nécessaires se chiffrant à 6 909,6 millions de dollars pour la période allant du 1er janvier 2011 au 31 décembre 2012, dont 2 783,9 millions devaient être affectés à la rémunération du personnel — salaires, avantages sociaux, prestations de retraite et incitatifs annuels (EB-2010-0008, p. 8, 49 et 80).

[129] Dans sa décision, la Commission dit soumettre à [TRADUCTION] « deux types d'examen » les dépenses du service public. En ce qui concerne les dépenses prévues — par le service public, pour une

a future period and which can still be reduced or avoided — the Board said that Ontario Power Generation bears the burden of showing that these costs are reasonable. On the other hand, when the Board would be evaluating costs for which "[t]here is no opportunity for the company to take action to reduce", otherwise known as committed costs, it said that it would undertake "an after-the-fact prudence review . . . conducted in the manner which includes a presumption of prudence", that is, a presumption that the utility's expenditures are reasonable: p. 19.

[130] The Board made no distinction between those compensation costs that were reducible and those that were not. Instead, it subjected all compensation costs to the kind of assessment it uses for reducible, forecast costs and disallowed $145 million because it concluded that the utility's compensation rates and staffing levels were too high.

[131] On appeal, a majority of the Divisional Court upheld the Board's order. In dissenting reasons, Aitken J. concluded that the Board's decision was unreasonable because it did not apply the proper approach to the compensation costs which were, as a result of legally binding collective agreements, fixed and not adjustable. Instead, the Board "lumped" all compensation costs together and made no distinction between those that were the result of binding contractual obligations and those that were not. As she said:

First, I consider any limitation on [Ontario Power Generation's] ability to manage nuclear compensation costs on a go-forward basis, due to binding collective agreements in effect prior to the application and the test period, to be costs previously incurred and subject to an after-the-fact, two-step, prudence review. Second, I conclude that, in considering [Ontario Power Generation's] nuclear compensation costs, as set out in its application, the [Board] in its analysis (though not necessarily in its final number) was required to differentiate between such earlier incurred liabilities and other aspects of the nuclear compensation cost package that were truly projected and

période ultérieure et qu'il est toujours possible de réduire ou d'éviter —, la Commission soutient qu'il incombe à Ontario Power Generation de démontrer leur caractère raisonnable. En revanche, pour ce qui est des dépenses à l'égard desquelles « [l]a société ne pouvait prendre de mesures de réduction », à savoir les dépenses convenues, la Commission dit qu'elle effectuera « un contrôle de la prudence après coup, [. . .] comportant l'application d'une présomption de prudence », c'est-à-dire une présomption selon laquelle les dépenses du service public sont raisonnables (p. 19).

[130] La Commission ne fait aucune distinction entre les dépenses de rémunération qui sont réductibles et celles qui ne le sont pas. Elle soumet plutôt toutes les dépenses de rémunération à l'appréciation qu'elle réserve aux dépenses prévues réductibles et elle refuse d'approuver les paiements demandés à raison de 145 millions de dollars au motif que les barèmes de rémunération et les niveaux de dotation sont trop élevés.

[131] En appel, les juges majoritaires de la Cour divisionnaire confirment l'ordonnance de la Commission. Dans ses motifs dissidents, la juge Aitken conclut que la décision de la Commission est déraisonnable, car elle n'applique pas la bonne approche aux dépenses de rémunération, lesquelles constituent, par l'effet de conventions collectives contraignantes en droit, des dépenses fixes et non ajustables. Selon elle, la Commission [TRADUCTION] « regroupe » plutôt toutes les dépenses de rémunération et ne fait aucune distinction entre celles qui découlent d'obligations contractuelles obligatoires et celles qui n'en découlent pas. Comme elle l'affirme :

[TRADUCTION] Premièrement, j'estime que les dépenses de rémunération du secteur nucléaire [d'Ontario Power Generation], pour une période ultérieure, assujetties à une contrainte en raison de conventions collectives qui s'appliquaient avant la demande et la période de référence, constituent des dépenses déjà faites qui doivent faire l'objet d'un contrôle de la prudence après coup, en deux étapes. Deuxièmement, dans l'analyse (mais pas nécessairement dans l'appréciation finale) des dépenses de rémunération du secteur nucléaire dont fait état la demande, la [Commission] était tenue de faire une distinction entre les dépenses déjà effectuées et d'autres

not predetermined. Third, in my view, the [Board] was required to undergo a prudence review in regard to those aspects of the nuclear compensation package that arose under binding contracts entered prior to the application and the test period. In regard to the balance of factors making up the nuclear compensation package, the [Board] was free to determine, based on all available evidence, whether such factors were reasonable. Fourth, had a prudence review been undertaken, there was evidence upon which the [Board] could reasonably have decided that the presumption of prudence had been rebutted in regard to those cost factors mandated in the collective agreements. Unfortunately, I cannot find anywhere in the Decision of the [Board] where such an analysis was undertaken. The [Board] lumped all nuclear compensation costs together. It dealt with them as if they all emanated from the same type of factors and none reflected contractual obligations to which the [Ontario Power Generation] was bound due to a collective agreement entered prior to the application and the test period. Finally, I conclude that, when the [Board] was considering the reasonableness of the nuclear compensation package, it erred in considering evidence that came into existence after the date on which the collective agreements were entered when it assessed the reasonableness of the rates of pay and other binding provisions in the collective agreements. [para. 75]

réellement prévues, mais non préétablies. Troisièmement, à mon avis, la [Commission] devait soumettre à un contrôle de la prudence la partie des dépenses de rémunération du secteur nucléaire qui découlait de contrats obligatoires conclus avant la demande et la période de référence. Pour ce qui est des autres facteurs présidant à la rémunération globale du secteur nucléaire, la [Commission] pouvait, en se fondant sur toute la preuve disponible, décider s'ils étaient raisonnables ou non. Quatrièmement, si un contrôle de la prudence avait été effectué, des éléments de preuve auraient pu raisonnablement permettre à la [Commission] de conclure à la réfutation de la présomption de prudence en ce qui a trait aux éléments issus des conventions collectives qui influaient sur les dépenses. Malheureusement, je constate que nulle part dans sa décision la [Commission] ne se livre à une telle analyse. Elle regroupe sans distinctions toutes les dépenses de rémunération du secteur nucléaire. Elle considère qu'elles ont toutes la même origine et qu'aucune ne découle d'obligations contractuelles auxquelles [Ontario Power Generation] était tenue par une convention collective conclue avant la demande et la période de référence. Enfin, j'estime que, lorsqu'elle se penche sur le caractère raisonnable de la rémunération globale du secteur nucléaire, la [Commission] commet l'erreur de tenir compte d'éléments de preuve ayant vu le jour après la conclusion des conventions collectives pour apprécier le caractère raisonnable des barèmes de rémunération et d'autres dispositions contraignantes des conventions collectives. [par. 75]

[132] The Court of Appeal unanimously agreed with Aitken J.'s conclusion, finding that "the compensation costs at issue before the [Board] were committed costs" which should therefore have been assessed using a presumption of prudence. As they both acknowledged, it was open to the Board to find that the presumption had been rebutted in connection with the binding contractual obligations, but the Board acted unreasonably in failing to take the immutable nature of the fixed costs into consideration.

[132] La Cour d'appel souscrit à l'unanimité à la conclusion de la juge Aitken et statue que [TRADUCTION] « les dépenses de rémunération en cause devant la [Commission] étaient des dépenses convenues » qu'il aurait donc fallu apprécier en présumant leur prudence. Elles reconnaissent toutes deux qu'il était loisible à la Commission de conclure que la présomption était réfutée en ce qui concerne les obligations contractuelles obligatoires, mais qu'elle a agi déraisonnablement en ne tenant pas compte de la nature immuable des coûts fixes.

[133] I agree. The compensation costs for approximately 90 per cent of Ontario Power Generation's regulated workforce were established through legally binding collective agreements which obligated the utility to pay fixed levels of compensation, regulated staffing levels, and provided unionized employees with employment security. Ontario Power Generation's compensation costs

[133] Je suis d'accord. Les dépenses de rémunération visant environ 90 p. 100 de l'effectif obligatoire d'Ontario Power Generation étaient établies par des conventions collectives contraignantes en droit qui imposaient des barèmes de rémunération fixes, qui déterminaient les niveaux de dotation et qui garantissaient la sécurité d'emploi des employés syndiqués. Les dépenses de rémunération

were therefore overwhelmingly predetermined and could not be adjusted by the utility during the relevant period. These are precisely the type of costs that the Board referred to in its decision as costs for which "[t]here is no opportunity for the company to take action to reduce" and which must be subjected to "a prudence review conducted in the manner which includes a presumption of prudence": para. 75.

[134] In my respectful view, failing to acknowledge the legally binding, non-reducible nature of the cost commitments reflected in the collective agreements and apply the review the Board itself said should apply to such costs, rendered its decision unreasonable.

Analysis

[135] Pursuant to s. 78.1(5) of the *Ontario Energy Board Act, 1998*, upon application from Ontario Power Generation, the Board is required to determine "just and reasonable" payment amounts to the utility. In the utility regulation context, the phrase "just and reasonable" reflects the aim of "navigating the straits" between overcharging a utility's customers and underpaying the utility for the public service it provides: *Verizon Communications Inc. v. Federal Communications Commission*, 535 U.S. 467 (2002), at p. 481; see also *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186, at pp. 192-93.

[136] The methodology adopted by the Board to determine "just and reasonable" payments to Ontario Power Generation draws in part on the regulatory concept of "prudence". Prudence is "a legal basis for adjudging the meeting of utilities' public interest obligations, specifically in regard to rate proceedings": Robert E. Burns et al., *The Prudent Investment Test in the 1980s*, report NRRI-84-16, The National Regulatory Research Institute, April 1985, at p. 20. The concept emerged in the early 20th century as a judicial response to the "mind-numbing complexity" of other approaches being

d'Ontario Power Generation étaient donc en très grande partie préétablies et ne pouvaient être rajustées par l'entreprise au cours de la période considérée. Il s'agit précisément du type de dépenses que la Commission qualifie, dans sa décision, de dépenses à l'égard desquelles [TRADUCTION] « [l]a société ne pouvait prendre de mesures de réduction » et qui doivent faire l'objet d'un « contrôle de la prudence comportant l'application d'une présomption de prudence » (par. 75).

[134] Soit dit tout en respect, la Commission rend une décision déraisonnable en ne reconnaissant pas le caractère contraignant en droit et non réductible des dépenses auxquelles le service public s'était engagé lors de la signature des conventions collectives et en omettant de soumettre ces dépenses au contrôle qui s'imposait pourtant selon elle à leur égard.

Analyse

[135] Conformément au par. 78.1(5) de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario*, sur demande d'Ontario Power Generation, la Commission fixe le montant des paiements « justes et raisonnables » auxquels a droit le service public. Dans le contexte de la réglementation des services publics, l'expression « justes et raisonnables » traduit l'objectif qui consiste à [TRADUCTION] « naviguer entre les récifs » que sont, d'une part, les tarifs excessifs imposés au consommateur et, d'autre part, la rétribution insuffisante du service public (*Verizon Communications Inc. c. Federal Communications Commission*, 535 U.S. 467 (2002), p. 481; voir aussi *Northwestern Utilities Ltd. c. City of Edmonton*, [1929] R.C.S. 186, p. 192-193).

[136] La méthode retenue par la Commission pour déterminer le montant des paiements « justes et raisonnables » auxquels a droit Ontario Power Generation prend en partie appui sur la notion de « prudence ». En droit réglementaire, la prudence offre un [TRADUCTION] « fondement juridique pour se prononcer sur le respect des obligations des services publics liées à l'intérêt public, plus particulièrement en ce qui concerne le processus de tarification » (Robert E. Burns et autres, *The Prudent Investment Test in the 1980s*, rapport NRRI-84-16, The National Regulatory Research Institute, avril 1985, p. 20). Apparue

used by regulators to determine "just and reasonable" amounts, and introduced a legal presumption that a regulated utility has acted reasonably: *Verizon Communications*, at p. 482. As Justice Brandeis famously explained in 1923:

> The term prudent investment is not used in a critical sense. There should not be excluded from the finding of the base, investments which, under ordinary circumstances, would be deemed reasonable. The term is applied for the purpose of excluding what might be found to be dishonest or obviously wasteful or imprudent expenditures. Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown. [Emphasis added.]

(*State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923), at p. 289, fn. 1, per Brandeis J., dissenting)

[137] The presumption of prudence is the starting point for the type of examination the Board calls a "prudence review". In undertaking a prudence review, the Board applies a "well-established set of principles":

- Decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds.
- To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.
- Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.
- Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be

au début du 20e siècle, cette notion jurisprudentielle visait à remédier à la [TRADUCTION] « complexité paralysante » des approches différentes utilisées par les organismes de réglementation pour arrêter des montants « justes et raisonnables », et elle présumait que le service public réglementé avait agi raisonnablement (*Verizon Communications*, p. 482). Ainsi, comme l'explique le juge Brandeis dans un extrait bien connu datant de 1923 :

> [TRADUCTION] L'emploi de l'expression « investissement prudent » n'est pas décisif. L'établissement de la base de tarification ne devrait pas exclure les investissements qui, dans des circonstances ordinaires, seraient considérés raisonnables. Cet emploi vise plutôt à exclure les dépenses qui pourraient être jugées malhonnêtes ou manifestement excessives ou imprudentes. On peut supposer que tout investissement considéré a été fait dans l'exercice d'un jugement raisonnable, sauf preuve du contraire. [Je souligne.]

(*State of Missouri ex rel. Southwestern Bell Telephone Co. c. Public Service Commission of Missouri*, 262 U.S. 276 (1923), p. 289, note 1, le juge Brandeis (dissident))

[137] La présomption de prudence constitue le point de départ de l'examen que la Commission appelle [TRADUCTION] « contrôle de la prudence ». Lorsqu'elle entreprend ce contrôle de la prudence, la Commission applique un « ensemble bien établi de principes » :

[TRADUCTION]

- La décision de la direction du service public est généralement présumée prudente, sauf contestation pour motifs valables.
- Pour qu'elle soit prudente, la décision doit être raisonnable eu égard aux circonstances que connaissait ou qu'aurait dû connaître le service public au moment où il l'a prise.
- Le recul est exclu dans l'appréciation de la prudence, même lorsque les conséquences de la décision peuvent légitimement servir à réfuter la présomption de prudence.
- La prudence est appréciée dans le cadre d'une analyse factuelle rétrospective en ce que la preuve doit porter sur le moment où la décision a été prise et

based on facts about the elements that could or did enter into the decision at the time.

