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December 22, 2015

The Board of Commissioners of Public Utilities
Prince Charles Building
120 Torbay Road, P.O. Box 21040
St. John's, NL A1A 5B2

Attention: Ms. Cheryl Blundon
Director Corporate Services & Board Secretary

Dear Ms. Blundon:

Re: Newfoundland and Labrador Hydro – 2013 General Rate Application
Prudence Review - Final Submission

Enclosed please find the original plus 12 copies of Newfoundland and Labrador Hydro's final submission in relation to the above-noted matter.

Should you have any questions, please contact the undersigned.

Yours truly,

NEWFOUNDLAND AND LABRADOR HYDRO

Geoffrey P. Young
Senior Legal Counsel

GPY/bs

cc: Gerard Hayes – Newfoundland Power
Paul Coxworthy – Stewart McKelvey Stirling Scales
Thomas J. O'Reilly, Q.C. - Cox & Palmer
Dennis Browne, Q.C. - Browne Fitzgerald Morgan & Avis
Danny Dumaresque
Thomas Johnson, Q.C. - Consumer Advocate
Yvonne Jones, MP Labrador
Senwung Luk – Olthuis, Kleer, Townshend LLP
Genevieve M. Dawson – Benson Buffett

IN THE MATTER OF the *Electrical Power Control Act,* 1994, SNL 1994, Chapter E-5.3 (the "*EPCA*") and the *Public Utilities Act*, RSNL, 1990, Chapter P-47 (the "*Act*"), as amended, and Regulations thereunder; and

IN THE MATTER OF a general rate application filed by Newfoundland and Labrador Hydro on July 30, 2013; and

IN THE MATTER OF an amended general rate Application filed by Newfoundland and Labrador Hydro on November 10, 2014; and

IN THE MATTER OF a prudence review relating to certain Action and costs of Newfoundland and Labrador Hydro

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Newfoundland and Labrador Hydro

Prudence Review
Closing Submissions

December 22, 2015

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1. INTRODUCTION

Newfoundland and Labrador Hydro ("Hydro") is pleased to provide the following Closing Submissions in the prudence review relating to certain actions and costs of Hydro, as part of Hydro's 2013 General Rate Application (the "Prudence Review"). Hydro has participated fully in the Investigation and Hearing into Supply Issues and Power Outages on the Island Interconnected System (the "Outage Inquiry") following the January 2014 supply issues and the subsequent Prudence Review in relation to those issues and various other matters identified for review by the Board of Commissioners of Public Utilities (the "Board"). Throughout the Outage Inquiry and Prudence Review processes, Hydro has responded to hundreds of Requests for Information ("RFIs"), provided various reports and updates to the Board and interested parties, and provided Reply and Surrebuttal Evidence respectively in response to the Liberty Consulting Group's ("Liberty") Final Report on the Prudence Review dated July 6, 2015 ("Liberty Final Report"), and Liberty's Reply Evidence of September 17, 2015 ("Liberty Reply Evidence").

Throughout the pre-hearing evidential phase of the Prudence Review process, and during oral testimony and through cross-examination of Liberty, Hydro has worked to ensure that the Board has the full context surrounding the decisions and actions of Hydro that are under review in this process. Hydro has worked diligently with Liberty and appreciates Liberty's efforts in both the Outage Inquiry and subsequent Prudence Review. Hydro has adopted nearly all of the recommendations made by Liberty in the Outage Inquiry, the majority of which were consistent with Hydro's own findings arising out of its internal investigations following the events of January 2014. Hydro also continues to take under advisement Liberty's various comments with respect to issues for ongoing and future improvements with respect to the reliability of Hydro's system.

Hydro takes the suggestion that certain of its decisions or actions may have been imprudent very seriously. Where discussed below, Hydro believes that when reviewed in light of the information known at the time, and in the full context, its decisions and actions were reasonable. As noted in its letter to the Board dated December 16, 2015, Hydro accepts responsibility for the costs associated with the January 2013 events.

