EB-2010-0018
Filed: August 10, 2011

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O.1998, c.15, Schedule B;

AND IN THE MATTER OF an Application by Natural Resource Gas Limited for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution and storage of gas commencing October 1, 2010

AND IN THE MATTER OF an Application by Natural Resource Gas Limited for an Order or Orders approving a multi-year incentive rate mechanism plan

SUBMISSIONS OF INTEGRATED GRAIN PROCESSORS CO-OPERATIVE INC. and IGPC ETHANOL INC.

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ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O.1998, c.15, Schedule B;

AND IN THE MATTER OF an Application by Natural Resource Gas Limited for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution and storage of gas commencing October 1, 2010

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SUBMISSIONS OF INTEGRATED GRAIN PROCESSORS CO-OPERATIVE INC. AND IGPC ETHANOL INC. IN RESPECT OF MOTION

1. IGPC Ethanol Inc. and Integrated Grain Processors Co-operative ("**IGPC**") are making submissions pursuant to Procedural Order No. 7 which provide the opportunity for Parties to make submissions as to whether the issues raised in the Motion are within the jurisdiction of the Board. Procedural Order No. 7 further provided that a Party may rely upon the materials filed in response to Procedural Order No. 5 by advising the Board. IGPC repeats and relies upon its submissions, written and oral, made in response to Procedural Order No. 5. These submissions are in addition and supplement the previous submissions.

2. The fundamental issue is whether the Board has the authority to determine the rate a utility can charge for the expansion of its distribution system to provide distribution services to a ratepayer. Natural Resource Gas Ltd. ("**NRG**") charged IGPC rates that were a combination of a contribution in aid of construction and periodic monthly payments. The manner of calculating such rates and the obligations of NRG and IGPC were provided in the Pipeline Cost Recovery Agreement (the "**PCRA**") and the Gas Delivery Contract (the "**GDC**") which were reviewed and approved by the Board as part of the granting of leave for the construction of the IGPC Pipeline. Absent the authorization of the Board, NRG had no ability to charge IGPC any rate or to construct the IGPC Pipeline.

3. Therefore, it is IGPC's position that the Board does have the jurisdiction to determine the issues raised in the Motion. Further, IGPC would submit that the jurisdictional argument is a collateral attack on the Board's order granting NRG leave to construct in EB-2006-0243 and the Board's authority regarding the distribution of natural gas and setting charges pursuant to the Board's authority under section 36 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Schedule B (the "**OEB Act**").

4. IGPC would note that the Motion deals with issues related to the PCRA, the GDC and the Bundled T Service Receipt Contract (the "**Bundled T**"). The analysis of the Board's jurisdiction will depend upon the agreement and the specific nature of the issue in dispute.

Board's Jurisdiction - Generally

5. The legislative framework provided by the OEB Act creates a comprehensive authority to establish regulatory oversight of the distribution of natural gas in Ontario with the Board. Pursuant to section 19(6) of the OEB Act, the Board has exclusive authority over matters within its jurisdiction.

6. The authority provided by section 36 of the OEB Act obligates the Board to establish rates, as that term is defined in the OEB Act, which are just and reasonable which the utility is permitted to charge to ratepayers. Further, the OEB Act requires the fulfillment of this mandate to be completed in the public interest and consistent with the statutory objectives provided in section 2 of the OEB Act.

7. Section 3 of the OEB Act includes the following definition: "*"rate" means a rate, charge or other consideration and includes a penalty for late payment;".* This is an expansive definition that goes beyond periodic monthly payments and includes a contribution in aid of construction.

8. Section 36 of the OEB Act provides the Board with the authority to establish the rates a utility may charge for the distribution of natural gas.

> 36. (1) No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract.
>
> (2) The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas.
>
> (3) In approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate.

9. Pursuant to section 36(1) of the OEB Act, NRG is statutorily prohibited from charging a customer except in accordance with an order of the Board. This includes any charge, whether by way of a contribution in aid of construction or the ongoing monthly payments calculated in accordance with a rate order.

10. Pursuant to the authority granted by the OEB Act, the Board has developed a process for utilities to charge customers where a capital expenditure is required by the utility for the distribution of natural gas. This process contemplates the potential for a one-time payment, a

contribution in aid of construction, combined with a series of periodic payments determined in the current and future rate orders. The calculation of the contribution in aid of construction is performed in accordance with EBO 188.

11. Section 2 of the OEB Act provides the Board's objectives in carrying out this mandate.

> 2. The Board, in carrying out its responsibilities under this or any other Act in relation to gas, shall be guided by the following objectives:
> 1. To facilitate competition in the sale of gas to users.
> 2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service.
> 3. To facilitate rational expansion of transmission and distribution systems.
> 4. To facilitate rational development and safe operation of gas storage.

12. This mandate expressly includes the protection of the interests of consumers. IGPC is NRG's largest consumer.

13. It is commonly understood that utilities have the ability to exercise monopoly power and that the regulatory framework is intended ensure that such power is not abused. A utility cannot escape regulatory oversight and charge rates that are not just and reasonable by forcing a customer to pay a contribution in aid of construction relating to unreasonable and imprudently incurred costs.

14. In general, the Board has obligated utilities that required an expansion of the distribution system to perform an economic analysis in accordance with a prescribed approach. This approach was developed in EBO 188.

15. The prescribed formula in EBO 188 is essentially a comparison of the net present value of the revenue from a project against the net present value of the capital expenditures and incremental operation and maintenance ("**O&M**") costs associated with a project.

16. The utility projects a future revenue stream based upon the applicable currently approved monthly charges. Where the overall profitability index of the project is greater than 1.0, the projected revenues from the monthly charges over the forecast horizon are greater than the forecasted costs, capital and incremental O&M, of the utility. EBO 188 permits the utility to proceed with the project without any requirement to charge a rate in the form of a contribution in aid of construction.