(*Enersource Hydro Mississauga Inc. (Re)*, 2012 LNONOEB 373 (QL), at para. 55, citing *Enbridge Gas Distribution Inc. (Re)*, 2002 LNONOEB 4 (QL), at para. 3.12.2.)

[138] This form of prudence review, including a presumption of prudence and a ban on hindsight, was endorsed by the Board and by the Ontario Court of Appeal as an appropriate method to determine "just and reasonable" rates in *Enbridge Gas Distribution Inc. (Re)*, at paras. 3.12.1 to 3.12.5, aff'd *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006), 210 O.A.C. 4, at paras. 8 and 10-12.

[139] In the case before us, however, the Board decided not to submit all costs to a prudence review. Instead, it stated that it would use two kinds of review. The first would apply to "forecast costs", that is, those over which a utility retains discretion and can still be reduced or avoided. It explained in its reasons that it would review such costs using a wide range of evidence, and that the onus was on the utility to demonstrate that its forecast costs were reasonable:

When considering forecast costs, the onus is on the company to make its case and to support its claim that the forecast expenditures are reasonable. The company provides a wide spectrum of such evidence, including business cases, trend analysis, benchmarking data, etc. The test is not dishonesty, negligence, or wasteful loss; the test is reasonableness. And in assessing reasonableness, the Board is not constrained to consider only factors pertaining to [Ontario Power Generation]. The Board has the discretion to find forecast costs unreasonable based on the evidence — and that evidence may be related to the cost/benefit analysis, the impact on ratepayers, comparisons with other entities, or other considerations.

reposer sur des faits quant aux éléments qui ont pu entrer en ligne de compte ou qui sont effectivement entrés en ligne de compte dans la décision.

(*Enersource Hydro Mississauga Inc. (Re)*, 2012 LNONOEB 373 (QL), par. 55, citant *Enbridge Gas Distribution Inc. (Re)*, 2002 LNONOEB 4 (QL), par. 3.12.2.)

[138] Dans *Enbridge Gas Distribution Inc. (Re)*, par. 3.12.1 à 3.12.5, conf. par *Enbridge Gas Distribution Inc. c. Ontario Energy Board* (2006), 210 O.A.C. 4, par. 8 et 10-12, la Commission et la Cour d'appel de l'Ontario considèrent ce contrôle — qui comporte l'application d'une présomption de prudence et exclut le recul — comme la méthode appropriée pour fixer des tarifs « justes et raisonnables ».

[139] Toutefois, dans la présente affaire, la Commission choisit de ne pas soumettre toutes les dépenses à un contrôle de la prudence. Elle dit plutôt recourir à deux examens. Le premier s'appliquerait aux « dépenses prévues », soit celles à l'égard desquelles le service public conserve un pouvoir discrétionnaire et qu'il peut toujours réduire ou éviter. Dans ses motifs, la Commission explique qu'elle examine ces dépenses au regard d'une vaste gamme d'éléments de preuve et qu'il incombe au service public de démontrer le caractère raisonnable de ses dépenses :

[TRADUCTION] Lors de l'examen des dépenses prévues, il incombe à la société d'établir le bien-fondé de sa demande et d'étayer son allégation selon laquelle ces dépenses sont raisonnables. Elle doit fournir un large éventail d'éléments de preuve en ce sens, notamment des analyses de rentabilité et de tendances, des données de référence, etc. Le critère applicable n'est pas celui de la malhonnêteté, de la négligence ou de la perte menant au gaspillage, mais bien celui du caractère raisonnable. Et dans l'appréciation du caractère raisonnable, la Commission n'est pas tenue d'examiner uniquement les données qui intéressent [Ontario Power Generation]. Elle a le pouvoir discrétionnaire de conclure que les dépenses prévues sont déraisonnables au vu de la preuve, laquelle peut se rapporter à l'analyse coût/bénéfice, à l'incidence sur les consommateurs, aux comparaisons avec d'autres entités ou à autre chose.

The benefit of a forward test period is that the company has the benefit of the Board's decision in advance regarding the recovery of forecast costs. To the extent costs are disallowed, for example, a forward test period provides the company with the opportunity to adjust its plans accordingly. In other words, there is not necessarily any cost borne by shareholders (unless the company decides to continue to spend at the higher level in any event). [paras. 74-75]

[140] A different approach, the Board said, would be applied to those costs the company could not "take action to reduce". These costs, sometimes called "committed costs", represent binding commitments that leave a utility with no discretion about whether to make the payment. The Board explained that it evaluates these costs using a "prudence review", which includes a presumption that the costs were prudently incurred:

Somewhat different considerations will come into play when undertaking an after-the-fact prudence review. In the case of an after-the-fact prudence review, if the Board disallows a cost, it is necessarily borne by the shareholder. There is no opportunity for the company to take action to reduce the cost at that point. For this reason, the Board concludes there is a difference between the two types of examination, with the after-the-fact review being a prudence review conducted in the manner which includes a presumption of prudence. [para. 75]

[141] In *Enersource Hydro Mississauga Inc. (Re)*, for example, the Board concluded that it had to conduct a prudence review when evaluating the costs that Enersource had already incurred:

This issue concerns expenditures which have largely already been incurred by the company. . . . Given that the issue concerns past expenditures which are now in dispute, the Board must conduct a prudence review. [para. 55]

[142] As the Board said in its reasons, the prudence review makes sense for committed costs because disallowing costs Ontario Power Generation cannot avoid, forces the utility to pay out of pocket

L'avantage d'une période de référence ultérieure est qu'elle permet à la société de connaître à l'avance la décision de la Commission concernant le recouvrement de dépenses prévues. Par exemple, lorsque des dépenses sont refusées, la société peut modifier ses plans en conséquence. Autrement dit, l'actionnaire n'a pas nécessairement à assumer un coût (à moins que la société ne décide, en tout état de cause, de maintenir les dépenses jugées excessives). [par. 74-75]

[140] Selon la Commission, une démarche différente serait suivie pour les dépenses à l'égard desquelles la société ne pouvait [TRADUCTION] « prendre de mesures de réduction ». Ces dépenses, parfois appelées « dépenses convenues », résultent d'obligations contractuelles qui excluent tout pouvoir discrétionnaire permettant au service public de ne pas les acquitter. La Commission explique qu'elle jauge ces dépenses en se livrant à un « contrôle de la prudence » qui comporte l'application d'une présomption selon laquelle les dépenses ont été faites de manière prudente :

[TRADUCTION] Des considérations quelque peu différentes entreront en jeu lors d'un contrôle de la prudence après coup. La dépense que la Commission refusera alors d'approuver sera nécessairement assumée par l'actionnaire. La société ne pourra plus prendre de mesures de réduction à son égard. C'est pourquoi la Commission estime qu'il existe une différence entre les deux types d'examen, le contrôle après coup constituant un contrôle de la prudence assorti d'une présomption de prudence. [par. 75]

[141] À titre d'exemple, dans *Enersource Hydro Mississauga Inc. (Re)*, la Commission conclut qu'elle doit effectuer un contrôle de la prudence pour apprécier les dépenses qu'Enersource a déjà faites :

[TRADUCTION] Le présent dossier porte sur des dépenses que la société a déjà faites en grande partie. [. . .] Comme il est question de dépenses antérieures qui sont aujourd'hui contestées, la Commission doit effectuer un contrôle de la prudence. [par. 55]

[142] Comme le dit la Commission dans ses motifs, il est logique de soumettre à un contrôle de la prudence des dépenses convenues, car refuser d'approuver des dépenses auxquelles Ontario

for expenses it has already incurred. This could negatively affect Ontario Power Generation's ability to operate, leading the utility to restructure its relationships with the financial community and its service providers, or even lead to bankruptcy: see Burns et al., at pp. 129-65. These outcomes would "increase capital costs and utility rates above the levels that would exist with a limited prudence penalty", forcing Ontario consumers to pay higher electricity bills: Burns et al., at p. vi.

[143] The issue in this appeal therefore centres on the Board assessing *all* compensation costs in Ontario Power Generation's collective agreements as adjustable forecast costs, without determining whether any of them were costs for which "[t]here is no opportunity for the company to take action to reduce" (para. 75). The Board did not actually call them forecast costs, but by saying that "collective agreements may make it difficult to eliminate positions quickly" and that "changes to union contracts . . . will take time" (paras. 346 and 352), the Board was clearly treating them as reducible in theory. Moreover, the fact that it failed to apply the prudence review it said it would apply to non-reducible costs confirms that it saw the collectively bargained commitments as adjustable.

[144] The Board did not explain why it considered compensation costs in collective agreements to be adjustable forecast costs, but the effect of its approach was to deprive Ontario Power Generation of the benefit of the Board's assessment methodology that treats committed costs differently. In my respectful view, the Board's failure to separately assess the compensation costs committed as a result of the collective agreements from other compensation costs, ignored not only its own methodological template, but labour law as well.

Power Generation ne peut se soustraire oblige le service public à acquitter sur ses propres deniers des dépenses déjà faites. Cela pourrait nuire au bon fonctionnement d'Ontario Power Generation et l'amener à restructurer ses liens avec les milieux financiers et ses fournisseurs de services, voire à faire faillite (voir Burns et autres, p. 129-165). Dès lors, [TRADUCTION] « les coûts en capital et les tarifs seraient supérieurs à ce qu'ils auraient été si une sanction modérée avait résulté de l'application du principe de prudence », de sorte que le consommateur ontarien serait contraint de payer des tarifs d'électricité plus élevés (Burns et autres, p. vi).

[143] Le présent pourvoi a donc pour objet la décision de la Commission de considérer *toutes* les dépenses de rémunération issues des conventions collectives d'Ontario Power Generation comme des dépenses prévues ajustables, sans se demander s'il s'agit en partie de dépenses pour lesquelles [TRADUCTION] « [l]a société ne pouvait prendre de mesures de réduction » (par. 75). La Commission ne les qualifie pas à proprement parler de dépenses prévues, mais lorsqu'elle affirme que « les conventions collectives peuvent rendre ardue l'élimination rapide de certains postes » et que « modifier des conventions collectives [. . .] prend du temps » (par. 346 et 352), elle considère clairement qu'il s'agit de dépenses théoriquement compressibles. De plus, l'omission de soumettre celles-ci au contrôle de la prudence qu'elle dit pourtant s'appliquer aux dépenses non réductibles confirme l'assimilation des obligations issues de négociations collectives à des obligations ajustables.

[144] La Commission ne dit pas pourquoi elle estime que les dépenses de rémunération issues des conventions collectives constituent des dépenses prévues ajustables, mais par l'adoption de son approche, elle empêche Ontario Power Generation de bénéficier de l'application de sa méthode d'appréciation qui considère différemment les dépenses convenues. À mon humble avis, en omettant d'apprécier les dépenses de rémunération issues des conventions collectives séparément des autres dépenses de rémunération, la Commission méconnaît à la fois son propre cadre méthodologique et le droit du travail.

[145] Ontario Power Generation was a party to binding collective agreements with the Power Workers' Union and the Society of Energy Professionals covering most of the relevant period. At the time of the application, it had already entered into a collective agreement with the Power Workers' Union for the period of April 1, 2009 to March 31, 2012.

[146] Its collective agreement with the Society of Energy Professionals, which required resolution by binding mediation-arbitration in the event of contract negotiations disputes, expired on December 31, 2010. As a result of a bargaining impasse, the terms of a new collective agreement for January 1, 2011 to December 31, 2012 were imposed by legally binding arbitration: *Ontario Power Generation v. Society of Energy Professionals*, [2011] O.L.A.A. No. 117 (QL).

[147] The collective agreements with the Power Workers' Union and the Society of Energy Professionals prescribed the compensation rates for staff positions held by represented employees, strictly regulated staff levels at Ontario Power Generation's facilities, and limited the utility's ability to unilaterally reduce its compensation rates and staffing levels. The collective agreement with the Power Workers' Union, for example, stipulated that there would be no involuntary layoffs during the term of the agreement. Instead, Ontario Power Generation would be required either to relocate surplus staff or offer severance in accordance with rates set out in predetermined agreements between the utility and the union: "Collective Agreement between Ontario Power Generation Inc. and Power Workers' Union", April 1, 2009 to March 31, 2012, at art. 11.

[148] Similarly, Ontario Power Generation's collective agreement with the Society of Energy Professionals severely limited the utility's bargaining power and control over compensation levels. When the contract between Ontario Power Generation and

[145] Ontario Power Generation était partie à des conventions collectives obligatoires qui étaient intervenues avec le Syndicat des travailleurs et travailleuses du secteur énergétique et Society of Energy Professionals et qui s'appliquaient pendant la plus grande partie de la période considérée. À l'époque de la demande, elle avait déjà conclu une convention collective avec le Syndicat des travailleurs et travailleuses du secteur énergétique pour la période comprise entre le 1er avril 2009 et le 31 mars 2012.

[146] La convention collective intervenue avec Society of Energy Professionals et imposant la médiation-arbitrage pour le règlement des différends pendant des négociations collectives a expiré le 31 décembre 2010. Par suite d'une impasse dans les négociations, les conditions d'une nouvelle convention collective pour la période du 1er janvier 2011 au 31 décembre 2012 ont été imposées par voie d'arbitrage obligatoire (*Ontario Power Generation c. Society of Energy Professionals*, [2011] O.L.A.A. No. 117 (QL)).

[147] Les conventions collectives conclues avec les deux syndicats prescrivaient les barèmes de rémunération des employés syndiqués, réglementaient rigoureusement les niveaux de dotation aux installations d'Ontario Power Generation et limitaient le pouvoir du service public de réduire unilatéralement ses barèmes de rémunération et ses niveaux de dotation. Par exemple, la convention collective conclue avec le Syndicat des travailleurs et travailleuses du secteur énergétique prévoyait qu'il n'y aurait aucun licenciement pendant la durée de son application. Bien au contraire, Ontario Power Generation serait contrainte soit de réaffecter tout employé excédentaire, soit de lui offrir une indemnité de départ selon les barèmes établis au préalable par le service public et le syndicat (« Collective Agreement between Ontario Power Generation Inc. and Power Workers' Union », 1er avril 2009 au 31 mars 2012, art. 11).

[148] De même, la convention collective conclue avec Society of Energy Professionals limitait grandement le pouvoir du service public de négocier et de déterminer les barèmes de rémunération. À l'expiration de cette convention le 31 décembre 2010,

the Society of Energy Professionals expired on December 31, 2010, the utility's bargaining position had been that its sole shareholder, the Province of Ontario, had directed that there be a zero net compensation increase over the next two-year term. The parties could not reach an agreement and the dispute was therefore referred to binding arbitration as required by previous negotiations. The resulting award by Kevin M. Burkett provided mandatory across-the-board wage increases of 3 per cent on January 1, 2011, 2 per cent on January 1, 2012, and a further 1 per cent on April 1, 2012: *Ontario Power Generation v. Society of Energy Professionals*, at paras. 1, 9, and 28.