To the extent that the Board may determine that in its view a certain decision or action of Hydro was imprudent, Hydro also believes that certain of the proposed disallowances put forward by Liberty would be inappropriate to apply in the circumstances. These issues will also be discussed in detail below. Consistent with the Terms of Reference for the Prudence Review dated February 27, 2015 ("Terms of Reference"), it is clear that **hindsight should not be used in determining prudence, and that a decision or action cannot be determined imprudent where it was within the range of reasonable alternatives for the issue in question**. 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 and must be based on facts about the elements that could or did enter into the decision at the relevant time. Hydro respectfully submits that within this construct, the evidence before the Board is clear that Hydro's applicable decisions and actions at the relevant points in time were within the range of reasonable alternatives, as discussed below.

The remainder of these Closing Submissions deal with the specific projects or issues which were the subject of the Prudence Review. The scope of the Prudence Review included certain decisions and actions in relation to outages experienced during the winters of 2013 and 2014 on the Island Interconnected System ("IIS"), as well as certain other decisions and actions of Hydro where the Board deferred recovery of the associated costs pending further review. Those issues with respect to which Liberty has suggested a potential disallowance are all in relation to the outages in 2013 and 2014. With respect to the matters for which Liberty has either concluded they were prudent or no disallowance is appropriate, being:

- Black Tickle;
- the Labrador City Terminal Stations; and
- the Holyrood Unit 3 forced draft fan motor,

there is no further evidence on the record that supports any disallowance, and these issues were not addressed in any substantive way during the oral portion of the proceedings. Accordingly, Hydro has no further comments to add to the record in these Closing Submissions with respect to those three matters.

With respect to the issue of supply-related costs, Liberty concluded that Hydro acted prudently in making the generation-related decisions that required the use of the additional sources of generation, but also concluded that certain equipment failures on Hydro's transmission system caused supply issues for customers, for which Liberty suggests a disallowance related to the period January 5-8, 2014.[1] Hydro deals specifically with this suggested disallowance below.

Liberty also found Hydro's planning, procurement and installation of the new Holyrood Combustion Turbine ("CT") to be prudent. However, this issue was raised during the oral hearing, particularly by Mr. Dumaresque, and Hydro addresses this matter further below.

The focus of the remainder of this argument will, however, be principally on those areas where Liberty has suggested Hydro has acted imprudently and has proposed a disallowance in that regard. Finally, Liberty has made various comments with respect to the implications for Hydro's 2014 Revenue Deficiency filing based on Liberty's findings, which will also be addressed in this submission.

2. NOTE ON RECENT JURISPRUDENCE

The Board set out the "Standards for Prudence Review" in the Terms of Reference, citing jurisprudence from the Nova Scotia Utility and Review Board and the Ontario Court of Appeal. The approaches that were identified from the jurisprudence clearly state that hindsight should not be used in determining prudence and the review should relate to the circumstances that were known or ought to have been known at the time in question.

In two recent decisions – *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44 ("OEB") and *ATCO Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2015 SCC 45 ("ATCO") – the Supreme Court of Canada ("SCC") considered the question of whether regulatory tribunals were bound to apply a particular prudence test in evaluating utility costs. While the decisions recognize that, in certain circumstances, regulatory tribunals may have discretion to consider other methods in assessing prudence; these decisions support the appropriateness of the no-hindsight test for prudence in the context of the costs under review in this case.

[1] Liberty Final Report, pages 16-17.

In OEB, the majority of the SCC cited the same cases the Board identified in the Terms of Reference, finding at para. 102 that the test outlined in these cases is "...a valid and widely accepted tool that regulators may use when assessing whether payments to a utility would be just and reasonable." The majority decision noted that this no-hindsight prudence review has most frequently been applied in the context of capital costs, and further stated at para. 104 that (emphasis added):

> "...**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...** 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."

Similarly, at para. 48 in ATCO, the SCC stated (emphasis added):

> "As explained in *OEB*, **understanding whether the costs are committed or forecast may be helpful in reviewing the reasonableness of a regulator's choice of methodology**: see para. 83. **Committed costs are those costs that a utility has already spent or that were committed as a result of a binding agreement or other legal obligation that leaves the utility with no discretion as to whether to make the payment in the future**: para. 82. If the costs are forecast, there is no reason to apply a no-hindsight prudence test because the utility retains discretion whether to incur the costs: para. 83. By contrast, **the no-hindsight prudence test may be appropriate when the regulator reviews utility costs that are committed**: paras. 102-05."