17. However, where the forecasted revenue stream does not exceed the forecasted capital and incremental O&M expenditures, the profitability index is less than 1.0. In such situations EBO 188 obligates the utility to charge a rate in the form a contribution in aid of construction in addition to the periodic monthly charges.

18. The authorized contribution in aid of construction is not an arbitrary figure but rather a payment, or series of payments, to the utility to ensure the profitability index is equal to 1.0. It does not authorize the utility to charge a contribution in aid of construction that results in the profitability index exceeding 1.0. This ensures the financial framework results in just and reasonable rates for the utility and the customer.

19. In the present situation, the Board reviewed the profitability index during EB-2006-0243, and noted that absent a contribution in aid of construction, the profitability index for the project was 0.55.[1]

20. The terms and conditions of the PCRA provided the detailed commitments between the parties, IGPC and NRG, regarding the manner in which rates were to be charged and payments would be made. This would ensure NRG would achieve a profitability index of 1.0. IGPC made

[1] EB-2006-0243, Decision and Order, dated February 2, 2007, page 2.

a series of payments totalling $3,538,792.47 as a contribution in aid of construction based upon the forecasted costs of NRG to bring the profitability index to 1.0.

21. To ensure NRG did not over-recover, and thereby charge rates that are not just and reasonable and outside the statutory obligation, the Board required NRG to perform a reconciliation based upon the actual capital expenditures required for the construction of the IGPC Pipeline. Conversely, if the costs had exceeded the forecast, the Board would have expected and required NRG collect such additional monies to drive the profitability index to 1.0. The requirement for a reconciliation is expressly provided in the PCRA which was reviewed by the Board and found to be in the public interest.

22. In reviewing the actual expenditures of NRG, IGPC submits that certain of the expenditures claimed by NRG were imprudent and unreasonable. Therefore, the rate charged by NRG should not be permitted to include such expenditures.

23. IGPC submits that the rate paid in the form of a contribution in aid of construction is excessive as certain costs were unreasonable and imprudently incurred. As such, IGPC is owed a refund by NRG.

Board's Jurisdiction – Leave to Construct and Just and Reasonable Rates

24. The objectives of the OEB Act also include the facilitation of the rational expansion of the distribution system. Where an expansion is of a nature within the requirements of section 90 (see below) of the OEB Act, the utility must come before the Board, seek and obtain leave to construct.

> **90.** (1) No person shall construct a hydrocarbon line without first obtaining from the Board an order granting leave to construct the hydrocarbon line if,
> (a) the proposed hydrocarbon line is more than 20 kilometres in length;

> (b) the proposed hydrocarbon line is projected to cost more than the amount prescribed by the regulations;
> (c) any part of the proposed hydrocarbon line,
> (i) uses pipe that has a nominal pipe size of 12 inches or more, and
> (ii) has an operating pressure of 2,000 kilopascals or more; or
> (d) criteria prescribed by the regulations are met.

25. If a hydrocarbon line meets any of the requirements of section 90, a utility must apply to the Board for leave to construct. The IGPC Pipeline met several of the 90 criteria it is a 28.5km NPS 6 steel pipeline which cost in excess of $2,000,000 (the amount prescribed by regulation). As such, NRG was statutorily barred by section 90 of the OEB Act from constructing the IGPC Pipeline without an order of the Board granting leave to construct.

26. Section 96 of the OEB Act

> **96.** (1) If, after considering an application under section 90, 91 or 92 the Board is of the opinion that the construction, expansion or reinforcement of the proposed work is in the public interest, it shall make an order granting leave to carry out the work.

27. The Board is obligated to grant leave where it determines the proposed work is in the public interest. Part of the fulfillment of the public interest is ensuring the economic bargain between the utility and the customer results in just and reasonable rates.

28. In EB-2006-0243 the Board relied upon the terms and conditions contained in the PCRA and the GDC to ensure the statutory requirement to serve the public interest was fulfilled. The Board Findings were as follows:

> The Board is satisfied that the terms and conditions of the two agreements, the GDC and the PCRA, adequately protect the interests of NRG and its ratepayers against anticipated risks. In making its finding to grant the requested leave to construct, the Board is placing significant reliance on the terms and conditions of both the PCRA and GDC that protect the interest of NRG's ratepayers.

> The Board finds that the Proposed Facilities are in the public interest and grants the requested leave to construct. The Board notes this is a significant expansion of NRG's facilities and will increase its rate base by approximately 50%.[2]

29. But for the contractual commitments in the PCRA and the GDC which ensure a profitability index of 1.0 in respect of the IGPC Pipeline, the Board would not have found the proposed work was in the public interest.

30. NRG would not have been granted the authority to charge and collect the contribution in aid of construction or the authority to construct the IGPC Pipeline. As such, the amount of the contribution in aid of construction, or the Actual Aid-to-Construct as that term is used in the PCRA, is within the Board jurisdiction to ensure "rates" are just and reasonable.

31. The Board, in EB-2006-0243 then went on to impose a series of conditions in granting leave which included the following:

> **IT IS THEREFORE ORDERED THAT**:
>
> .....
>
> 2. The granting of leave is subject to the Conditions of Approval set forth in Appendix "B".
>
> **Appendix B**
>
> 5.2 NRG shall not, without the prior approval of the Board, consent to any alteration or amendment to the Gas Delivery Contract or the Pipeline Cost Recovery Agreement as those agreements were executed on January 31, 2007, where such alteration or amendment has or may have any material impact on NRG's ratepayers.

32. The Board's EB-2006-0243 Decision and Order clearly asserts jurisdiction over the PCRA and GDC and the ability to amend the agreements. There was no suggestion that the Board lacked the jurisdiction to impose such a condition. Condition 5.2 is intimately linked to the

[2] EB-2006-0243, Decision and Order, dated February 2, 2007, page. 4.

conditions for the sale and distribution of natural gas and the assurance the public interest will be satisfied.