[149] The obligations contained in these collective agreements were immutable and legally binding commitments: *Labour Relations Act, 1995*, s. 56. As a result, Ontario Power Generation was prohibited from unilaterally reducing the staffing levels, wages, or benefits of its unionized workforce. These agreements therefore did not just leave the utility "with limited flexibility regarding overall compensation rates or staffing levels", as the majority notes (at para. 84), they made it *illegal* for the utility to alter the compensation and staffing levels of 90 per cent of its regulated workforce in a manner that was inconsistent with its commitments under the agreements.

[150] Instead, the Board, applying the methodology it said it would use for the utility's forecast costs, put the onus on Ontario Power Generation to prove the reasonableness of its costs and concluded that it had failed to provide "compelling evidence" or "documentation or analysis" to justify compensation levels: para. 347. Had the Board used the approach it said it would use for costs the company had "no opportunity . . . to reduce", it would have used an after-the-fact prudence review, with a rebuttable presumption that the utility's expenditures were reasonable.

le service public défendait la position de son unique actionnaire, la province d'Ontario, à savoir l'exclusion de toute augmentation nette des salaires pendant les deux années suivantes. Les parties n'ont pu parvenir à un accord, de sorte que le dossier a été renvoyé à l'arbitrage obligatoire comme convenu lors de négociations précédentes. Dans sa décision, l'arbitre Kevin M. Burkett a ordonné une augmentation générale des salaires de 3 p. 100 le 1er janvier 2011, de 2 p. 100 le 1er janvier 2012 et, en sus, de 1 p. 100 le 1er avril 2012 (*Ontario Power Generation c. Society of Energy Professionals*, par. 1, 9 et 28).

[149] Les obligations contractées dans ces conventions collectives constituaient des engagements immuables ayant force obligatoire (*Loi de 1995 sur les relations de travail*, art. 56). Il était donc interdit à Ontario Power Generation de réduire unilatéralement les niveaux de dotation, les salaires ou les avantages sociaux de ses employés syndiqués. Contrairement à ce qu'affirment les juges majoritaires (par. 84), ces conventions ne laissaient pas seulement « peu de marge de manœuvre quant aux barèmes de rémunération et aux niveaux de dotation dans leur ensemble », elles rendaient *illégale* la modification par le service public — d'une manière incompatible avec les engagements qu'il y prenait — des barèmes de rémunération et des niveaux de dotation quant à 90 p. 100 de son effectif obligatoire.

[150] En appliquant la méthode qu'elle a dit qu'elle utiliserait à l'égard des dépenses prévues du service public, la Commission oblige en fait Ontario Power Generation à prouver le caractère raisonnable de ses dépenses et conclut que l'entreprise n'a présenté ni [TRADUCTION] « preuve convaincante », ni « documents ou analyses » qui justifient les barèmes de rémunération (par. 347). Si elle avait eu recours à l'approche qu'elle a dit qu'elle utiliserait pour les dépenses à l'égard desquelles la société ne pouvait « prendre de mesures de réduction », la Commission aurait contrôlé la prudence des dépenses après coup et appliqué la présomption réfutable selon laquelle elles étaient raisonnables.

[151] Applying a prudence review to these compensation costs would hardly, as the majority suggests, "have conflicted with the burden of proof in the *Ontario Energy Board Act, 1998*". To interpret the burden of proof in s. 78.1(6) of the *Ontario Energy Board Act, 1998* so strictly would essentially prevent the Board from ever conducting a prudence review, notwithstanding that it has comfortably done so in the past and stated, even in its reasons in this case, that it would review committed costs using an "after-the-fact prudence review" which "includes a presumption of prudence". Under the majority's logic, however, since a prudence review always involves a presumption of prudence, the Board would not only be limiting its methodological flexibility, it would be in breach of the Act.

[151] Contrairement à ce que soutiennent les juges majoritaires, appliquer le contrôle de la prudence à ces dépenses de rémunération serait difficilement « incompatible avec le fardeau de preuve que prévoit la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* ». Considérer que le par. 78.1(6) de la *Loi de 1998 sur la Commission de l'énergie de l'Ontario* prévoit un fardeau de preuve aussi strict a essentiellement pour effet d'empêcher totalement la Commission d'effectuer des contrôles de la prudence, alors qu'elle en a effectués sans difficulté dans le passé et qu'elle a affirmé — comme dans ses motifs en l'espèce — qu'il y a lieu de soumettre les dépenses convenues à « un contrôle de la prudence après coup, [. . .] comportant l'application d'une présomption de prudence ». Or, suivant le raisonnement des juges majoritaires, comme le contrôle de la prudence présume toujours la prudence, la Commission ne verrait pas seulement sa marge de manœuvre réduite sur le plan méthodologique, mais elle contreviendrait aussi à la Loi.

[152] The application of a prudence review does not shield the utility's compensation costs from scrutiny. As the Court of Appeal observed, a prudence review

> does not mean that the [Board] is powerless to review the compensation rates for [Ontario Power Generation's] unionized staff positions or the number of those positions. In a prudence review, the evidence may show that the presumption of prudently incurred costs should be set aside, and that the committed compensation rates and staffing levels were not reasonable; however, the [Board] cannot resort to hindsight, and must consider what was known or ought to have been known at the time. A prudence review allows for such an outcome, and permits the [Board] both to fulfill its statutory mandate and to serve as a market proxy, while maintaining a fair balance between [Ontario Power Generation] and its customers. [para. 38]

[152] L'application du principe de la prudence ne soustrait pas les dépenses de rémunération du service public à tout examen. Comme le fait remarquer la Cour d'appel, le contrôle de la prudence

> [TRADUCTION] n'écarte pas la possibilité que la [Commission] puisse contrôler les barèmes de rémunération applicables aux employés syndiqués d'[Ontario Power Generation] ou le nombre de leurs postes. Lors d'un tel contrôle, il peut ressortir de la preuve, d'une part, que la présomption selon laquelle les dépenses ont été faites de manière prudente doit être écartée et, d'autre part, que les barèmes de rémunération et les niveaux de dotation convenus ne sont pas raisonnables; cependant, la [Commission] ne peut se prononcer avec le recul, mais doit tenir compte de ce qui était connu ou qui aurait dû l'être à l'époque. Le contrôle de la prudence admet un tel résultat et permet à la [Commission] de s'acquitter de son mandat légal et de jouer son rôle de substitut du marché tout en assurant un juste équilibre entre les intérêts d'[Ontario Power Generation] et ceux de ses clients. [par. 38]

[153] The majority's suggestion (at para. 114) that "if the legislature had intended for costs under collective agreements to also be inevitably imposed on consumers, it would not have seen fit to grant

[153] L'affirmation des juges majoritaires selon laquelle, « si le législateur avait voulu que les dépenses [. . .] issues [de conventions collectives] se répercutent inévitablement sur les consommateurs, il

the Board oversight of utility compensation costs", is puzzling. The legislature did not intend for *any* costs to be "inevitably" imposed on consumers. What it intended was to give the Board authority to determine just and reasonable payment amounts based on Ontario Power Generation's existing and proposed commitments. Neither collective agreements nor any other contractual obligations were intended to be "inevitably" imposed. They were intended to be inevitably considered in the balance. But it is precisely because of the unique nature of binding commitments that the Board said it would impose a different kind of review on these costs.

[154] It may well be that Ontario Power Generation has the ability to manage some staffing levels through attrition or other mechanisms that did not breach the utility's commitments under its collective agreements, and that these costs may therefore properly be characterized as forecast costs. But no factual findings were made by the Board about the extent of any such flexibility. There is in fact no evidence in the record, nor any evidence cited in the Board's decision, setting out what proportion of Ontario Power Generation's compensation costs were fixed and what proportion remained subject to the utility's discretion. The Board made virtually no findings of fact regarding the extent to which the utility could reduce its collectively bargained compensation costs. On the contrary, the Board, as Aitken J. noted, "lumped" all compensation costs together, acknowledged that reducing those in the collective agreements would "take time" and "be difficult", and dealt with them as globally adjustable.

[155] Given that collective agreements are legally binding, it was unreasonable for the Board to assume that Ontario Power Generation could reduce the costs fixed by these contracts in the absence of any evidence to that effect. To use the majority's

n'aurait pas jugé opportun d'investir la Commission du pouvoir de surveiller les dépenses de rémunération d'un service public » (par. 114), laisse perplexe. Le législateur ne voulait pas que *toute* dépense se répercute « inévitablement » sur les consommateurs. Son intention était de donner à la Commission le pouvoir d'arrêter des paiements justes et raisonnables en fonction des engagements actuels et projetés d'Ontario Power Generation. Ni les conventions collectives ni aucune autre obligation contractuelle ne devaient « inévitablement » se répercuter sur qui que ce soit. Cependant, elles devaient inévitablement peser dans la balance. Or, c'est précisément la nature unique des engagements contraignants qu'a invoquée la Commission lorsqu'elle a affirmé qu'elle soumettrait ces dépenses à un contrôle différent.

[154] Il se peut fort bien qu'Ontario Power Generation puisse modifier certains niveaux de dotation par voie d'attrition ou grâce à d'autres mécanismes qui ne vont pas à l'encontre de ses obligations suivant les conventions collectives. Il se peut fort bien aussi que les dépenses puissent donc être assimilées à juste titre à des dépenses prévues. La Commission ne tire toutefois aucune conclusion de fait sur l'étendue d'une telle marge de manœuvre. En fait, aucun élément du dossier ou de la preuve invoquée par la Commission n'indique dans quelle proportion les dépenses de rémunération d'Ontario Power Generation sont fixes et dans quelle proportion elles demeurent assujetties au pouvoir discrétionnaire du service public. La Commission ne tire pour ainsi dire aucune conclusion de fait quant à savoir dans quelle mesure l'entreprise pouvait réduire ses dépenses de rémunération issues des conventions collectives. Au contraire, comme le souligne la juge Aitken, la Commission [TRADUCTION] « regroupe » sans distinctions toutes les dépenses liées à la rémunération, reconnaît que la réduction de celles issues des conventions collectives « prend[rait] du temps » et « [serait] ardue », et considère qu'elles sont globalement ajustables.

[155] Comme les conventions collectives sont contraignantes en droit, il était déraisonnable que la Commission présume qu'Ontario Power Generation pouvait réduire les dépenses déterminées par ces contrats en l'absence de toute preuve en ce

words, these costs are "legal obligations that leave [the utility] with no discretion as to whether to make the payment in the future" (para. 82). According to the Board's own methodology, costs for which "[t]here is no opportunity for the company to take action to reduce" are entitled to "a presumption of prudence": para. 75.

[156] Disallowing costs that Ontario Power Generation is legally required to pay as a result of its collective agreements, would force the utility and the Province of Ontario, the sole shareholder, to make up the difference elsewhere. This includes the possibility that Ontario Power Generation would be forced to reduce investment in the development of capacity and facilities. And because Ontario Power Generation is Ontario's largest electricity generator, it may not only threaten the "financial viability" of the province's electricity industry, it could also imperil the assurance of reliable electricity service.

[157] The majority nonetheless assumes that the ongoing relationship between Ontario Power Generation and the unions should give the Board greater latitude in disallowing the collectively bargained compensation costs than it would have had if it applied a no-hindsight, presumption-of-prudence analysis. It also accepts the Board's conclusion that Ontario Power Generation's collectively bargained compensation costs may be "excessive", and therefore concludes that the Board was reasonable in choosing to avoid the "prudence" test in order to so find. This approach finds no support even in the methodology the Board set out for itself for evaluating just and reasonable payment amounts.

[158] In my respectful view, selecting a test which is more likely to confirm an assumption that collectively bargained costs are excessive, misconceives the point of the exercise, namely, to determine

sens. Pour reprendre les propos des juges majoritaires, ces dépenses correspondent à des « obligations qui écartent tout pouvoir discrétionnaire [. . .] permettant [au service public] de ne pas acquitter la somme ultérieurement » (par. 82). Selon la propre méthode de la Commission, les dépenses à l'égard desquelles [TRADUCTION] « [l]a société ne pouvait prendre de mesures de réduction » bénéficient d'une « présomption de prudence » (par. 75).

[156] Refuser d'approuver des dépenses qu'Ontario Power Generation est juridiquement tenue d'acquitter en raison de ses conventions collectives obligerait le service public et son seul actionnaire, la province d'Ontario, à combler la différence en puisant ailleurs. Ontario Power Generation pourrait notamment être forcée de réduire ses investissements dans l'accroissement de sa capacité et dans l'amélioration de ses installations. Et, comme il s'agit du plus grand producteur d'électricité de l'Ontario, un tel refus pourrait non seulement nuire à la « viabilité financière » du secteur de l'électricité de la province, mais également mettre en péril la garantie d'un service d'électricité fiable.

[157] Les juges majoritaires tiennent cependant pour acquis que la relation continue entre Ontario Power Generation et les syndicats devrait conférer à la Commission, relativement aux dépenses de rémunération issues de négociations collectives, un pouvoir de refus plus grand que celui dont elle bénéficie dans le cadre d'une analyse qui exclut le recul et présume la prudence. Ils font droit également à la conclusion de la Commission selon laquelle les dépenses de rémunération issues de négociations collectives auxquelles Ontario Power Generation a participé pourraient être [TRADUCTION] « excessives » et concluent donc que la Commission a agi raisonnablement en écartant le principe de la « prudence » pour arriver à sa conclusion. Leur approche ne trouve aucun appui, pas même dans la méthode que la Commission établit elle-même pour déterminer le montant de paiements justes et raisonnables.

[158] En tout respect pour l'opinion contraire, en choisissant un critère éminemment susceptible de confirmer l'hypothèse que les dépenses issues de négociations collectives sont excessives, on se

whether those costs were in fact excessive. Blaming collective bargaining for what are *assumed* to be excessive costs, imposes, with respect, the appearance of an ideologically driven conclusion on what is intended to be a principled methodology based on a distinction between committed and forecast costs, not between costs which are collectively bargained and those which are not.

[159] I recognize that the Board has wide discretion to fix payment amounts that are "just and reasonable" and, subject to certain limitations, to "establish the . . . methodology" used to determine such amounts: O. Reg. 53/05, s. 6, *Ontario Energy Board Act, 1998*, s. 78.1. That said, once the Board establishes a methodology to determine what is just and reasonable, it is, at the very least, required to faithfully apply that approach: see *TransCanada Pipelines Ltd. v. National Energy Board* (2004), 319 N.R. 171 (F.C.A.), at paras. 30-32, per Rothstein J.A. This does not mean that collective agreements "supersede" or "trump" the Board's authority to fix payment amounts; it means that once the Board selects a methodology for itself for the exercise of its discretion, it is required to follow it. Absent methodological clarity and predictability, Ontario Power Generation would be left in the dark about how to determine what expenditures and investments to make and how to present them to the Board for review. Wandering sporadically from approach to approach, or failing to apply the methodology it declares itself to be following, creates uncertainty and leads, inevitably, to needlessly wasting public time and resources in constantly having to anticipate and respond to moving regulatory targets.