The SCC concluded at para. 65 in ATCO that (emphasis added):

> "While **there are undoubtedly situations in which a failure to apply a no-hindsight methodology may result in unjust outcomes for utilities**, and thus violate the statutory requirement that rates must strike a just and reasonable balance between consumer and utility interests, the Commission did not act unreasonably **in this case**. **The disallowed costs were forecast costs**..."

The costs under review in OEB and ATCO were forecast costs or costs that were not fully committed. In those circumstances, the SCC held that it was not unreasonable to use a method other than a no-

hindsight prudence review. However, in the context of a review of actual costs already incurred by Hydro and the engineering decisions made at points in time prior to the January 2013 and 2014 outages, it is clear that the no-hindsight methodology (as originally identified in the Board's Terms of Reference) remains the correct approach.

This is consistent with the views expressed by Mr. Antonuk during cross-examination by Mr. O'Brien at the hearing, where he noted: "...you should not use hindsight to evaluate the reasonableness of decisions..." and "...when you're dealing with the quality of a decision or an action, that's when you should not use hindsight."[2]

3. THE NEW HOLYROOD COMBUSTION TURBINE

(a) CT

Liberty summarized its findings with respect to the new CT as follows:

> "Liberty found Hydro's decision not to move forward with the CT until after the January 2014 outages to be prudent in the circumstances Hydro faced. Moreover, had Hydro acted earlier to install new capacity, costs to customers would not likely have proven less than the amount for which Hydro seeks recovery."[3]

Hydro submits that there is no evidence to the contrary and nothing raised during the oral hearing which would suggest otherwise.

One issue that was canvassed in some detail during cross-examination was that between the time of filing of Liberty's Final Report and the oral hearing Hydro's ultimate costs for the CT had risen from an estimated $119 million to $128.5 million Canadian[4].

In this regard, during direct examination, Mr. Mazzini of Liberty noted as follows:

> "Well, as you say, we learned of this cost increase after our report was written. I therefore went back and redid the analysis and I found that the new total cost is still reasonable. In my previous analysis, it indicated that the cost of the new CT was slightly

[2] November 12, 2015 Transcript, page 165, line 13 to page 166, line 1.
[3] Liberty Final Report, page 7.
[4] November 4, 2015 Transcript, page 15, line 10 to page 16, line 11.

> below the industry average as I had calculated it. With this new number, it's now slightly above, but right at about the median of the plants that I sampled. So on that basis, I don't see any reason to change the conclusion that based on industry data the costs seem to be reasonable."[5]

Mr. MacIsaac for Hydro confirmed that utilizing the comparative review approach taken by Liberty the costs for the CT would be approximately $115 million US, well within the range of pricing identified by Liberty.[6] He fully explained the nature of the cost increase, which was substantially in relation to the CT building enclosure, and that the overall project cost increase was 8.5 percent[7], within the 10 percent threshold for Hydro's capital expenditure variance reporting[8].

Mr. MacIsaac also confirmed in redirect that the $118.9 million Canadian estimate for the CT provided to the Board in Hydro's Combustion Turbine Generation Application filed April 10, 2014 ("CT Application") was clearly identified as an AACE[9] Class 3 estimate within an accuracy of +20% to -10%.[10] The final CT pricing is within this estimate range identified by Hydro to the Board in its CT Application. With respect to the ultimate CT project constructed and its cost, Mr. MacIsaac specifically noted that he was "entirely confident that [Hydro] gave customers and rate payers in the province value for money".[11]

Mr. MacIsaac also confirmed on numerous occasions that Hydro's approach to obtaining least cost for its customers was to follow the public tender process. In particular, he explained how that process allowed Hydro to obtain the least cost option that satisfied the technical specifications and functional requirements.[12] Mr. MacIsaac also confirmed that the option chosen delivered 25% more capacity than the next closest bid.[13]

[5] November 12, 2015 Transcript, page 34, lines 10-22.
[6] November 4, 2015 Transcript, page 16, lines 1-9.
[7] November 4, 2015 Transcript, page 15, lines 11-18. See also Undertaking No. 99, which indicates that the final project variance is now forecast to be within 8% of the original budget.
[8] See the Board's *Capital Budget Application Guidelines*, Section C.1 and Undertaking No. 94.
[9] Association for the Advancement of Cost Engineering.
[10] November 6, 2015 Transcript, page 92, line 8 to page 93, line 24.
[11] November 6, 2015 Transcript, page 71, lines 1-3.
[12] November 5, 2015 Transcript, page 183, lines 16-22; page 188, lines 19-24; and page 190, lines 7-15
[13] November 5, 2015 Transcript, page 183, lines 22-24 and November 4, 2015 Transcript, page 215, lines 4-6.