33. NRG could not, without the approval of the Board, modify the PCRA to remove the obligation to complete a reconciliation based upon actual reasonable capital costs of the IGPC Pipeline as to do so would place NRG and its ratepayers at risk if such actual costs incurred exceeded the forecasted amount.

34. As such the fulfillment of the Board's mandate to ensure rates are just and reasonable and that the public interest is fulfilled necessitated that IGPC and NRG abided by the terms of the PCRA and GDC. NRG has failed to abide by such terms.

35. The Board's order in EB-2006-0243 established the legal obligations for the determination of payments between NRG and IGPC and these obligations are contained in the terms and conditions of the PCRA and the GDC. These terms and conditions included the obligation to comply with EBO 188 and the Board's authority to establish just and reasonable rates pursuant to section 36 of the OEB Act.

36. As such, the Board's jurisdiction to enforce the payment obligations contained in the PCRA and GDC is based upon its authority to ensure a gas distributor only charges in accordance with a Board order and that such charges or rates are just and reasonable.

37. In the present situation IGPC submits that NRG has failed to comply with the Board's order in respect of the charges authorized by the Board pursuant to the Board's order.

Incorporating Capital Expenditures into Rates: EB-2010-0018

38. In the Board's Decision and Order (the "**Decision**") dated December 6, 2010 the Board established the basis for NRG's monthly charges or rates for all of its customers, including IGPC. In that Decision, the Board approved the inclusion of a level of capital expenditures related to the IGPC Pipeline in the Rate Base of Natural Resource Gas Ltd. ("**NRG**").

39. In setting rates in EB-2010-0018, the Board did not determine the total prudent or reasonable capital cost of the IGPC pipeline.

40. The Board took the approach that the amount that could be incorporated into the monthly rates was the discounted revenue created by the project. During oral submissions, the Board panel indicated that the approach used by the Board in the statement of Panel Member Quesnelle.

> MR. QUESNELLE: From a rates perspective, you know, there is a formula in place. Establishment from a rates perspective, recognizing there might be some slight differences depending on what -- the depreciation, and what have you, but from an order of the process, the determination of what would be going into rate base would be what can be paid for with the revenue stream.[3]

41. IGPC did not suggest the prudently incurred reasonable costs of NRG were less than the revenue stream. As such, the Board could take the approach that the capital expended in a prudent manner by NRG exceeded the revenue stream. The Board then used the revenue stream to determine the amounts to be included in the monthly rates that NRG would be authorized to charge. Had the allegations of imprudence been such that the revenue stream

[3] EB-2010-0018, Transcript, Sept. 7, 2010, page 97, ll. 15-20.

exceeded the prudently incurred costs the Board would have been obligated to determine the total actual prudently incurred costs.

42. However, this left the rate charged by way of a contribution in aid of construction to be determined later.

43. Utilities are not permitted to recover imprudent expenditures. In *Enbridge Gas Distribution Inc. v. Ontario Energy Board*, 2005 CanLII 4941 (ON SCDC), the Court made these statements about the prudence standard to which utilities are held:

> [8] Essentially, a utility is entitled to recover its prudently incurred costs. The test of prudence was first developed in United States jurisprudence, but has since been widely accepted in Canada: *State of Missouri ex. rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923) at 289; *British Columbia Electric Railway Co. Ltd. v. British Columbia (Utilities Commission)*, 1960 CanLII 44 (S.C.C.), [1960] S.C.R. 837 at 854; *Transcanada Pipelines Ltd. v. Canada (National Energy Board)*, [2004] F.C.J. No. 654 (C.A.) at para. 32; *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No.1)*, 294 U.S. 63 (1935) at 68.
>
> [9] Before us, and likewise before the Board, there was no dispute between the parties as to the applicability of the prudence standard and the nature of the test. Expenditures are deemed to be prudent, in the absence of some evidence suggesting the contrary. However, costs that are found to be dishonestly incurred, or which are negligent or wasteful losses, are excluded from the legitimate operating costs of the utility in determining rates that may be charged.

44. IGPC raised legitimate questions regarding the prudence of certain expenditures including the administrative penalty, legal costs, costs associated with Mr. Bristoll and interest charges.

45. For example, the interest claimed by NRG was originally approximately $190,000 but contained several errors which were acknowledged by NRG during cross-examination. Also, the Administrative Penalty was waived subsequently to the Board's Decision in EB-2010-0018.

As such there would be no basis for including the $140,000 cost in the rate to be charged by NRG.

46. Further, NRG was claiming more than $130,000 for contingencies yet had no intention of actually ever incurring any such costs. IGPC is not aware of any situation where a utility is permitted to claim and recover through rates costs that were never and will never be incurred. Furthermore, the concept of "*prudently incurred costs*" entails that the cost to be recovered have actually been "incurred". NRG seeks to recover in its contribution in aid of construction amounts that NRG admits were not actually incurred.

47. IGPC is not suggesting that a contribution in the aid of construction was not required. IGPC is stating that the contribution in aid of construction that was charged and collected was excessive, contravened the PCRA, the Board's order and section 36 of the OEB Act. The total capital costs claimed by NRG were not prudently incurred and the Board should not authorize NRG to retain such amounts.

48. The rate charged by NRG is a combination of the contribution in aid of construction and the monthly payments made pursuant to the applicable rate orders.

49. To claim the Board only retained jurisdiction to review certain of the expenditures up to the revenue stream is illogical and inconsistent with the Board's statutory authority to set just and reasonable rates.

50. The fact that the rate charge was in the form of a capital contribution does not cause the Board to lose its jurisdiction to review the prudence of such capital expenditures. IGPC is effectively requesting the capital expenditures of NRG in respect of the IGPC Pipeline be reviewed by the Board.

51. To say the Board loses its jurisdiction to review expenditures and enforce the determination of the contribution in aid of construction is inconsistent with the Board's authority under section 36 and the fulfillment of the Board's statutory objective of protecting consumers. It effectively says that the Board's statutory objective is restricted to the protection of NRG's other customers, who would be affected if an excess amount were allowed to go into rate base, but does not extend the protection to IGPC, the new customer, with respect to charges from NRG.