[160] In disallowing $145 million of the compensation costs sought by Ontario Power Generation on the grounds that the utility could reduce salary and staffing levels, the Board ignored the legally binding nature of the collective agreements

méprend sur l'objectif de la démarche, qui est de déterminer si ces dépenses étaient bel et bien excessives. Imputer à la négociation collective ce que l'on *suppose* constituer des dépenses excessives revient, soit dit tout en respect, à substituer ce qui a l'apparence d'une conclusion idéologique à ce qui est censé résulter d'une méthode d'analyse raisonnée qui distingue entre les dépenses convenues et les dépenses prévues, non entre les dépenses issues de négociations collectives et celles qui ne le sont pas.

[159] Je reconnais que la Commission jouit d'un vaste pouvoir discrétionnaire lui permettant de déterminer les paiements qui sont « justes et raisonnables » et, à l'intérieur de certaines limites, de [TRADUCTION] « définir la [. . .] méthode » utilisée pour établir le montant de ces paiements (règlement 53/05, art. 6; *Loi de 1998 sur la Commission de l'Énergie de l'Ontario*, art. 78.1). Cela dit, dès lors qu'elle a établi une méthode pour déterminer ce qui est juste et raisonnable, la Commission doit à tout le moins l'appliquer avec constance (*TransCanada Pipelines Ltd. c. Office national de l'Énergie*, 2004 CAF 149 (CanLII), par. 30-32, le juge Rothstein). Pour autant, les conventions collectives ne « priment » pas le pouvoir de la Commission de fixer les paiements, mais une fois que la Commission a choisi une méthode pour exercer son pouvoir discrétionnaire, elle doit s'y tenir. En l'absence de clarté et de prévisibilité quant à la méthode à appliquer, Ontario Power Generation serait vouée à l'incertitude quant à la démarche à suivre pour déterminer les dépenses et les investissements à faire et quant à la manière de les soumettre à l'examen de la Commission. Passer sporadiquement d'une approche à une autre ou ne pas appliquer la méthode que l'on prétend appliquer crée de l'incertitude et mène inévitablement au gaspillage inutile du temps et des ressources publics en ce qu'il faut constamment anticiper un objectif réglementaire fluctuant et s'y ajuster.

[160] En refusant d'approuver des dépenses de 145 millions de dollars au motif qu'Ontario Power Generation pouvait réduire ses barèmes de rémunération et ses niveaux de dotation, la Commission a méconnu le caractère contraignant en droit des

and failed to distinguish between committed compensation costs and those that were reducible. Whether or not one can fault the Board for failing to use a particular methodology, what the Board can unquestionably be analytically faulted for, is evaluating all compensation costs fixed by collective agreements as being amenable to adjustment. Treating these compensation costs as reducible was, in my respectful view, unreasonable.

[161] I would accordingly dismiss the appeal, set aside the Board's decision, and, like the Court of Appeal, remit the matter to the Board for reconsideration in accordance with these reasons.

Appeal allowed, ABELLA J. *dissenting.*

Solicitors for the appellant: Stikeman Elliott, Toronto.

Solicitors for the respondent Ontario Power Generation Inc.: Torys, Toronto; Ontario Power Generation Inc., Toronto.

Solicitors for the respondent the Power Workers' Union, Canadian Union of Public Employees, Local 1000: Paliare Roland Rosenberg Rothstein, Toronto.

Solicitors for the respondent the Society of Energy Professionals: Cavalluzzo Shilton McIntyre Cornish, Toronto.

Solicitors for the intervener: Jay Shepherd Professional Corporation, Toronto.

conventions collectives et a omis de distinguer les dépenses de rémunération convenues de celles qui étaient réductibles. On peut reprocher ou non à la Commission de ne pas avoir appliqué une certaine méthode, mais on peut assurément lui reprocher, sur le plan analytique, d'avoir considéré toutes les dépenses de rémunération déterminées par des conventions collectives comme des dépenses ajustables. Voir dans ces dépenses des dépenses réductibles est à mon sens déraisonnable.

[161] Je suis donc d'avis de rejeter le pourvoi, d'annuler la décision de la Commission et, à l'instar de la Cour d'appel, de renvoyer l'affaire à la Commission pour qu'elle la réexamine à la lumière des présents motifs.

Pourvoi accueilli, la juge ABELLA *est dissidente.*

Procureurs de l'appelante : Stikeman Elliott, Toronto.

Procureurs de l'intimée Ontario Power Generation Inc. : Torys, Toronto; Ontario Power Generation Inc., Toronto.

Procureurs de l'intimé le Syndicat des travailleurs et travailleuses du secteur énergétique, Syndicat canadien de la fonction publique, section locale 1000 : Paliare Roland Rosenberg Rothstein, Toronto.

Procureurs de l'intimée Society of Energy Professionals : Cavalluzzo Shilton McIntyre Cornish, Toronto.

Procureurs de l'intervenante : Jay Shepherd Professional Corporation, Toronto.

BRITISH COLUMBIA ELECTRIC RAILWAY CO. LTD. ..... APPELLANT;

1960
*May 4, 5, 6
Oct. 4

AND

THE PUBLIC UTILITIES COMMISSION OF BRITISH COLUMBIA, BRITISH COLUMBIA LUMBER MANUFACTURERS' ASSOCIATION, THE CORPORATION OF THE CITY OF VICTORIA, THE CORPORATION OF THE DISTRICT OF OAK BAY, THE CORPORATION OF THE DISTRICT OF SAANICH, CORPORATION OF THE TOWNSHIP OF ESQUIMALT AND CITY OF VANCOUVER ..... RESPONDENTS.

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Public utilities—Case stated by Public Utilities Commission—Matters to be considered by Commission in changing rates—Order of priority to be given to factors considered—The Public Utilities Act, R.S.B.C. 1948, c. 277, s. 16(1)(a) and (b).

*PRESENT: Kerwin C.J. and Locke, Cartwright, Martland and Ritchie JJ.

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The first of a series of questions submitted for the consideration of the Court of Appeal for British Columbia, in a case stated for the opinion of the Court, asked if the Public Utilities Commission of that Province was right in deciding "that no one of the matters and things referred to in clauses (*a*) and (*b*) of subsection (1) of Section 16 of the "Public Utilities Act" should as a matter of law be given priority over any other of those matters or things and that, if a conflict arises among these matters or things, it is the Commission's duty to act to the best of its discretion."

The question was answered in the affirmative. The appellant appealed from that portion of the judgment of the Court of Appeal which comprised this answer.

Held (Kerwin C.J. *dissenting*): The appeal should be allowed.

Per Locke J.: There is an absolute obligation on the part of the Commission on the application of the utility to approve rates which will produce the fair return to which the utility has been found entitled, and the obligation to have due regard to the protection of the public is also to be discharged. It is not a question of considering priorities between "the matters and things referred to in clauses (*a*) and (*b*) of subsection (1) of s. 16", but consideration of these matters is to be given by the Commission in the light of the fact that the obligation to approve rates which will give a fair and reasonable return is absolute.

Per Cartwright, Martland and Ritchie JJ.: The combined effect of the two clauses referred to is that the Commission, when dealing with a rate case, has unlimited discretion as to the matters which it may consider as affecting the rate, but it must when actually setting the rate, meet the requirements specifically mentioned in clause (*b*), i.e., the rate to be imposed should be neither excessive for the service nor insufficient to provide a fair return on the rate base. These two factors should be given priority over any other matters which the Commission may consider.

Although there is no priority directed by the Act as between these two matters, there is a duty imposed on the Commission to have due regard to both of them, and accordingly there must be a balancing of the interests concerned.

Per Kerwin C.J., *dissenting*: The statute does not require that any weight be given to the matters and things referred to in the two clauses after they have been considered, and therefore the weight to be assigned is a question of fact for the Commission to decide in each instance.

APPEAL from a portion of a judgment of the Court of Appeal for British Columbia[1], comprising the answer to the first of five questions submitted to it by the Public Utilities Commission. Appeal allowed, Kerwin C.J. dissenting.

J. W. de B. Farris, Q.C., A. Bruce Robertson, Q.C., and *R. R. Dodd*, for the appellant;

[1] (1959), 29 W.W.R. 533.

J. A. Clark, Q.C., for The Public Utilities Commission of British Columbia, respondent;

T. P. O'Grady, for The Corporation of The City of Victoria, The Corporation of The District of Oak Bay, The Corporation of the District of Saanich and Corporation of The Township of Esquimalt, respondents;

R. K. Baker, for City of Vancouver, respondent.

THE CHIEF JUSTICE (*dissenting*):—Pursuant to s. 107 of the *Public Utilities Act* of British Columbia, R.S.B.C. 1948, c. 277, the Public Utilities Commission stated a case for the opinion of the Court of Appeal for that Province. The case was stated in respect of five questions but we are concerned only with Question 1 as, by order of this Court, British Columbia Electric Railway Company, Limited was granted leave to appeal only from that portion of the judgment of the Court of Appeal comprising the answer given thereto. That question is as follows:

1. (*a*) Was the Commission right in deciding as appears in the said Reasons for Decision of 14th July, 1958, that no one of the matters and things referred to in clauses (*a*) and (*b*) of subsection (1) of Section 16 of the "Public Utilities Act" should as a matter of law be given priority over any other of those matters or things and that, if a conflict arises among these matters or things, it is the Commission's duty to act to the best of its discretion?

(*b*) If the answer to question (1) (*a*) is "No", what decision should the Commission have reached on the point?

The Court's answer to Question 1 reads:

The Commission was right in deciding as appears in its Reasons for Decision of 14th July, 1958 that no one of the matters and things referred to in clauses (*a*) and (*b*) of subsection (1) of Section 16 of the Public Utilities Act R.S.B.C. 1948, chapter 277 should as a matter of law be given priority over any other of those matters or things and that, if a conflict arises among these matters or things, it is the Commission's duty to act to the best of its discretion.

At the conclusion of the argument the judgment of the Court of Appeal appeared to me to be correct and further consideration has confirmed me in that view. Reasons were given by Sheppard J.A. on behalf of himself and the other four members of the Court who heard the argument on the

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stated case. I adopt all that he said and would have nothing to add were it not for an argument presented on behalf of the appellant. Section 16(1)(*a*) and (*b*) read as follows:

16. (1) In fixing any rate:—

(*a*) The Commission shall consider all matters which it deems proper as affecting the rate:

(*b*) The Commission shall have due regard, among other things, to the protection of the public from rates that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the public utility; and to giving to the public utility a fair and reasonable return upon the appraised value of the property of the public utility used, or prudently and reasonably acquired, to enable the public utility to furnish the service:

Mr. Farris submitted that the Court of Appeal had not taken into consideration the words in (1)(*b*) "The Commission shall have due regard.....and to giving to the public utility a fair and reasonable return upon the appraised value of the property of the public utility used, or prudently and reasonably acquired, to enable the public utility to furnish the service:". However, I am satisfied upon a review of the reasons of Sheppard J.A., relevant to Question 1, and particularly of the extract transcribed below, which is the substance of his reasoning upon the matter, that he did consider and apply these words. The extract reads:

A further inquiry is what weight should be given to the matters required to be considered by Sec. 16 (1) (*b*) and particularly to the "fair and reasonable return". Under Sec. 16 (1) (*b*), the Commission is required to consider "the protection of the public" and the "giving to the public utility a fair and reasonable return". Although clauses (*a*) and (*b*) of Sec. 16 (1) require certain matters to be considered, they do not state what weight is to be assigned by the Commission. Consequently, the Statute requires only that the Commission consider the matters falling within Sec. 16 (1) (*a*), namely, "all matters which it deems proper as affecting the rate" and those falling within Sec. 16 (1) (*b*), namely, "the protection of the public" and "a fair and reasonable return" to the Utility. But the Statute does not require more, and does not require any weight to be given to these matters after they have been considered. Hence the weight to be assigned is outside any statutory requirement and must be a question of fact for the Commission in each instance.

Furthermore, as Mr. Clark pointed out, the Commission when dealing with the electric rates applications, had, under heading "III.—A Fair Return", discussed that subject; and that in their reasons for decision with reference to the transit fares applications the Commission speaks "of the misunderstanding which arose from the recent decision on

electric rates"; and that later, in the same paragraph, they said: "The 6.5% rate remains the standard of the fair and reasonable return to which the Commission has due regard".

The appeal should be dismissed but there should be no costs.

LOCKE J.:—The sections of the *Public Utilities Act*, R.S.B.C. 1948, c. 277, which must be considered in deciding the first question are quoted in the reasons of my brother Martland which I have had the advantage of reading.

The real question might have been stated more clearly had it asked whether as a matter of law a duty rested upon the Commission to approve rates which would produce for the appellant a fair and reasonable return upon the appraised value of the property used or prudently and reasonably acquired by it to enable it to furnish the service described in the Act when the fact as to what constituted a fair return had previously been determined by the Commission. This is the matter to be determined.

Some assistance in interpreting the sections of the Act is to be obtained by an examination of the earlier legislation dealing with the control of rates charged for electrical power in British Columbia.

The first statutory provision dealing with the matter appears in the *Water Act Amendment Act* of 1929 which appeared as c. 67 of the statutes of that year. This Act provided for the control of such rates and imposed upon a power company producing electrical energy by water power the duty of supplying electrical energy to the public in the manner defined. Power companies were required to file schedules of their tolls with the Water Board constituted under the *Water Act*, R.S.B.C. 1924, c. 271.

"Unjust and unreasonable" as applied to tolls was declared to include injustice and unreasonableness, whether arising from the fact that the tolls were insufficient to yield fair compensation for the service rendered or from the fact that they were excessive as being more than a fair and reasonable charge for service of the nature and quality furnished.

Section 141B authorized the Board upon the complaint of any person interested that a toll charge was unjust, unreasonable or unduly discriminatory to enquire into the matter,

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to disallow any rate found to be excessive, and to fix the tolls to be charged by the power company for its service or respecting the improvement of the service in such manner as the Board considered just and reasonable.

Section 141C read:

> Every power company shall be entitled to a fair return on the value of all property acquired by it and used in providing service to the public of the nature and kind furnished by such power company or reasonably held by such power company for use in such service and the Board in determining any toll shall have due regard to that principle.