With respect to the increase in cost, this was substantially related to the CT building enclosure.[14] Mr. MacIsaac noted during cross-examination that "a lot of these gas turbines in North America and elsewhere sit outside and don't have buildings whatsoever"[15]. Given that the engineering was still outstanding, the initial $8 million figure related to the building was an allowance that Hydro had inserted as a line item as an estimate of what it thought the building would be.[16] Mr. MacIsaac then explained that Hydro "ended up in a place where we have a building that's different than what we originally had envisioned, both in terms of complexity, the design, and to execute".[17] He further confirmed that the two principal drivers were the heavier design required and the cost for erection of the building in Newfoundland[18], and as well the HVAC system was more complex and the FM Global requirements were more stringent than the contractor was familiar with.[19]

Mr. MacIsaac also explained in detail the process between Pro Energy and Hydro in relation to Pro Energy's claim for overages.[20] This included obtaining advice from a leading consultancy with respect to dispute resolution in construction projects (Revay & Associates) and an evaluation of the strengths and merits of the overage claim by Pro Energy. As explained by Mr. MacIsaac, Pro Energy had initially sought additional costs of $27 million and Hydro eventually settled on $12 million substantially related to the building.[21]

Mr. Dumaresque raised questions with respect to numerous issues, such as the nature of the Engineering, Procurement and Construction ("EPC") contract, the pricing for the turbine component in relation to the Pro Energy advertisement, the pricing of the turbine in relation to the overall price for the entire project, the due diligence carried out on the turbine, the nature of the bid security, and other items. Hydro submits that these issues were all fully addressed by Mr. MacIsaac, and the record is clear that Hydro carried out an appropriate tender for the CT and awarded the contract on the basis of the

[14] November 5, 2015 Transcript, page 9, lines 3-4 and Undertaking No. 104.
[15] November 5, 2015 Transcript, page 10, lines 20-23.
[16] November 5, 2015 Transcript, page 5, line 14 to page 6, line 6. See also Transcript, November 5, 2015, page 25, line 5 to page 26, line 19.
[17] November 5, 2015 Transcript, page 9, line 23 to page 10, line 2.
[18] November 5, 2015 Transcript, page 12, lines 4-7.
[19] November 4, 2015 Transcript, page 179, lines 7-20.
[20] For a full discussion of this issue, see November 5, 2015 Transcript, page 19, line 21 to page 28, line 2.
[21] November 5, 2015 Transcript, page 20, line 1 to page 21, line 5.

least cost solution which met the technical requirements. Hydro submits that none of the issues raised by Mr. Dumaresque in any way suggest a lack of prudence on behalf of Hydro with respect to the acquisition, procurement and construction of the new CT.

The CT was constructed on a very aggressive time line, was delivering power to the grid within three weeks of scheduled delivery[22], was constructed for a cost within comparable projects costing, and has been fully tested and utilized for the purposes of providing capacity to the system. As with any new generating unit, the CT has experienced both planned and forced outages, but has operated consistent with its planned reliability.[23]

With respect to overall project management for the CT, Liberty noted as follows:

> "Hydro made an early decision that it required a strong, dedicated team to achieve the accelerated schedule for the new CT in a cost effective manner. The Company selected well-regarded vendors to manage field operations, thoroughly vetted the machine supplier and the equipment involved, and assembled a capably project management team, headed by trusted contractors. The management team applied proven management techniques, proactively identified and acted to mitigate risks, and adjusted staffing as issues emerged. Late in the schedule, electrical issues in the field resulted in limited schedule delays and the need for more aggressive mitigation strategies. In the broader context, and in light of what initially appeared to be a particularly aggressive schedule, final results provided very strong."[24]

Liberty further stated:

> "The decision to proceed [with the CT] has produced substantial benefits. Hydro secured a larger unit and an in-service date better than was expected. With respect to unit size, the supply situation was tenuous in the first quarter of 2014. The doubling of the unit's size (compared with earlier plans) and its early availability proved to have considerable value."[25]

[22] November 5, 2015 Transcript, page 85, lines 19-25.
[23] November 4, 2015 Transcript, page 193, line 15 to page 194, line 12.
[24] Liberty Final Report, page 13.
[25] *Ibid*.