Collateral Attack

52. In EB-2006-0243 the Board required NRG and IGPC to submit the PCRA and the GDC prior to making a determination as to whether leave to construct the IGPC Pipeline was in the public interest. The financial terms and conditions for the expansion of the natural gas pipeline network and the delivery of natural gas by NRG to IGPC were of the utmost importance for the Board to ensure the public interest was served.

53. It is IGPC's position that the obligation to adhere to the contractual commitments in the PCRA and GDC were part of the Board's order in EB-2006-0243.

54. Compliance with an order of the Board is squarely within the Board's jurisdiction. The suggestion the Board lacks jurisdiction is a collateral attack on the Board's order in EB-2006-0243 that incorporated adherence to the PCRA and the Board's jurisdiction in authorizing rates that may be charged by a utility pursuant to section 36 of the OEB Act.

55. Section 3 of the OEB Act includes the following definition:

> "enforceable provision" means,
> (a) a provision of this Act or the regulations,.....

(h) a provision of an order of the Board,

56. Part VII.1 of the OEB Act provides the Board with the authority to takes steps to remedy the contravention, or potential contravention of an enforceable provision. Section 112.3 provides the Board with the authority to remedy the contravention.

> **112.3** (1) If the Board is satisfied that a person has contravened or is likely to contravene an enforceable provision, the Board may make an order requiring the person to comply with the enforceable provision and to take such action as the Board may specify to,
> (a) remedy a contravention that has occurred; or
> (b) prevent a contravention or further contravention of the enforceable provision.

57. In the present situation, IGPC submits NRG has failed to fulfill the requirements for the charges it was authorized to impose and has thereby contravened an enforceable provision within the meaning of the OEB Act.

58. The statute places the subject matter, the rate charged, within the jurisdiction of the Board.

Response to Board Staff's Submissions

59. IGPC has reviewed the submission of Board Staff and respectfully submits that Board Staff have failed to frame the issue properly. The issue is whether the subject matter in dispute, the rate charged by NRG, is within the Board's jurisdiction and whether ensuring compliance with an order of the Board is within the Board's jurisdiction. The PCRA and GDC are the contractual implementation to ensure rates are just and reasonable.

60. Board Staff's position would also result in a fluid jurisdiction dependent upon the assumptions of the utility in performing the economic analysis rather than a principled review of the nature of the issue. Further, Board Staff have ignored the fact that the Motion dealt with

issues other than the capital cost of the IGPC Pipeline and ignores the sequence of events in EB-2006-0243.

a) EB-2006-0243 Board Reviews Draft PCRA and GDC

61. EB-2006-0243 Procedural Order No. 2 required NRG to file draft PCRA and GDC agreements which was completed on December 20, 2006 more than a month prior to the Board's review of the executed agreements and Decision and Order. It is clear that the Board did have the opportunity to review draft PCRA and GDC agreements. The Board expressly reviewed the obligations and placed reliance on such contractual obligations to find the proposal was in the public interest. It is clear that absent concluded agreements between NRG and IGPC leave would not have been granted by the Board. To suggest the Board was not aware of the terms contained in the PCRA and the GDC is incorrect.

b) Board's Authority to Review Capital Expenditures

62. Accepting the Board Staff's position would effectively mean that the Board loses authority to review the capital expenditures where the consumer pays a rate in the form of a contribution in aid of construction.

63. If the facts were slightly different the Board would have to determine the total capital cost of the pipeline as part of the rate case. Suppose the Profitability Index exceeded 1.0. In such a situation, the total capital expenditure would be reviewed for the purpose of determining the amount to be included in rate base. If NRG sought to include unreasonable or imprudently incurred costs, the Board would exclude such unreasonable or imprudent costs from the rate base.

64. There would be no dispute that the Board had the jurisdiction to make such a finding. The Board does not lose this jurisdiction to review the prudency of the utility's costs merely because the profitability index is greater than 1.0.

65. Clearly, the Board Staff's position would alter the Board's jurisdiction depending upon the level of capital spending in respect of a project and the forecasted revenue stream. The Board's jurisdiction is based upon the provisions of the OEB Act and a principled approach to their application.

66. The Board's jurisdiction is found in its authorization of rates as set out in section 36 of the OEB Act, whether in the form of a contribution in aid of construction or in the form of monthly charges.

67. Another concern is that Board Staff's position is discriminatory in that it permits consumers who did not pay a contribution in aid of construction to be able to review all capital expenditures related to their project whereas consumers that paid a contribution in aid of construction consumers can only review certain expenditures up to the revenue stream.

68. If one were to accept Board Staff's position, there would be two classifications of consumers created those charged monthly and those charged monthly plus an upfront contribution in aid of construction. Such a double standard is not intended by the OEB Act.

69. IGPC would note that Article IX of the PCRA, provides that the parties will attempt to resolve the dispute and may resort to the Board where they are unable to come to a mutual acceptable resolution. This is not the appointment of an arbitrator but rather a recognition of the role of the Board as the industry regulator.

c) Issues not Related to the Capital Cost of the IGPC Pipeline

70. Board Staff's submission completely ignores the fact the improper nomination pertained to the Bundled T which NRG is obligated by the rate order to have entered with IGPC. The basis for the issue and claim was covered in paragraphs 24 to 29 of the Motion.

71. As a result of the Board's order in response to the Motion in 2008 IGPC has provided financial assurance to Union Gas. In addition, IGPC has provided financial assurance to NRG in accordance with the terms of the GDC. IGPC would note that NRG has not reflected the new lower Rate 6 in the calculation of the security required. The continued provision of additional security to Union Gas Ltd. effectively means that IGPC is has provided excess protection to NRG as any obligation in respect of deliveries to IGPC is secured directly by IGPC to Union Gas.