Section 141D read in part:

> In considering any complaint and making any order respecting the tolls to be charged by any power company the Board shall have due regard, among other things, to allowing the company a fair return upon the value of the property of the company referred to in Clause 141C and to the protection of the public from tolls that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the company.

These amendments to the *Water Act* appeared as ss. 138 to 157 in the Revision of the Statutes of 1936 and these sections were repealed when the first *Public Utilities Act* was passed by the Legislature, c. 47 of the statutes of 1938.

It will be seen by an examination of the *Public Utilities Act* that in large measure the language of the amendments to the *Water Act* made in 1929 was adopted. The definition of the terms "unjust" and "unreasonable", which appeared in the 1929 amendment as part of s. 2, was reproduced in s. 2 of the Act of 1938. The prohibition against levying any unjust and unreasonable, unduly discriminatory or unduly preferential rate appearing as s. 8 of the *Public Utilities Act* merely expresses in slightly different terms the prohibition contained in s. 141B. The expression "shall have due regard" which appears in s. 16(1)(*b*) of the *Public Utilities Act* was apparently taken from ss. 141C and D.

The *Public Utilities Act,* however, did not, when first enacted, and does not now contain any section which declares in express terms, as did s. 141C of the *Water Act Amendment Act,* that the power company shall be entitled to a fair return on the value of its property. Had the present Act contained such a provision it appears to me to be perfectly clear that the answer to be made to the first question should differ from that given by the Court of Appeal.

Whether its omission affects the matter is to be determined.

As it has been pointed out, the utility in the present matter is required by the Act to maintain its property in such condition as to enable it to supply an adequate service to the public and to furnish that service to all persons who may be reasonably entitled thereto without discrimination and without delay. It may not discontinue its operations without the permission of the Public Utilities Commission. The utility has, so far as we are informed, a monopoly on the sale of electrical energy in the Cities of Vancouver and Victoria and in my opinion at common law the duty thus cast upon it by statute would have entitled it to be paid fair and reasonable charges for the services rendered in the absence of any statutory provision for such payment.

I consider that, in this respect, the position of such a utility would be similar to that of a common carrier upon whom is imposed as a matter of law the duty of transporting goods tendered to him for transport at fair and reasonable rates. This has been so from very early times. In *Bastard v. Bastard*[1], in an action against a common carrier in the Court of King's Bench for the loss of a box delivered to him for carriage, in delivering judgment for the plaintiff it was said that, while there was no particular agreement as to the amount to be paid for the carriage, "then the carrier might have a *quantum meruit* for his hire".

In *Great Western Railway v. Sutton*[2], Blackburn J. said in part:

> The obligation which the common law imposed upon him was to accept and carry all goods delivered to him for carriage according to his profession (unless he had some reasonable excuse for not doing so) on being paid a reasonable compensation for so doing.

The result of the authorities appears to me to be correctly summarized in Browne's Law of Carriers, at p. 42, where it is said:

> We have already seen that the law imposes very onerous duties, and very considerable risks, upon a person who is designated a common carrier. As to his duty, he is bound by law to undertake the carriage of goods. Another man is free from any such duty until he has entered into a special agreement; but the law holds that the common carrier, by the very fact of his trade and business, has, on his side, entered into an agreement with the public to carry goods, which becomes at once a complete and binding contract when any person brings him the goods,

[1] (1679), 2 Show. 81, 89 E.R. 807.
[2] (1869), L.R. 4 H.L. 226 at 237, 38 L.J Ex. 177.

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and makes the request that he should carry them to a certain person or place. To make such a contract binding upon him as a common carrier, it is not necessary that a specific sum of money should be promised or agreed upon; but where that is not the case, there is an implied undertaking upon the part of the bailor that the remuneration shall be reasonable.

The *Water Act Amendment Act* of 1929 appears to have followed closely the form of public utilities legislation in certain of the United States. There had been statutes of this nature in force in various parts of the Union for a considerable time prior to the year 1929.

I do not find that the American statutes generally declared in terms as did s. 141C of the *Water Act Amendment Act* that a power company providing service to the public should be entitled to a fair return on the value of all property acquired by it and used in providing service to the public. This method, however, of establishing a fair and reasonable rate would appear to have been followed universally.

The authorities in the American cases are to be found summarized in Nichols—Ruling Principles of Utility Regulation, at p. 49—where a passage from the judgment of the Supreme Court of the United States in *Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission*[1] is quoted reading:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. This is so well settled by numerous decisions of this court that citation of the cases is scarcely necessary.

In *New Jersey Public Utility Commissioners v. New York Telephone Company*[2], Butler J. said:

> The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for public service. And rates not sufficient to yield that return are confiscatory.

While without the provision made in s. 141C of the *Water Act Amendment Act* a power company compelled by the amendment to furnish electrical service on demand

[1] (1923), 262 U.S. 679.

[2] (1925), 271 U.S. 23 at 31.

upon the conditions prescribed would in my opinion have been entitled to a fair and reasonable payment for such service, the Legislature, by s. 141C, defined the manner in which fair and reasonable rates should be established.

As I have said, the *Public Utilities Act* does not contain any provision which in terms declares the right of the utility to a fair return on the value of its property. It does, however, by the definition of the terms "unjust" and "unreasonable" adopted from the *Water Act Amendment Act* declare that these expressions include rates that are insufficient to yield fair compensation for the service rendered, and the Public Utilities Commission in the present matter have interpreted this in its context as indicating the yardstick to be used in determining the fair and reasonable return to which the appellant was entitled.

Under the powers given to the Commission by s. 45 of the Act the value of the property of the appellant used, or prudently or reasonably acquired to enable the company to furnish its services was determined as at December 31st, 1942, and since then has been kept up to date. On September 11th, 1952, the Commission, after public hearings, decided that until some change in the financial and market circumstances convinced the Commission that a different rate should be applied, the Commission would apply the rate of 6.5 per cent. on the rate base as a fair and reasonable rate of return for the company.

That decision remains unchanged and is not questioned by anyone in these proceedings.

In interpreting the statute, the position at common law of the utility after the repeal of the sections of the *Water Act* must be considered. Had the statute imposed upon the appellant the obligation to furnish service of the natures defined upon demand, without more, it would have been entitled as a matter of law to recover from a person demanding service reasonable and fair compensation. It will not in my opinion be presumed that it was the intention of the Legislature to deprive a utility of that common law right.

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In *Colonial Sugar Refining Company v. Melbourne Harbour Trust Commissioners*[1], the Judicial Committee said:

> In considering the construction and effect of this Act the Board is guided by the well known principle that a statute should not be held to take away private rights of property without compensation, unless the intention to do so is expressed in clear and unambiguous terms.

In Maxwell on Statutes, 10th ed., at p. 286, the authorities are thus summarized:

> Proprietary rights should not be held to be taken away by Parliament without provision for compensation unless the legislature has so provided in clear terms. It is presumed, where the objects of the Act do not obviously imply such an intention, that the legislature does not desire to confiscate the property or to encroach upon the right of persons, and it is therefore expected that, if such be its intention, it will manifest it plainly, if not in express words at least by clear implication and beyond reasonable doubt.

Subsection 6 of s. 23 of the *Interpretation Act*, R.S.B.C. 1948, c. 1, directs that every Act shall receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act. In my opinion the true meaning of the relevant sections of the *Public Utilities Act* is that a utility is given a statutory right to the approval of rates which will afford to it fair compensation for the services rendered and that the quantum of that compensation is to be a fair and reasonable rate of return upon the appraised value of the property of the company referred to in s. 16(1)(*b*).

The appellant in addition to the sale of electrical energy operates a public transportation system and sells gas and by an Order-in-Council made under the provisions of s. 15(1)(*c*) of the Statutes of 1938 it was directed that these three categories of service should be considered as one unit in fixing the rates. In the reasons delivered by the Commission upon the application to increase the rates for electricity, it is said that the appellant has never earned the approved rate of return and that the rates proposed by it, and which were not approved, would not enable it to do so even in respect of the electrical system alone.

[1] [1927] A.C. 343 at 359, 96 L.J.P.C. 74.

Rates that fail to yield fair compensation for the service rendered are declared by s. 2 to be unjust and unreasonable as they were by s. 2 of the *Water Act Amendment Act* of 1929. The Commission is directed by s. 16(1)(*b*) to have due regard to fixing a rate which will give to the utility a fair and reasonable return upon the appraised value of its property used or prudently and reasonably acquired to enable it to furnish the service. It is the inclusion of the expression "shall have due regard" which has led the Commission and the Court of Appeal to conclude that this means that allowing a fair return upon the appraised value is simply one of the matters to be considered by the Commission in fixing the rate. Clearly no such interpretation could have been placed upon this expression under the provisions of the *Water Act* in view of the express provisions of s. 141C, and with great respect I think no such interpretation should be given to it in the present statute.

The fair compensation referred to in s. 2 of the *Water Act Amendment Act* of 1929 referred, and could only refer, to an aggregate produced by tolls sufficient to yield to the power company the fair return on the value of its property to which s. 141C declared it was entitled. The fair compensation referred to in s. 2 of the *Public Utilities Act* is in its context, in my opinion, to be construed in the same manner. The Order of the Commission of September 11th, 1952, determined what that compensation should be. The rates to be put into force to yield such fair compensation, which, at least in the case of electricity, vary in accordance with the use to which it is put and the quantities purchased, are matters to be determined by the Commission. The direction to the Commission in s. 16(1)(*b*) to have due regard to the protection of the public from rates that are excessive as being more than a fair and reasonable charge for the services requires it, in my opinion, to approve rates which are in its judgment fair and reasonable having in mind the purpose for which the electricity is used, the quantities purchased and such other matters as it considers justify the approval of rates which differ for different users.

I can find nothing in this legislation indicating an intention on the part of the Legislature to empower the Commission to deprive the utility of its common law right to be paid fair compensation for the varying services rendered or

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to depart from the declared intention of the Legislature in the *Water Act Amendment Act* that such companies upon whom these obligations are imposed are entitled to have the quantum of such fair compensation determined as a fair return upon the appraised value of the properties required.

I do not think it is possible to define what constitutes a fair return upon the property of utilities in a manner applicable to all cases or that it is expedient to attempt to do so. It is a continuing obligation that rests upon such a utility to provide what the Commission regards as adequate service in supplying not only electricity but transportation and gas, to maintain its properties in a satisfactory state to render adequate service and to provide extensions to these services when, in the opinion of the Commission, such are necessary. In coming to its conclusion as to what constituted a fair return to be allowed to the appellant these matters as well as the undoubted fact that the earnings must be sufficient, if the company was to discharge these statutory duties, to enable it to pay reasonable dividends and attract capital, either by the sale of shares or securities, were of necessity considered. Once that decision was made it was, in my opinion, the duty of the Commission imposed by the statute to approve rates which would enable the company to earn such a return or such lesser return as it might decide to ask. As the reasons delivered by the Commission show, the present appellant did not ask the approval of rates which would yield a return of 6.5 per cent. to which it was entitled under the Order of the Board.

I do not consider that Question (1) can be answered by a simple affirmative or negative. The obligation to approve rates which will produce the fair return to which the utility has been found entitled is, in my opinion, absolute, which does not mean that the obligation of the Commission to have due regard to the protection of the public, as required by s. 16(1)(*b*), is not to be discharged. It is not a question of considering priorities between "the matters and things referred to in Clauses (*a*) and (*b*) of subsection (1) of s. 16". The Commission is directed by s. 16(1)(*a*) to consider all matters which it deems proper as affecting the rate but that consideration is to be given in the light of the fact that the obligation to approve rates which will give a fair and reasonable return is absolute.

In my opinion the answer to be made to Question (1)(*a*) is that the Commission was wrong in deciding that it was not required to approve rates which in the aggregate would produce for the utility the fair return which by its order of September 11, 1952, the Commission found it to be entitled or such lower rates as the utility might submit for approval. The duty of the Commission to have due regard to the protection of the public from excessive rates referred to in the first four lines of s. 16(1)(*b*) refers to the approval of rates according to the use to be made by and the quantities supplied to those to whom the service is rendered.

The second part of Question (1) reads:

> If the answer to (1)(*a*) is "No", what decision should the Commission have reached on the point?

As to this I agree with the answer proposed by my brother Martland.

I would allow this appeal but make no order as to costs.

The judgment of Cartwright, Martland and Ritchie JJ. was delivered by

MARTLAND J.:—Pursuant to the provisions of subs. (1) of s. 107 of the *Public Utilities Act* of British Columbia, R.S.B.C. 1948, c. 277, the Public Utilities Commission of that Province stated a case for the opinion of the Court of Appeal of British Columbia. Five questions were submitted for the consideration of the Court, of which the first was as follows:

> (1) (*a*) Was the Commission right in deciding as appears in the said Reasons for Decision of 14th July, 1958, that no one of the matters and things referred to in clauses (*a*) and (*b*) of subsection (1) of Section 16 of the "Public Utilities Act" should as a matter of law be given priority over any other of those matters or things and that, if a conflict arises among these matters or things, it is the Commission's duty to act to the best of its discretion?
>
> (*b*) If the answer to question (1) (*a*) is "No", what decision should the Commission have reached on the point?

Question (1)(*a*) was answered in the affirmative. The appellant, by special leave of this Court, has appealed from that portion of the judgment of the Court of Appeal which comprises the answer given by it to question (1). The other four questions and the answers given to them are not in issue in this appeal.

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The relevant circumstances involved are contained in the case stated by the Public Utilities Commission and are as follows:

The appellant and British Columbia Electric Company Limited (together called "the Company") are related companies and between them own and operate equipment and facilities for the transportation of persons and property by railway, trolley coach and motor buses and for the production, generation and furnishing of gas and electricity, all for the public for compensation.

The Company is regulated by the Public Utilities Commission of British Columbia (called "the Commission") pursuant to the provisions of the *Public Utilities Act*.

By appraisal the Commission ascertained the value of the property of the Company used, or prudently and reasonably acquired, to enable the Company to furnish its services. The appraisal was made as of December 31, 1942, and since then has been kept up to date. The appraised value is referred to as "the rate base".

By Order-in-Council No. 1627, approved on July 16, 1948, the Commission was directed to consider the classes or categories of the regulated services of the Company as one unit in fixing the rates.

On September 11, 1952, the Commission after public hearing made "Findings as to Rate of Return" and decided that, "until changed financial and market circumstances convince the Commission that a different rate should be applied, the Commission will in its continuing examination of the Company's operations apply the rate of 6.5%" on the rate base as a fair and reasonable rate of return for the Company. This decision remains unchanged.

The Company from time to time amended its rate schedules with the consent of the Commission and filed with the Commission schedules showing the rates so established. On April 23, 1958, it applied for the consent of the Commission, under s. 17 of the *Public Utilities Act,* to file amended schedules containing increased rates for its electric service on the Mainland and on Vancouver Island. On July 28, 1958, it also applied for the consent of the Commission to file amended schedules containing increased transit fares for its transit systems in Vancouver and other Mainland areas and in Victoria and surrounding areas.