72. The obligation and amount of financial assurance to be provided is within the Board's jurisdiction. The Motion dealt with the excessive security in paragraphs 30 to 32.

Concluding Submissions

73. The jurisdiction for the Board is found in the rates charged by NRG to IGPC pursuant to the provisions of the OEB Act as embodied in the PCRA and the GDC. The issues are properly before the Board and IGPC requests the Board proceed to review the Motion on its merits.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

August 10, 2011

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Lawyers for the Moving Parties Integrated Grain Processors Co-operative Inc. and IGPC Ethanol Inc.

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TAB A

Enbridge Gas Distribution Inc. v. Ontario Energy Board

FILE NO.: 40/03
DATE: 20050302

2005 CanLII 4941 (ON SCDC)

ONTARIO

SUPERIOR COURT OF JUSTICE
DIVISIONAL COURT

LANE, MOLLOY and POWER JJ.

B E T W E E N:	)	
	)	
ENBRIDGE GAS DISTRIBUTION INC.	)	*J. L. McDougall Q.C., Jerry H. Farrell*, and *Michael Schafler*, for the Appellant
	)	
Appellant	)	
	)	
- and -	)	
	)	
ONTARIO ENERGY BOARD	)	*Kenneth T. Rosenberg* and *Richard P. Stephenson*, for the Respondent
	)	
Respondent	)	
	)	
	)	**HEARD:** February 15, 2005

MOLLOY J.:

REASONS FOR DECISION

A. INTRODUCTION

[1] Enbridge Gas Distribution ("Enbridge") appeals from a decision of the Ontario Energy Board ("the OEB" or "the Board") dated December 18, 2002.

[2] Enbridge is a gas distributor and a seller of gas to consumers, and as such is subject to regulation by the OEB under the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 ("the Act"). The rates Enbridge is permitted to charge to its customers are fixed by the OEB, based on what the OEB deems to be just and reasonable. The OEB must balance fairness to the consumer (in terms of a reasonable price for gas) and fairness to Enbridge and its shareholders (in terms of a

reasonable rate of compensation and profit). Generally speaking, Enbridge would be permitted by the OEB to pass on its costs to the consumer, but only to the extent those costs were prudently incurred.

2005 CanLII 4941 (ON SCDC)

[3] Prior to 1996, Enbridge shipped its gas through the TransCanada Pipeline System ("the Trans Canada"). Between 1996 and 1999, Enbridge entered into a series of four agreements with various entities to deliver some of its gas through alternate pipeline routes. These new routes became operational in 2000 and proved to be more costly than the TransCanada route. In mid-2000, Enbridge applied to the OEB for an increase in the rates it could charge to its customers in 2001 in order to reflect this increase in its supply costs. (The OEB referred to the four agreements as Alliance 1, Alliance 2, Vector 1 and Vector 2, and for ease of reference I will do the same.)

[4] The parties entered into a provisional settlement in 2000, which was conditional upon various contentious issues being deferred to be argued at a subsequent Enbridge rates hearing. As a term of the settlement, Enbridge agreed to set up a "Notional Deferral Account" to record, over a ten-month period, the differential between its actual costs for the Alliance/Vector lines and its hypothetical costs if it had used the TransCanada line.

[5] The next year, Enbridge applied for approval of its rates proposed for 2002. One of the contentious issues still remaining to be resolved was whether the costs incurred by Enbridge with respect to the Alliance and Vector lines were "prudently incurred". That issue proceeded to a full hearing before the Board in June 2002.

[6] The Board issued its decision on December 18, 2002. The Board found that Enbridge did not act prudently in incurring the Alliance 1 and Alliance 2 costs and was therefore not permitted to build those costs into the rates it charged. The Board found, however, that the Vector 1 costs were prudently incurred and could be passed on. The Board deferred its consideration of the Vector 2 costs. In the result, Enbridge was not permitted to recover $11 million in costs incurred in respect of Alliance 1 and 2.

[7] The Act provides for an appeal to this court from the decision of the Board, but "only upon a question of law or jurisdiction": s. 33 (1) and (2). Enbridge argues on this appeal that the Board erred in law by failing to apply the correct legal test in determining whether Enbridge acted prudently at the time it entered into the two Alliance agreements. Specifically, Enbridge submits that although the Board articulated the correct legal test, it fell into error when it was influenced by the benefit of hindsight rather than confining itself to a consideration of prudence based solely on circumstances that existed at the time the decisions in question were made.

B. THE PRUDENCE STANDARD

[8] Essentially, a utility is entitled to recover its prudently incurred costs. The test of prudence was first developed in United States jurisprudence, but has since been widely accepted in Canada: *State of Missouri ex. rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923) at 289; *British Columbia Electric Railway Co.*

Ltd. v. British Columbia (Utilities Commission), [1960] S.C.R. 837 at 854; *Transcanada Pipelines Ltd. v. Canada (National Energy Board)*, [2004] F.C.J. No. 654 (C.A.) at para. 32; *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No.1)*, 294 U.S. 63 (1935) at 68.

2005 CanLII 4941 (ON SCDC)

[9] Before us, and likewise before the Board, there was no dispute between the parties as to the applicability of the prudence standard and the nature of the test. Expenditures are deemed to be prudent, in the absence of some evidence suggesting the contrary. However, costs that are found to be dishonestly incurred, or which are negligent or wasteful losses, are excluded from the legitimate operating costs of the utility in determining rates that may be charged. The examination of whether an expenditure was prudent must be based on the particular circumstances at the time the decision to incur those costs was made. That is so even if in hindsight it is obvious the decision was a bad one. As was stated by the United States Court of Appeals (First Circuit) in *Violet v. FERC*, 800 F. 2d 280 at 282 (1st Cir. 1986):

> In an industry that combines long lead times for plant construction with wide fluctuations in supply and demand, constant changes in the regulatory environment, and unpredictability in the availability and price of alternative sources of fuel, some projects that seem prudent at the time when costs are incurred may appear, some years later, in hindsight, to have been unnecessary or inadvisable. The prudence of the investment must be judged by what a utility's management knew, or could have known, at the time the costs were incurred. (citations omitted)

[10] The parties also agree that the Board in this case correctly defined the prudence standard at paragraph 3.12.2 of its decision as follows:

- 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 based on facts about the elements that could or did enter into the decision at the time.

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C. THE DECISION OF THE BOARD

[11] The Reasons of the Board are extensive, covering 216 pages. For purposes of this appeal, it is unnecessary to review those Reasons in detail, as there is no real issue with respect to the facts. The portion of the Reasons dealing with the Alliance/Vector issues runs from pages 27-72. However, the actual findings of the Board commence at page 62. First, the prudence test is defined (see preceding paragraph). Next, the Board examined the presumption of prudence and whether it was rebutted. The Board noted the argument made by Enbridge that it was unnecessary to consider this aspect of the test as Enbridge conceded a prudence review was appropriate. However, the Board determined that it would nevertheless be useful to actually rule on the point.

[12] There was evidence before the Board that Enbridge's corporate parent, Enbridge Inc., held an equity interest in both the Alliance and Vector pipelines at the time Enbridge entered into the agreements in question. The Board found that the fact Enbridge Inc. may have profited as a result of Enbridge entering into these contracts was not sufficient evidence to establish that the arrangements were not therefore prudent. However, the Board noted that the interests of Enbridge Inc. and Enbridge might not completely coincide and found the evidence of this ownership interest was "sufficient to overcome the presumption of prudence and invite further inquiry by the Board": paragraph 3.12.11 of the Reasons.

[13] The Board noted that it is permissible to use hindsight in determining the threshold issue as to whether the presumption of prudence is rebutted. In this regard, the Board considered the balance in the Notional Deferral Account, which favoured the traditional TransCanada pipeline, and held this evidence would suggest that the prudence of Enbridge's decisions to use the Alliance and Vector routes should be examined.

[14] The Board then concluded (at paragraph 3.12.13) that "the presumption of prudence has been overcome and that there are reasonable grounds to inquire into the prudence of [Enbridge's] decisions to enter into long term transportation arrangements with the Alliance and Vector pipelines."

[15] The Board then proceeded (from pages 65 to 69) to consider whether Enbridge made prudent decisions to enter into each of the four contracts, examining the circumstances of each decision under a separate subject heading. At this point, the onus would be on Enbridge to establish its prudence in entering into each of the four contracts.

[16] Under the heading "Alliance 1" (paragraphs 3.12.14 to 3.12.21), the Board considered the justifications advanced by Enbridge for its decision in 1996 to enter into this contract. The Board focused on what was referred to as the "Otsason Memo", based on Enbridge's testimony that the memo summarized all of the factors Enbridge took into account in making this decision. The Board described the Otsason Memo as a "rudimentary financial analysis". The Board then took issue with a number of conclusions in the Otsason Memo (the content of which is not

relevant for purposes of this appeal) as well as noting Enbridge's failure to consider the full range of reasonable alternatives. The Board then concluded (at paragraph 3.12.23) that it was "not satisfied that [Enbridge's] decision to enter into the Alliance 1 contract in 1996 was prudent".

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[17] For purposes of this appeal, Enbridge does not take issue with this portion of the Board's Reasons in respect of Alliance 1, except for the Board's reference in paragraph 3.12.20 to the fact that a risk identified in the Ostason Memo had in fact materialized. Mr. McDougall, for Enbridge, submits that this reference illustrates error by the Board in using hindsight to evaluate prudence. The relevant paragraph of the Reasons states:

> 3.12.20 One of the disadvantages identified in the Ostason Memo was the risk of in-service delays for the Alliance pipeline. This risk in fact materialized; the in-service date was delayed by over one year from November 1999 to December 2000. (emphasis added)

[18] Under the heading "Alliance 2", the Board held that all of its concerns with respect to Alliance 1 were equally applicable to the 1997 decision to enter into the Alliance 2 contract, and also noted two additional concerns. The Board then concluded (at paragraph 3.12.27) that it was not satisfied that Enbridge's 1997 decision to enter into the Alliance 2 contract was prudent.

[19] The Board next considered Vector 1 (paragraphs 3.12.28 to 3.12.31) and concluded that Enbridge's decision to enter into that contract in 1999 was in fact prudent.

[20] The last portion of the Board's consideration of prudence falls under the heading "Vector 2" (paragraphs 3.12.32 to 3.12.33). The Board started by noting that Enbridge had "advised" the Board that it entered into the Vector 2 contract in order to replace its expiring capacity on the TransCanada pipeline. The Board then found (at paragraph 3.12.32) that Enbridge "did not provide the Board with sufficient evidence and analysis, including alternatives, to justify this decision." The Board noted that the Vector 2 decision was independent from and unrelated to the Alliance 1 and 2 and Vector 1 contracts. The Board then stated, at paragraphs 3.12.33 to 3.12.34:

> 3.12.33 .... In addition, the Board notes that the costs consequences of the Vector 2 contract were not included in the calculation of the Notional Deferral Account, which is a key element of the Board's prudence review of the Alliance and Vector arrangements. (emphasis added)
>
> 3.12.34 As a result, the Board is not prepared at this time to make a determination of the prudence of [Enbridge's] decision to enter into the Vector 2 contract.

[21] Mr. McDougall relies on this passage as a further illustration of the Board's improper use of hindsight in evaluating prudence.

[22] The balance of the Board's decision on Alliance and Vector is devoted to "Relief and Remedies" at pages 70-71 of the Reasons and is not relevant for purposes of this appeal.