Public hearings were held by the Commission and it handed down its decision with respect to the electric applications on July 14, 1958, and with respect to the transit applications on October 30, 1958.

Briefly, the decisions of the Commission accepted the proposed rate schedules submitted by the Company, except that it refused to approve the proposed increases in the principal residential electric rates on the Mainland and on Vancouver Island. It directed that those rates be scaled down by approximately 25%. In its decision with respect to electric rates the Commission stated:

> The Commission has therefore consented to the filing to be effective July 15th, 1958, of all the rate schedules submitted by the Company for the Mainland and Vancouver Island, as modified and supplemented by the Company during the course of the hearings on its application, except the residential rate schedules and Mainland Rate 3035 for industrial users.
>
> The Commission has decided that the principal residential rate on the Mainland (Schedule 1109) and the principal residential rate on the Island (Schedule 1110 under which the principal divisions are Billing Codes 1110 and 1112) should be adjusted to yield not more than three-quarters of the additional revenue proposed. The adjustment must be applied primarily to reduce sharp changes in impact and lessen disproportionately large percentage increases in the consumption range of 60 KWH to 280 KWH per month. Comparable adjustments must also be made in some of the related special residential rates of lesser importance. Most of the relief would be given to the small residential user.

At the same time the Commission decided that further increases in the commercial and industrial rates to compensate for this reduction in the proposed residential rates would not be justified.

During the hearings it was contended by counsel for the Company that, the Commission, having determined on a fair and reasonable return to the Company, namely, 6.5%, the Commission should authorize rates which would yield that return, or whatever lesser return the Company's application requested for the time being. The Commission did not accept this contention and the rates which were approved by the Commission would yield approximately $750,000 less per annum than those applied for by the Company would yield. The rates for which the Company sought approval themselves would not have yielded to the Company the full allowed rate of return of 6.5%.

The relevant portions of s. 16(1) of the *Public Utilities Act* provide as follows:

> 16. (1) In fixing any rate:—

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(*a*) The Commission shall consider all matters which it deems proper as affecting the rate:

(*b*) The Commission shall have due regard, among other things, to the protection of the public from rates that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the public utility; and to giving to the public utility a fair and reasonable return upon the appraised value of the property of the public utility used, or prudently and reasonably acquired, to enable the public utility to furnish the service:

(*c*) Where the public utility furnishes more than one class of service, the Commission shall segregate the various kinds of service into distinct classes or categories of service; and for the purpose of fixing the rate to be charged for the service rendered, each distinct class or category of service shall be considered as a self-contained unit, and the rates fixed for each unit shall be such as are considered just and reasonable for that unit without regard to the rates fixed for any other unit. If it is considered by the Lieutenant-Governor in Council that the rates as so determined might be inequitable or contrary to the general public interest, the Lieutenant-Governor in Council may direct that two or more classes or categories of service shall be considered as one unit in fixing the rate:

In the reasons given for its decision the Commission deals with the effect of clauses (*a*) and (*b*) of s. 16(1) and says:

With great respect, the Commission considers that although for this purpose the statutory duty of the Commission to have due regard to all matters which the Commission deems proper as affecting the rate might without any significant inaccuracy be described as the right of the Commission, and its statutory duty to *have due regard to giving* the utility a fair and reasonable return might without significant inaccuracy be described as the Commission's *responsibility for giving* the utility a fair and reasonable return, there is nothing in the Act to relieve the Commission in the case now before it from complying with the language of the Act and giving due regard to all those matters to which the legislature has directed the Commission to give due regard in fixing a rate. No one of those matters should, in the opinion of the Commission, be given as a matter of law priority over any other of those matters and if, as the legislature appears to have thought possible, a conflict arises among those matters, the Commission considers that it is its duty to act to the best of its discretion.

The Court of Appeal concurred in this view. The judgment of the Court[1], delivered by Sheppard J.A., refers to this question in the following words:

A further inquiry is what weight should be given to the matters required to be considered by Sec. 16(1)(*b*) and particularly to the "fair and reasonable return". Under Sec. 16(1)(*b*), the Commission is required

[1] (1959), 29 W.W.R. 533 at 538.

to consider "the protection of the public" and the "giving to the public utility a fair and reasonable return". Although clauses (*a*) and (*b*) of Sec. 16(1) require certain matters to be considered, they do not state what weight is to be assigned by the Commission. Consequently, the Statute requires only that the Commission consider the matters falling within Sec. 16(1)(*a*), namely, "all matters which it deems proper as affecting the rate" and those falling within Sec. 16(1)(*b*), namely, "the protection of the public" and "a fair and reasonable return" to the Utility. But the Statute does not require more, and does not require any weight to be given to these matters after they have been considered. Hence the weight to be assigned is outside any statutory requirement and must be a question of fact for the Commission in each instance.

From this decision the present appeal is brought.

To determine the intent and meaning of clauses (*a*) and (*b*) of s. 16(1) of the Act it is necessary to consider them in relation to the other provisions of the Act, with which they must be read.

Section 5 imposes upon a public utility the duty to maintain its property and equipment in such condition as to enable it to furnish, and to furnish, service to the public in all respects adequate, safe, efficient, just and reasonable. Section 7 prevents a public utility which has been granted a certificate of public convenience and necessity or a franchise from ceasing its operations or any part of them without first obtaining the permission of the Commission.

Section 6 requires every public utility, upon reasonable notice, to furnish to all persons who may apply therefor, and be reasonably entitled thereto, suitable service without discrimination and without delay.

Sections 38, 42 and 43 contain provisions whereby, in the circumstances therein defined, a public utility may be ordered by the Commission to extend its existing services.

These four sections last mentioned involve a statutory obligation on the part of a public utility to make capital outlays for extensions of its service. A public utility which operates in a rapidly expanding community may be required to make substantial expenditures of that nature in order to keep pace with increasing demands. It must, if it is to fulfil those obligations, be able to obtain the necessary

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capital which is required, which it can only do if it is obtaining a fair rate of return upon its rate base. The meaning of a fair return was defined by Lamont J. in *Northwestern Utilities, Limited v. City of Edmonton*[1]:

> By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.

The necessity for giving a public utility fair compensation for the service which it renders appears in the definition of the words "unjust" and "unreasonable" in s. 2(1), which is as follows:

> "Unjust" and "unreasonable" as applied to rates shall be construed to include respectively injustice and unreasonableness, whether arising from the fact that rates are excessive as being more than a fair and reasonable charge for service of the nature and quality furnished by the public utility, or from the fact that rates are insufficient to yield fair compensation for the service rendered, or arising in any other manner:

The word "service", which appears in this definition, is defined in the Act to include:

> the use and accommodation afforded consumers or patrons, and any product or commodity furnished by a public utility; and also includes, unless the context otherwise requires, the plant, equipment, apparatus, appliances, property, and facilities employed by or in connection with any public utility in performing any service or in furnishing any product or commodity and devoted to the purposes in which the public utility is engaged and to the use and accommodation of the public:

These defined words appear in two sections of the Act which relate to the rates to be charged by a public utility.

Section 8, which is among a group of sections dealing with the duties and restrictions imposed on public utilities, provides:

> 8. (1) No public utility shall make demand or receive any unjust, unreasonable, unduly discriminatory, or unduly preferential rate for any service furnished by it within the Province, or any rate otherwise in violation of law; and no public utility shall, as to rates or service, subject any person or locality, or any particular descripiton of traffic, to any undue prejudice or disadvantage, or extend to any person any form of agreement, or any rule or regulation, or any facility or privilege, except such as are regularly and uniformly extended to all persons under substantially similar circumstances and conditions in respect of service of the same description, and the Commission may by regulations declare what constitute substantially similar circumstances and conditions.

[1] [1929] S.C.R. 186 at 193, 2 D.L.R. 4.

(2) It shall be a question of fact, of which the Commission shall be the sole judge, whether any rate is unjust or unreasonable, or whether in any case there is undue discrimination, preference, prejudice, or disadvantage in respect of any rate or service, or whether service is offered or furnished under substantially similar circumstances and conditions. 1938, c. 47, s. 8; 1939, c 46, s. 5.

Section 20, which empowers the Commission to determine rates, reads as follows:

20. The Commission may upon its own motion or upon complaint that the existing rates in effect and collected or any rates charged or attempted to be charged by any public utility for any service are unjust, unreasonable, insufficient, or discriminatory, or in anywise in violation of law, after a hearing, determine the just, reasonable, and sufficient rates to be thereafter observed and in force, and shall fix the same by order. The public utility affected shall thereupon amend its schedules in conformity with the order and file amended schedules with the Commission.

It will be noted that this section, in addition to the use of the words "unjust" and "unreasonable", also uses the terms "insufficient" and "sufficient" in relation to rates.

Both of these sections contemplate a system of rates which would be fair to the consumer on the one hand and which will yield fair compensation to the public utility on the other hand.

Section 16, the section with which we are concerned in this appeal, also deals with this matter of fairness of rates. In addition, it spells out the method by which a public utility is to obtain fair compensation for its service; i.e., by a fair and reasonable return upon its rate base, which rate base, pursuant to s. 45, the Commission can determine by appraisal.

Section 16 deals with the duties of the Commission in fixing rates. Clause (*a*) of subs. (1) states that the Commission shall consider all matters which it deems proper as affecting the rate. It confers on the Commission a discretion to determine the matters which it deems proper for consideration and it requires the Commission to consider such matters.

Clause (*b*) of subs. (1) does not use the word "consider", which is used in clause (*a*), but directs that the Commission "shall have due regard", among other things, to two specific matters. These are:

(i) The protection of the public from rates that are excessive as being more than a fair and reasonable charge for services of the nature and quality furnished by the public utility; and

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(ii) To giving to the public utility a fair and reasonable return upon the appraised value of its property used or prudently and reasonably acquired to enable the public utility to furnish the service.

As I read them, the combined effect of the two clauses is that the Commission, when dealing with a rate case, has unlimited discretion as to the matters which it may consider as affecting the rate, but that it must, when actually setting the rate, meet the two requirements specifically mentioned in clause (*b*). It would appear, reading ss. 8, 16 and 20 together, that the Act contemplates these two matters to be of primary importance in the fixing of rates.

In my opinion, therefore, these two factors should be given priority over any other matters which the Commission may consider under clause (*a*), or any other things to which it shall have due regard under clause (*b*), when it is fixing any rate.

The second portion of question (1)(*a*) was as to whether, in case of conflict among the matters and things referred to in clauses (*a*) and (*b*) of s. 16(1), it was the Commission's duty to act to the best of its discretion. I have already expressed my view regarding the priority as between those things specifically mentioned in clause (*b*) and the other matters or things referred to in clauses (*a*) and (*b*). This leaves the question as to possible conflict as between the two matters specifically mentioned in clause (*b*).

Clearly, as between these two matters there is no priority directed by the Act, but there is a duty imposed upon the Commission to have due regard to both of them. The rate to be imposed shall be neither excessive for the service nor insufficient to provide a fair return on the rate base. There must be a balancing of interests. In my view, however, if a public utility is providing an adequate and efficient service (as it is required to do by s. 5 of the Act), without incurring unnecessary, unreasonable or excessive costs in so doing, I cannot see how a schedule of rates, which, overall, yields less revenue than would be required to provide that rate of return on its rate base which the Commission has determined to be fair and reasonable, can be considered, overall, as being excessive. It may be that within the schedule certain rates may operate unfairly, relatively, as

between different classes of service or different classes of consumers. If so, the Commission has the duty to prevent such discrimination. But this can be accomplished by adjustments of the relative impact of the various rates in the schedule without having to reduce the total revenues which the whole schedule of rates is designed to produce.

Accordingly, it is my opinion that the answer to question (1)(*a*) should be "No". My answer to question (1)(*b*) would be that the Commission, in priority to any other matters which it may deem proper to consider under clause (*a*) and any of the other things referred to in clause (*b*) of s. 16(1), should have due regard to the two matters specifically mentioned in clause (*b*). In the present case, having decided that certain of the rates proposed by the appellant would impose an unreasonable burden upon certain classes of consumers, the Commission should permit the Company to submit alternative schedules of rates, which, while yielding approximately the same overall revenues, would eliminate the comparatively excessive impact of those classes of rates to which the Commission objected, until a rate schedule is devised which meets the requirements of clause (*b*) of s. 16(1).

In my view the appeal should be allowed, but no costs should be payable.

Appeal allowed, Kerwin C.J. *dissenting.*

Solicitor for the appellant: A. Bruce Robertson, Vancouver.

Solicitors for The Public Utilities Commission of British Columbia, respondent: Clark, Wilson, Clark, White & Maguire, Vancouver.

Solicitors for The Corporation of The City of Victoria, The Corporation of The District of Oak Bay, The Corporation of The District of Saanich and Corporation of The Township of Esquimalt, respondents: Straith, O'Grady, Buchan, Smith & Whitley, Victoria.

Solicitor for City of Vancouver, respondent: R. K. Baker, Vancouver.

Transcanada Pipelines Ltd. v. Canada (National Energy Board)

Federal Court Judgments

Federal Court of Appeal

Toronto, Ontario

Rothstein, Noël and Sharlow JJ.A.

Heard: February 16, 2004.

Judgment: April 5, 2004.

Docket A-327-03

[2004] F.C.J. No. 654 | *[2004] A.C.F. no 654* | *2004 FCA 149* | *2004 CAF 149* | *319 N.R. 171* | *130 A.C.W.S. (3d) 1044*

Between Transcanada Pipelines Limited, appellant, and The National Energy Board, Canadian Association of Petroleum Producers, Centra Gas Manitoba Inc., Coral Energy Canada Inc., Industrial Gas Users Association, Mirant Canada Energy Marketing, Ltd. and Ontario Minister of Energy, respondents

(60 paras.)

Case Summary

Administrative law — Judicial review and statutory appeal — Standard of review — Administrative powers or functions — Discretionary powers — Fettering of — Commercial law — Consumer protection — Natural resources law — Oil and gas — Pipelines.

Appeal by Transcanada Pipelines from a decision of the National Energy Board rejecting its proposal to review and change the rate it was permitted to charge for natural gas. The tolls which the Board allowed Transcanada to charge its customers were designed to generate sufficient revenue to recover approved costs while at the same time fairly allocating charges to users in relation to the costs and benefits of different services. Transcanada argued that the Board erred, first, in taking customer interests into account in determining the rate of return on capital it allowed the natural gas transmission system to earn, and second, in fettering its discretion by refusing to depart from the automatic adjustment formula in establishing the rate of return on equity.
HELD: Appeal dismissed.