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D. STANDARD OF REVIEW

[23] It is well recognized that the applicable standard of appellate review is to be determined on a "functional and pragmatic approach" based on consideration of four factors: (1) the existence or absence of a privative clause in the enabling statute of the administrative tribunal; (2) the expertise of the tribunal relative to the court; (3) the purpose of the legislation; and (4) the nature of the problem: *Pushpanathan v. Canada (Minister of Citizenship and Immigration)* (1998), 160 D.L.R. (4th) 193 (S.C.C.) at 208-215; *Ryan v. Law Society of New Brunswick* (2003), 223 D.L.R. (4th) 577 (S.C.C.) at 587-592, paras. 27-42; *Dr. Q. v. College of Physicians & Surgeons (British Columbia)* (2003), 223 D.L.R. (4th) 599 (S.C.C.) at 609-13.

[24] In this case, the expertise of the tribunal in regulatory matters is unquestioned. This is a highly specialized and technical area of expertise. It is also recognized that the legislation involves economic regulation of energy resources, including setting prices for energy which are fair to the distributors and suppliers, while at the same time are a reasonable cost for the consumer to pay. This will frequently engage the balancing of competing interests, as well as consideration of broad public policy. That is why courts have accorded considerable deference to the Board and applied standards of reasonableness *simpliciter*, or even patent unreasonableness when reviewing decisions which engage the Board's expertise: *Consumer's Gas Co. v. Ontario (Energy Board)*, [2001] O.J. No. 5024 (Div.Ct.); *Graywood Investments Limited v. Ontario (Energy Board)*, [2005] O.J. No. 345; *ATCO Electric Ltd. v. Alberta (Energy and Utilities Board)*, [2004] A.J. No. 823 ("ATCO No. 1") (C.A.); *ATCO Electric Ltd. v. Alberta (Energy and Utilities Board)*, [2004] A.J. No. 906 ("ATCO No.2") (C.A.).

[25] However, the case before us involves a pure question of law. There is an appeal as of right to this court on a question of law, and there is no applicable privative clause. Further, the nature of the legal issue involved does not engage the expertise of the tribunal, *vis a vis* the court. The test is well understood and was correctly defined by the Board. The only issue is whether, in applying that test, the Board took into account an impermissible factor. That is not a situation of mixed fact and law, but rather an alleged error in applying the correct legal test. In *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 at paragraph 27, the Supreme Court of Canada (referring to its own earlier decision in *Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748) held as follows:

> 27 Once it has been determined that a matter being reviewed involves the application of a legal standard to a set of facts, and is thus a question of mixed fact and law, then the appropriate standard of review must be determined and applied. Given the different standards of review applicable to questions of law and questions of fact, it is often difficult to determine what the applicable standard of review is. In Southam, supra, at para. 39, this Court illustrated how an error on

a question of mixed fact and law can amount to a pure error of law subject to the correctness standard:

> . . . if a decision-maker says that the correct test requires him or her to consider A, B, C, and D, but in fact the decision-maker considers only A, B, and C, then the outcome is as if he or she had applied a law that required consideration of only A, B, and C. If the correct test requires him or her to consider D as well, then the decision-maker has in effect applied the wrong law, and so has made an error of law.
>
> Therefore, what appears to be a question of mixed fact and law, upon further reflection, can actually be an error of pure law.

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[26] The Supreme Court's illustration applies equally well in the reverse. If the correct test requires the consideration of A, B and C and prohibits the consideration of D, and the decision-maker considers D, that is an error of pure law.

[27] Given the right of appeal and the nature of the issue, in my opinion, the appropriate standard of review in this case is one of correctness. The Board was required to be correct on this point. If, in considering prudence, the Board took into account factors involving the application of hindsight, then it has committed legal error and its decision cannot stand.

E. ANALYSIS

[28] It is important to distinguish between things that can be considered at the stage of deciding if the presumption of prudence is rebutted, and things that can be considered as part of the prudence analysis itself. In considering the application of the presumption, it is acceptable to use the benefit of hindsight. Thus, a decision which turned out to have a bad economic outcome will not be presumed to be prudent, but rather will be subject to an analysis of the surrounding circumstances to determine if it was in fact prudent. In this case, the Board had before it evidence from the Notional Deferral Account as to the extra cost incurred by Enbridge as a result of the Alliance and Vector contracts, over and above what would have been the cost if the TransCanada pipeline had been used. The Board was entitled to use that information in determining the threshold issue as to whether the presumption of prudence was rebutted. It was not entitled to use the information as part of its analysis as to whether the decisions at issue were, or were not, prudent at the time they were made.

[29] The Board in this case was well aware of that distinction. The Board held, at paragraph 3.12.36 of its decision:

> 3.12.36 The Notional Deferral Account was intended as a measure to ascertain whether the cost differential between the old and the new paths was substantial, such that it would raise the issue of whether the presumption of prudence had been overcome. It was not intended as a method of determining the cost

consequences and any potential disallowance of costs if the Board were to find that entering into the Alliance and Vector agreements were not prudent.

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[30] Notwithstanding the Board's articulation of the proper use of this information, there are two clear references to matters of hindsight in the portion of its reasons dealing with the prudence of Enbridge's decisions.

[31] The first such reference is at paragraph 3.12.20 of the Board's reasons in which the Board refers to delay which occurred from November 1999 to December 2000 in determining whether a decision in 1996 was prudent. The impact of this reference could, however, be minimized since it was made in the context of a risk which Enbridge had identified and took into account in 1996. The impact on the decision would obviously be worse if the Board had been pointing out a delay that had occurred after the fact and had not been predicted or considered back in 1996. Therefore, if the only hint of a hindsight type analysis was this one reference, I would not have serious concerns.

[32] However, the Board's reference to later events in its analysis of the Vector 2 contract (in paragraph 3.12.33) is more troublesome. The Board had already determined that Enbridge "failed to provide sufficient evidence and analysis, including alternatives, to justify this decision." Since the onus was on Enbridge to establish prudence, that would have been sufficient to support a finding by the Board that Enbridge had not discharged that onus and that the extra costs of that decision could therefore not be passed on to consumers. Obviously, the Board was not required to make such a finding, and it was perfectly open to the Board to defer the matter to give Enbridge an opportunity to file additional evidence. However, the reason cited by the Board for deferring the matter was that the cost consequences of the Vector 2 contract had not been included in the calculation of the Notional Deferral Account. The inescapable inference from this is that the Board felt unable, or was unwilling, to make a decision on prudence without this information. However, information as to what the actual costs of the decision turned out to be after the fact, is clearly an application of hindsight and is not permitted as part of the analysis of prudence.