The Board did not err in law in taking into account customer interests in the determination of the rate of return. The Board was not required to use a specific methodology, but only to ensure that all tolls were just and reasonable from the point of view of both Transcanada and its customers. The cost of service method applied provided compensation to Transcanada through tolls for its prudently incurred costs, including its cost of capital and its cost of equity capital. While the impact on customers should not be considered in determining the rate of return on equity because this component of the deemed capital structure was unaffected by the impact of tolls on customers, Transcanada did not establish that the Board took that factor into account for the equity determination. The impact on customers could be a factor in the determination of the cost of equity capital if any resulting increase in tolls was so significant that it would lead to rate shock if implemented all at once, but this did not occur here. There was no

fettering of discretion by the use of the automatic adjustment formula for determining the cost of equity capital. The Board had considered Transcanada's alternative proposal, but decided the automatic adjustment formula remained valid.

Statutes, Regulations and Rules Cited:

National Energy Board Act, R.S.C. 1985, c. --7, ss. 21(1), 22, 22(2)(b)(i), 23(1), 60(1), 62.

National Energy Board Rules of Practice and Procedure, 1995, SOR/95-208, ss. 44, 44(2).

Counsel

Alan J. Lenczner, Risa M. Kirshblum and Wendy Moreland, for the applicant. Margery Fowke, for the respondent, National Energy Board. John J. Marshall, Q.C., and Don Davies, for the respondent, Canadian Association of Petroleum Producers. Alan Mark, for the respondent, Coral Energy Inc. Peter C.P. Thompson, Q.C., and Vincent J. DeRose, for the respondent, Industrial Gas Users Association. Keith F. Miller, for the respondent, Mirant Energy Marketing Canada Inc. John Turcnin and Sara Blake, for the respondent, Ontario Minister of Energy.

The judgment of the Court was delivered by

ROTHSTEIN J.A.

INTRODUCTION

1 This is an appeal from a February 2003 decision of the National Energy Board (RH-R-1-2002), pursuant to leave granted by this Court under section 22 of the National Energy Board Act, R.S.C. 1985, c. --7.

2 There are two issues in the appeal. The first is whether the National Energy Board ("Board") erred in taking customer or consumer interests into account in determining the rate of return on capital it would allow the appellant's Canadian Mainline natural gas transmission system ("the Mainline") to earn. The second is whether the Board erred by fettering its discretion by refusing to depart from an automatic adjustment mechanism it had used to establish the Mainline's rate of return on equity.

3 In order to understand the issues under appeal, it is first necessary to provide some background and the procedural history leading to the February 2003 decision.

BACKGROUND

4 The National Energy Board regulates interprovincial natural gas transmission pipelines. The Mainline is considered a Group 1 pipeline by the Board. Group 1 pipelines are major pipelines which are audited by the Board on a regular basis and whose operating results are continuously monitored by the Board.

5 The tolls charged for transporting natural gas on the Mainline are regulated by the Board on a cost of service basis. That means that for a future period, referred to as a "test" year, the Board, based on the evidence before it, estimates the costs to be incurred by the Mainline. The tolls which the Board allows the Mainline to charge its customers are designed to generate sufficient revenue to recover these approved costs while at the same time fairly allocating charges to users in relation to the costs and

benefits of different services. Included in the cost of service, and indeed, the largest single component of the Mainline's costs, is the Mainline's cost of capital.

6 The cost of capital to a utility is equivalent to the aggregate return on investment investors require in order to keep their capital invested in the utility and to invest new capital in the utility. That return will be made in the form of interest on debt and dividends and capital appreciation on equity. Usually, that return is expressed as the rate of return investors require on their debt or equity investments.

7 The rate of return on debt is not usually controversial. It normally consists of the weighted average interest rate for the test year on the utility's outstanding long-term debt. On the other hand, the rate of return on equity is often the subject of controversy and of much debate by expert witnesses.

8 Unlike debt, where the interest rate payable is directly observable, the rate of return on equity cannot be accurately determined in advance. There are various methods experts use to estimate the rate of return on equity required by investors. The one adopted by the Board is an Equity Risk Premium methodology whereby the Board estimates a risk-free rate based on government bond rates and adds a risk premium to account for the risk associated with equity investment in a "benchmark" pipeline.

9 Once the separate rates of return on debt and equity are established, they are consolidated into a composite rate of return on capital, based on the relative amounts of debt and equity in the utility's capital structure. In order to account for varying levels of risk between pipelines, the Board constructs for each pipeline a capital structure, i.e. the relative portions of debt and equity capital needed to finance its prudently acquired assets plus its working capital, on the basis of expert evidence. The greater the risk attributed to each pipeline, the greater the required equity component of its capital structure. That is because bond investors, who are more risk averse than equity investors, will not lend funds to an enterprise unless there is sufficient equity capital invested in the enterprise to give them confidence that they will be able to recover their investment from the assets of the enterprise in the event of default.

10 For example, if the required rate of return on debt is 5%, the required rate of return on equity is 10% and the utility's capital structure, as determined by the Board, consists of 60% debt and 40% equity, the composite rate of return on capital would be 5% X 0.60 + 10% X 0.40 = 7%.

11 The composite rate of return on capital is then multiplied by a rate base which consists of the Board's determination, according to its accounting regulations, of the net book value of the utility's prudently acquired assets plus its working capital. Multiplying the rate of return required by investors by this rate base gives the total dollar amount of return required by investors. The product is equivalent to the utility's estimated cost of capital for the test year. That cost is added to all other costs to get the utility's total cost of service. The total is then allocated amongst the utility's customers.

12 Even though cost of capital may be more difficult to estimate than some other costs, it is a real cost that the utility must be able to recover through its revenues. If the Board does not permit the utility to recover its cost of capital, the utility will be unable to raise new capital or engage in refinancing as it will be unable to offer investors the same rate of return as other investments of similar risk. As well, existing shareholders will insist that retained earnings not be reinvested in the utility.

13 In the long run, unless a regulated enterprise is allowed to earn its cost of capital, both debt and equity, it will be unable to expand its operations or even maintain existing ones. Eventually, it will go out of business. This will harm not only its shareholders, but also the customers it will no longer be able to

service. The impact on customers and ultimately consumers will be even more significant where there is insufficient competition in the market to provide adequate alternative service.

PROCEDURAL HISTORY

14 In 1994, the Board conducted a public hearing into the cost of capital of certain Group 1 pipelines including the Mainline. The purpose of the hearing was to fix the cost of capital for those pipelines for the period commencing January 1, 1995, and to establish, if possible, an automatic mechanism to adjust the rate of return on equity in the future in order to avoid the expense of litigating annual or biennial changes to the rate of return on equity.

15 As a result of that proceeding, the Board issued reasons for decision (RH-2-94) in March 1995 fixing the Mainline's return on equity for the 1995 test year at 12.25% based on a deemed capital structure of 70% debt and 30% equity. The Board's deemed capital structure did not provide for any explicit preferred share capital. Therefore, all references to equity refer to common equity.

16 The Board also established an adjustment mechanism by which the rate of return on equity would be adjusted on January 1 in 1996 and each subsequent calendar year. This mechanism was based upon the Equity Risk Premium methodology whereby:

1. a risk free (Government of Canada) bond yield forecast would be forecasted for the forthcoming year;
2. this bond yield forecast would be deducted from the bond yield forecast of the immediately preceding year;
3. this difference would be multiplied by a factor of 0.75 to determine the adjustment to the rate of return on equity;
4. the product derived in step 3 would be added to or deducted from the rate of return on equity determined by the Board for the preceding year;
5. the sum resulting from step 4 would be rounded to the nearest 25 basis points (1/100th of a percent).

17 The Mainline's rate of return on equity was adjusted according to this formula in 1996 and subsequent years, although in 1997, the Board abandoned the rounding adjustment, i.e. step 5 above.

18 By 2001, the appellant had concluded that application of the formula was understating its required rate of return on capital. Therefore, the appellant applied, pursuant to subsection 21(1) of the National Energy Board Act, for "review and variance of the [1995 decision] to allow for the determination of a fair return for TransCanada for the years 2001 and 2002." Subsection 21(1) provides:

> 21. (1) Subject to subsection (2), the Board may review, vary or rescind any decision or order made by it or rehear any application before deciding it.
>
> * * *
>
> 21. (1) Sous réserve du paragraphe (2), l'Office peut réviser, annuler ou modifier ses ordonnances ou décisions, ou procéder à une nouvelle audition avant de statuer sur une demande.

19 The appellant submitted that the Board should approve a new methodology for determining the

Mainline's cost of capital -- the After-Tax Weighted-Average Cost of Capital (ATWACC) methodology. Alternatively, if the ATWACC methodology was not accepted, the appellant submitted that the required rate of return on equity for the Mainline should be 12.5% for 2001 and 2002 and that based on its risk, the deemed equity component of the Mainline's capital structure should be increased to 40%.

20 As a result of the appellant's submissions, the Board conducted a hearing in February, March and April 2002. The issues at the hearing were:

1. Is the Rate of Return on Common Equity (ROE) formula, established by the Board in its RH-2-94 Decision, still appropriate for determining TransCanada's ROE?
2. Is the After Tax Weighted-Average Cost of Capital (ATWACC) methodology an appropriate regulatory approach to determining cost of capital?
3. In the event the Board decides to adopt the ATWACC methodology, what is the appropriate ATWACC for TransCanada?
4. In the event the Board declines to adopt the ATWACC methodology and it is determined that the ROE formula is no longer suitable:
   a) What would be an appropriate methodology for determining return on capital and capital structure for TransCanada?
   b) In applying the above-determined methodology, what would be an appropriate return on capital and capital structure for TransCanada?
5. What is the appropriate effective date for changes to TransCanada's cost of capital? (RH-4-2001 at 4).

21 By reasons for decision (RH-4-2001) dated June 2002, the Board:

1. rejected the appellant's ATWACC proposal;
2. determined that the rate of return on equity for the Mainline should continue to be based on the adjustment formula established in its 1995 decision; and
3. increased the deemed equity component of the Mainline's capital structure from 30% to 33% to account for increased business risk.

22 By application to the Board dated September 16, 2002, the appellant applied for a review and variance of the 2002 decision. This application was also made pursuant to subsection 21(1).

23 Section 44 of the National Energy Board Rules of Practice and Procedure, 1995, *SOR/95-208* sets out the requirements for a review application. Subsection 44(2) provides:

44 (2) An application for review or rehearing shall contain

...

(b) the grounds that the applicant considers sufficient, in the case of an application for review, to raise a doubt as to the correctness of the decision or order ... including

(i) any error of law or of jurisdiction,

...

* * *

(2) La demande de révision ou de nouvelle audition contient les éléments suivants :

...

b) les motifs que le demandeur juge suffisants pour mettre en doute le bien-fondé de la décision ou de l'ordonnance, s'il s'agit d'une demande de révision, ... notamment :

(i) une erreur de droit ou de compétence,

...

24 In its decision on the review & variance application (RH-R-1-2002), dated February 2003, the Board found that the appellant had not raised a doubt as to the correctness of its 2002 decision and dismissed the application for review and variance.

25 The appellant was granted leave to appeal the Board's 2003 decision to this Court.

ANALYSIS

1. Standard of Review and Approach to the Decision Being Appealed

26 In view of my conclusion that the appeal should be dismissed, it is not necessary to conduct an extensive standard of review analysis. Even on the most intrusive standard of review (correctness), it has not been demonstrated that the Board erred in law.

27 There is also a question of the extent to which the Court should consider the Board's 2002 decision, which itself was not appealed. Normally, the Court is to restrict itself to a consideration of the decision under appeal. However, when the question is whether the Board erred or came to an unreasonable or patently unreasonable result in finding in its 2003 decision that the appellant had not raised a doubt as to the correctness of the prior 2002 decision, it is necessary to have regard, at least to some extent, to that prior decision. Rather than becoming bogged down into the intricacies of the scope of the Court's review, I am satisfied, even on a unrestricted consideration of both the 2002 and 2003 decisions, that the Board made no error of law in either case.

2. Did the Board err in considering customer or consumer interests in determining the Mainline's rate of return on capital?

28 As a preliminary point, the appellant drew a distinction between its customers and the ultimate consumers. For purposes of this decision, such a distinction is immaterial. The appellant's position is that the Mainline's return on capital should be determined solely from the perspective of the Mainline, without considering other interests, whether they be direct customers or ultimate consumers.

a) The Board is not required to adopt any specific methodology in determining tolls.

29 The National Energy Board Act contains no provisions or directions which require the Board to determine a pipeline's rate of return on capital. The Act only requires that "all tolls be just and reasonable." Subsections 60(1) and section 62 provide:

60. (1) A company shall not charge any tolls except tolls that are

(a) specified in a tariff that has been filed with the Board and is in effect; or

(b) approved by an order of the Board.

62. All tolls shall be just and reasonable, and shall always, under substantially similar circumstances and conditions with respect to all traffic of the same description carried over the same route, be charged equally to all persons at the same rate.

* * *

60. (1) Les seuls droits qu'une compagnie peut imposer sont ceux qui sont :

a) soit spécifiés dans un tarif produit auprès de l'Office et en vigueur;

b) soit approuvés par ordonnance de l'Office.

62. Tous les droits doivent être justes et raisonnables et, dans des circonstances et conditions essentiellement similaires, être exigés de tous, au même taux, pour tous les transports de même nature sur le même parcours.

30 The authority of the Board to determine just and reasonable tolls is not limited by any statutory directions. The broad authority of the Board was well articulated by Thurlow C.J. in British Columbia Hydro and Power Authority v. West Coast Transmission Company Ltd. et al., *[1981] 2 F.C. 646* at 655-56 (C.A.):

> There are no like provisions in part IV of the National Energy Board Act. Under it, tolls are to be just and reasonable and may be charged only as specified in a tariff that has been filed with the Board and is in effect. The Board is given authority in the broadest of terms to make orders with respect to all matters relating to them. Plainly, the Board has authority to make orders designed to ensure that the tolls to be charged by a pipeline company will be just and reasonable. But its power in that respect is not trammelled or fettered by statutory rules or directions as to how that function is to be carried out or how the purpose is to be achieved. In particular, there are no statutory directions that, in considering whether tolls that a pipeline company propose to charge are just and reasonable, the Board must adopt any particular accounting approach or device or that it must do so by determining cost of service and a rate base and fixing a fair return thereon.

31 The Board has adopted a cost of service method for determining the Mainline's tolls. Before this Court, counsel for a number of the respondents suggested different methodologies for determining just and reasonable tolls that would be open to the Board, such as:

1. tolls based on agreements between pipelines and shippers;
2. tolls based on charges of other pipelines;
3. use of base year tolls adjusted for inflation;
4. tolls based on mechanisms to encourage utilities towards greater efficiency.

As no particular methodology is required by the National Energy Board Act, the Board could have adopted a different methodology for determining just and reasonable tolls for the Mainline.

b) Having adopted a cost of service methodology, the costs determined by the Board must be just and reasonable to both the Mainline and its users.

32 In the case of the Mainline, the Board has adopted a cost of service methodology whereby the Mainline is to be compensated through tolls for its prudently incurred costs, including its cost of capital, and in particular, its cost of equity capital. Once it did so, it had to faithfully determine the Mainline's costs based on the evidence and its own sound judgment.

33 Cost of equity for a future year cannot be directly measured and therefore must be based on estimates. The Board must choose an estimate that allows the Mainline to earn what has been termed a

"fair return." In Northwestern Utilities Ltd. v. Edmonton (City), *[1929] S.C.R. 186* at 192-93, the Supreme Court defined a fair return in the following terms:

> The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.

Tolls which reflect a fair return on capital will be just and reasonable to both the Mainline and its users.

34 To put the matter another way, when the cost of service methodology is used to determine just and reasonable tolls, if the Board does not permit the Mainline to recover its costs because it has understated the Mainline's cost of equity capital, the Mainline will be unable to earn a fair return on equity. The tolls will therefore not be just and reasonable from the Mainline's point of view. On the other hand, the tolls must also be just and reasonable from the point of view of the Mainline's customers and the ultimate consumers who rely on service from the Mainline. Therefore, customers and consumers have an interest in ensuring that the Mainline's costs are not overstated. As respondents' counsel pointed out, there are numerous costing issues that may be subject to challenge. Questions may arise about, among other things, the allocation of costs between the Mainline and other divisions of the appellant; whether costs have been, or are being, prudently incurred; and whether the Mainline's compensation plans are reasonable. And, specific to this appeal, customers and consumers have an interest in ensuring that the Mainline's cost of equity is not overstated.

c) The Board did not improperly consider the impact on customers or consumers of increasing tolls to reflect the appellant's costs.

35 In oral argument, the appellant conceded that it does not object to its customers having input into the Board's cost determinations and in particular, its cost of capital determination, provided the issues in dispute are restricted to the costs of the Mainline. However, the appellant does object to the Board taking the impact of tolls on customers and consumers into account in determining the Mainline's cost of equity capital. The appellant says that the required rate of return on equity must be determined solely on the basis of the Mainline's cost of equity capital. The impact of any resulting toll increases on customers or consumers is an irrelevant consideration in that determination. The appellant does concede that when the final tolls are being fixed, the impact on the customers and consumers may be relevant, but insists that it is irrelevant when determining the required return on equity.

36 I think that this argument is sound and in keeping with the decision of the Supreme Court in Northwestern Utilities. The cost of equity capital does not change because allowing the Mainline to recover it would cause an increase in tolls. Under the Board's Equity Risk Premium methodology, the cost of equity capital is driven by the Board's estimate of the risk-free interest rate and the degree of risk investors perceive in the "benchmark" pipeline. The higher the risk, the higher their required rate of return. The degree of risk specific to the Mainline is accounted for by adjustments to its deemed capital structure. Accordingly, the cost to the Mainline of providing that rate of return on the equity component of its deemed capital structure is unaffected by the impact of tolls on customers or consumers.

37 The appellant has not demonstrated that the Board took the impact on customers or consumers into account in making its determination of the Mainline's required rate of return on equity.

38 It is true that in its 2002 decision, the Board did state:

> In respect of the appropriate balance of customer and investor interests, the Board notes that customer interest in rate of return matters relates most directly to the impact the approved return will have on tolls. The Board is of the view that the impact of the rate of return on tolls is a relevant factor in the determination of a fair return (RH-4-2001 at 12).

39 The appellant says it cannot tell if the Board took the impact on customers or consumers into account in making its determination of the Mainline's required rate of return on equity. There is certainly no indication in its 2002 reasons that the Board adjusted its estimate of the required rate of return on equity based upon the impact it would have on tolls. In fact, the Board simply applied the automatic adjustment formula adopted in its 1995 decision. That formula does not take into account the impact of tolls on customers or consumers.

40 It is also true that, in relation to an adjustment the Board made in the Mainline's deemed capital structure in its 2002 decision, the Board did state:

> In light of the above, the Board is of the view that it would be appropriate to increase the Mainline's deemed common equity ratio from 30% to 33%. The Board notes that this increase will raise the Mainline's annual cost of service and tolls by approximately 2%. The Board has determined that the toll increase is warranted by the prospective business risk facing the Mainline and that it will not impose an undue burden on shippers (RH-4-2001 at 59).

41 As I understand the Board's reasons, in view of the Mainline's increased business risk, the equity component of its deemed capital structure was increased from 30% to 33%. Because the required rate of return on equity was greater than the required rate of return on debt, this increased the overall estimate of the Mainline's required rate of return on capital, resulting in a 2% increase in tolls.

42 While the Board observed that the increase would not be an undue burden on shippers, there is no suggestion that the increase in the equity component of the Mainline's deemed capital structure was in any way suppressed by considerations of its impact on customers or consumers. Nor, as I have said, is there any indication that the Board determined a required rate of return on equity for the Mainline and then adjusted it downward based on the impact it would have on tolls. In the absence of some indication in the Board's reasons, there is no basis for such an assumption.

> d) The Board may adopt temporary measures to ameliorate "rate shock" so long as the utility eventually recovers its costs.

43 I would add one further point. While I agree with the appellant that the impact on customers or consumers cannot be a factor in the determination of the cost of equity capital, any resulting increase in tolls may be a relevant factor for the Board to consider in determining the way in which a utility should recover its costs. It may be that an increase is so significant that it would lead to "rate shock" if implemented all at once and therefore should be phased in over time. It is quite proper for the Board to take such considerations into account, provided that there is, over a reasonable period of time, no economic loss to the utility in the process. In other words, the phased in tolls would have to compensate the utility for deferring recovery of its cost of capital. In the end, where a cost of service method is used, the utility must recover its costs over a reasonable period of time, regardless of any impact those costs may have on customers or consumers (see Hemlock Valley Electrical Services Ltd. v. British Columbia Utilities Commission et al., *[1992] 12 B.C.A.C. 1* at 20-21 (C.A.)). In this case, however, there is no suggestion that the Board sought to phase in or otherwise understate the Mainline's cost of capital.

3. Did the Board fetter its discretion?

a) Appellant's arguments

44 The appellant's second alleged error of law is that the Board fettered its discretion. The appellant submits that the Board placed an inappropriate onus on the appellant to demonstrate that the cost of equity adjustment formula established by the Board in its 1995 decision, but not expressed in the National Energy Board Act or in any judicial authority, was to govern unless the appellant could persuade the Board otherwise.

45 In its factum, the appellant states that the high onus of reversal placed on it by the Board caused the Board to act "inconsistently with its obligations of impartiality as an administrative tribunal." Some of the respondents characterised this as an allegation of bias against the Board.

46 In oral argument, the appellant added that the Board wrongly discarded evidence of both the appellant and the respondents because the Board was not open to reviewing the adjustment formula.

b) The intended duration of the automatic adjustment mechanism.

47 In its 1995 decision, the Board was expressly addressing "what simplified procedure should be implemented to effect an annual adjustment to the rate of return applicable to pipelines between cost of capital proceedings" (RH-2-94 at 1). The Board explained its reasons for seeking an automatic adjustment mechanism in the following words:

> In setting this matter down for hearing, it was the Board's intention to put in place means of improving the efficacy of the toll setting process for the year 1995 and beyond. The Board expressed the desire to avoid annual hearings on the cost of capital and was of the view that some automatic mechanism to adjust the return on common equity could be the most appropriate way to ensure that this return continued to be fair to all parties, while avoiding the expense of litigating annual or biennial changes in the rate of return. The Board therefore included as an issue in the RH-2-94 proceeding, the design and implementation of a predetermined adjustment mechanism to the rate of return on the common equity component. The Board's objective in this regard was to conduct detailed examinations of the pipelines' cost of capital only when significant changes had occurred in financial markets, business circumstances, or in general economic conditions (RH-2-94 at 1-2).

48 After an extensive hearing in which it considered the submissions of pipelines, shippers, governments and others, the Board established the automatic adjustment mechanism whereby the cost of equity capital would be determined. As to how long the automatic adjustment mechanism would remain in place, the Board stated:

> The Board is not setting a limit on the life of the mechanism and it does not expect to reassess the rate of return on common equity in a formal hearing for at least three years. The Board has confidence that the adjustment mechanism adopted will provide an appropriate balance between the interests of pipeline company shareholders and those of shippers (RH-2-94 at 32).

49 In its 1995 decision, the Board also established a deemed capital structure for the Group 1 pipelines. As discussed above, the Mainline was deemed to have a capital structure made up of 70% debt and 30% equity. The Board expressed the view that its capital structure determination would endure for an extended period of years, but that the Board would be prepared to consider a re-assessment of capital structure if requested by a pipeline, its shippers or another interested party:

> The Board also expects that the capital structure set in this hearing for each of the pipelines will endure for an extended period of years. The Board will be prepared to consider a reassessment of capital structures, likely on an individual basis, in the event of a significant change in business

> risk, in corporate structure or in corporate financial fundamentals. The Board does not favour routine reassessments of capital structure. For these reasons, the Board has not set out a specific date or any criteria for capital structure re-evaluation. Any reassessment of capital structure, for reasons such as those expressed above, must be at the request of the pipeline itself, its shippers or some other interested party. It would then be for the Board to assess the merits of such a request (RH-2-94 at 32).

50 The Board's Order TG/TO-1-95, which implemented the 1995 decision, set the Mainline's deemed capital structure and required that the Mainline's cost of equity capital for 1996 and subsequent years be determined through the application of the adjustment formula. The Order contained no time limit and therefore continues in force until reviewed or varied by the Board.

c) The appellant did bear the burden of showing that the automatic adjustment mechanism should no longer apply.

51 The Board applied its automatic adjustment mechanism annually until 2001 when the appellant brought its fair rate of return application, seeking a review and variance of the 1995 decision and the adoption of a new means of determining its cost of capital.

52 The appellant's position seems to be that when it brought its fair rate of return application in 2001, the Board was required to disregard entirely the automatic adjustment mechanism and start fresh -- with a clean slate as it were -- to determine the appropriate method by which to estimate the Mainline's cost of capital.

53 However, the adjustment formula was part of an order that continued to bind the appellant. Subsection 23(1) of the National Energy Board Act provides:

> 23. (1) Except as provided in this Act, every decision or order of the Board is final and conclusive.
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> * * *
>
> 23. (1) Sauf exceptions prévues à la présente loi, les décisions ou ordonnances de l'Office sont définitives et sans appel.

Section 22 allows for appeals to the Federal Court of Appeal while subsection 21(1) allows the Board to review, vary and rescind its decisions and orders. Neither the Board's 1995 decision nor the order implementing it were appealed. The adjustment formula therefore continued to apply until the appellant demonstrated to the Board that it should be replaced.

54 The hearing conducted by the Board on the appellant's fair return application was extensive. Written evidence was filed and the oral hearing proceeded for more than a month. The Board's 2002 decision was 64 pages long. The Board considered the appellant's ATWACC proposal and its alternative increased rate of return on equity proposal, reviewed the evidence of the witnesses and ultimately concluded that utilization of the automatic adjustment formula continued to yield a rate of return on equity that the Board considered to be appropriate for the Mainline.

55 However, the Board did, to some extent, accept the appellant's argument that the Mainline's business risk had increased. In order to take account of the increased risk, the Board increased the equity component of the Mainline's deemed capital structure from 30% to 33% so that the capital structure would be 33% equity and 67% debt.

56 I can detect no fettering of discretion or the placing of an improper onus on the appellant in the Board's reasons. In its 1995 decision, the Board stated that its automatic adjustment formula was to reflect a simplified procedure to determine annual adjustments to pipeline rates of return on common equity. It was therefore to continue indefinitely. When an affected party wishes to change the process, it has the onus to demonstrate that its proposal is preferable to the one which is the subject of a binding Board order. That is not an improper onus. Nor does it reflect a fettering of discretion by the Board. Most importantly, it does not give rise to any apprehension of impartiality or bias on the part of the Board.

57 In reviewing the 2002 decision, the Review and Variance Panel found in its 2003 decision that the onus was on the appellant to demonstrate that the automatic adjustment formula was no longer appropriate and that the appellant had failed to do so:

> The Fair Return Application was, among other things, an application for review of the RH-2-94 Decision and related orders, pursuant to subsection 21(1) of the Act. The onus was on TransCanada to prove to the Board in RH-4-2001 that the RH-2-94 Formula was no longer appropriate for determining the Mainline's return on equity. Neither the intervenors nor the Board had the onus in the RH-4-2001 proceeding to justify the continued use of the Formula. The Formula was appropriate unless and until TransCanada persuaded the Board otherwise.
>
> TransCanada failed to meet the burden and accordingly, the RH-2-94 Formula continued to apply. The Board was not required in the RH-4-2001 Decision to justify that the Formula was appropriate; that determination was made in the RH-2-94 proceeding (RH-R-1-2002 at 24).

I find no error on the part of the Board in that analysis or conclusion.

d) The Board did not disregard or ignore evidence.

58 As to the appellant's argument that the Board disregarded evidence, I agree that the Board did not adopt the evidence of any particular witness for or against the appellant. But that does not mean that the evidence was discarded or ignored. In cost of capital proceedings, the Board is entitled, on the basis of the evidence before it and the use of its own judgment, to choose a methodology for determining cost of capital and to estimate the cost of capital for a forthcoming year. Very often, the Board's estimate will not reflect the precise estimates of one side or the other or of one witness or another. Having regard to all the evidence, the Board will determine its own estimate. As long as that estimate is within the range of estimates put forward in the evidence and the Board demonstrates that it considered the estimates put forward, the Board cannot be said to have ignored evidence. Indeed, even if the Board's estimate is outside that range, if the Board shows that it considered the evidence submitted and provides adequate reasons for its opinion, the Board will not be found to have ignored evidence.

59 In this case, the estimates in the evidence of the required rate of return on equity ranged from 8.28% to 12.50%. The Board's reasons indicate that it considered the estimates put forward. Using its automatic adjustment formula, the Board calculated that the required rate of return on equity for the Mainline would be 9.61% in 2001 and 9.53% in 2002. I cannot see that the Board disregarded or ignored evidence in deciding to continue to utilize the automatic adjustment formula to determine the required rate of return on equity for the Mainline.

CONCLUSION

60 I would dismiss this appeal with costs.

ROTHSTEIN J.A.
NOËL J.A.:— I agree
SHARLOW J.A.:— I agree

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