[33] Counsel for the OEB submits that the reference to the Notional Deferral Account relates only to the rebuttal of the presumption of prudence and that the Board was not discussing the use of the financial information as part of its prudence analysis. Rather, he argues, the Board was simply stating it was unable to deal with whether the presumption of prudence applied without the missing information as to actual costs after the fact. I cannot accept that argument. The Board's decision is very logically laid out, as I have discussed above in paragraphs 11 to 22. The Board dealt first with the general test for relevance and then with whether the presumption of prudence was rebutted. It was only after finding the presumption was rebutted that the Board turned to a consideration of each of the four contracts and a determination of prudence in respect of each of them. When the decision is looked at as a whole, it is clear that in paragraphs 3.12.32 to 3.12.34 the Board was dealing with whether the prudence standard had been met for the Vector 2 contract. That is the context in which the Notional Deferral Account is mentioned, and it can only logically be interpreted as referring to the prudence standard.

[34] In any event, it was not necessary for the Board to have information from the Notional Deferral Account in order to deal with the presumption of prudence issue. For the Alliance 1, Alliance 2 and Vector 1 contracts, the Board had three bases upon which the presumption was rebutted:

(i) the concession by Enbridge that the presumption was rebutted and that a prudence review was warranted;

(ii) the potential for conflict of interest because of the ownership interest of Enbridges's parent in the Alliance and Vector pipelines; and

(iii) the substantial extra costs actually incurred as demonstrated by the Notional Deferral Account.

[35] With respect to the Vector 2 contract, the Board did not have the information from the Notional Deferral Account, but it had already determined that the conflict of interest issue alone was sufficient to rebut the presumption and it had the concession from Enbridge that a review of prudence was appropriate in the circumstances. The Board did not need the Notional Deferral Account information to make its decision on the presumption, and indeed had already made that decision in respect of all four contracts at paragraph 3.12.13 of its Reasons.

[36] Counsel for the OEB further argues that since the Board made no decision with respect to Vector 2, its reasoning on Vector 2 is not the subject of this appeal and not relevant to our consideration of whether the Board erred in its analysis of the Alliance contracts. That might well be a valid point if the Board had confined its reasoning in paragraph 3.12.33 to the Vector 2 contract itself. However, the Board referred to the absence of the Deferral Account information for Vector 2 and then commented that this information was "a key element of the Board's prudence review of the Alliance and Vector arrangements". Given the context in which these words appear as well as the actual language used, it seems clear that the Board did in fact consider the actual costs incurred for Alliance as compared to the TransCanada pipeline to be a "key element" in its determination that the Enbridge decision to enter into the Alliance contracts was not prudent.

[37] The Board clearly articulated the correct test for the prudence review and appeared to understand that the prudence review must be based on circumstance that were known, or should reasonably have been known, by management making the decision at the time the decision was made. Because the test is so clearly stated by the Board, I have considered very carefully whether the Board's references to matters of hindsight in paragraphs 3.12.20 and 3.12.33 ought to be considered as innocuous, or related to some other analysis. I cannot reach that conclusion. In my view, the Board must be taken to have meant what it said. There are two clear references to a consideration of events which occurred after the decisions were made in the context of the Board's consideration of the prudence of the decisions. Reading the Board's comments any other way would, in my view, unduly strain the language used, particularly in the context in which those words appear.

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[38] The retrospective application of the prudence test, ignoring the benefit of hindsight, is not an easy task for a decision-maker who is fully aware of the actual financial consequences of a decision. The decision-maker must shut out of his or her mind all knowledge of matters that are not permitted to be taken into account. This is something which is easier to describe than it is to carry out in practice. In this case, the Board described the test correctly, instructed itself not to use hindsight in evaluating prudence, but then slipped in its application of the test and did allow hindsight to creep into its consideration of prudence. That is a fundamental error of law.

F. CONCLUSIONS

[39] There was certainly evidence before the Board upon which it could have reasonably concluded that the Alliance contracts were not prudent. However, it is not possible to determine the extent to which an impermissible line of thinking clouded the Board's determination in this case. This is particularly problematic in that the hindsight considerations involved only the first 10 months of contracts that were to run for a period of 15 years. The appellant is entitled to a decision based on the correct application of the legal test to the relevant facts. In the result, the Board's decision cannot stand and is therefore quashed in so far as it relates to the Alliance 1 and Alliance 2 contracts.

[40] The determination of prudence and the remedies flowing from a determination that a particular decision was or was not prudent are matters within the specialized expertise of the Board. Such determinations are intended under the Act to be the sole province of the OEB and ought not to be made by courts. Accordingly, this matter is remitted back to the OEB for consideration by a differently constituted tribunal.

[41] If the parties are unable to agree on the costs of this appeal, they may be addressed in writing. Counsel for Enbridge is requested to coordinate the timing of the costs submissions and to forward three copies of all of the submissions, preferably bound and indexed, to the Divisional Court office.

MOLLOY J.

I agree:_____
LANE J.

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I agree:_____
POWER J.

Released:

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COURT FILE NO.: 40/03
DATE: 20050302

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ONTARIO

SUPERIOR COURT OF JUSTICE
DIVISIONAL COURT

LANE, MOLLOY and POWER JJ.

B E T W E E N:

ENBRIDGE GAS DISTRIBUTION INC.

Appellant

- and -

ONTARIO ENERGY BOARD

Respondent

REASONS FOR JUDGMENT

MOLLOY J.

Released: March 2, 2005