For all of the foregoing reasons Hydro submits that its decisions and actions with respect to the new CT were fully prudent.

(b) **Supply Planning**

With respect to Hydro's supply planning leading to the acquisition of the new CT, during cross-examination Mr. Humphries for Hydro indicated the situation prevailing in 2008 and subsequent years as follows:

> "Well, I think at that point in time, looking from 2008 out to the 2012-2013 timeframe, it's showing a significant step change in something between 2012 and 2013. In this case, I think for the most part, it was driven by load and the expectation of the Vale load in particular at that time and it coming on. So, when you look back and I think if you go through the recommendations there that we were recommending additional capacity in advance of that 2013 change in load and that I think it reflected that if -- to meet that timeline, decisions would need to be made in the 2010 timeframe to move things forward. So that became a focus back then and as time progressed, there were significant changes in the following year, in 2009, that basically changed the outlook. So, any activities that may have been -- or preparations to start activities in 2008 would have been somewhat relaxed after the next year's review which we ended up with the closure of the Abitibi facility in Grand Falls in 2009 and that, at that point, moved the deficit out to the 2015 timeframe."[26]
>
> "But back in 2010, we were at a stage where we had two -- still carrying two expansion plans and the level of certainty around Lower Churchill was much less back in 2010 and in fact, the two expansion plans were different. The CT was present in the interconnected scheme, but the isolated scheme had a different expansion plan. So, as we come through 2010, there's no doubt that towards the end of 2010, there was an additional level of certainty probably around the Lower Churchill with the signing of the term sheet with Emera. Still nothing definite. We progressed through 2011. Lower Churchill was still advancing, still becoming even more like -- more of a reality, but there was no sanction and it wasn't until we really got into mid to late 2012 that we, from a planning perspective, really had a clear line of sight on where we felt the expansion was going, and at that time, when we redid the analysis, the combustion turbine did come out in both alternatives. But again, it was more timing related and the fact that because the decision took so long that we got down to a stage where a combustion turbine was the only option in both alternatives. So moving into 2013, we looked at starting to move forward the combustion turbine proposal. We got into the black start analysis and looking at the synergies of how this combustion turbine could be used to also satisfy the black start. We went through the siting analysis and landed on the fact that Holyrood

[26] October 29, 2015 Transcript, page 8, line 17 to page 9, line 16.

> was by far the best site. And it was at that time that the size of the combustion turbine increased from 50 to 60 megawatts and there was -- the reasoning for that was that we had always considered the Holyrood black start combustion turbine as part of the island capacity and that provided ten megawatts, so to keep the level of island capacity consistent, the size of the combustion turbine was increased from 50 to 60 megawatts. And then we moved forward, and as I said, I think the timing would have been in the fall of 2013, the issue of the interim solution to install the 8[by]2 megawatt black start diesels came up. We, again, went back and looked at the implications that that would have on our recommendation moving forward and if the -- what the size of the gas turbine would be or if we would keep those diesels or remove them once the gas turbine went in place. We did an analysis on that, and that puts us into the fall of 2013, and as I said last week, we had an application functionally complete by the fall of 2013, late 2013. We're talking Christmas period. It did not get filed before the end of the year. And then we got into our January 2014 events and we sat back and took a whole new look at the generation adequacy and that's with -- as I said we involved external consultants. Liberty came into the picture and we had discussions with them and we landed on this modified criteria that identified that we would ultimately need a larger combustion turbine or it was prudent to go with a larger combustion turbine and we proceeded then to prepare that application and get it before the Public Utilities Board and that took us from January-February 2014 to April 2014."[27]

Thus, Hydro appropriately modified its plans for the additional generation based on the line of sight provided by its ongoing generation planning studies and criteria and changing circumstances. Mr. Humphries confirmed that at the time of Hydro's November 2012 generation planning report, Hydro had agreed to take the risk of exceeding the Loss of Load Hours ("LOLH") in the winter of 2014 and to have the CT in place in 2015.[28] He explained as follows:

> "Well, I think, as I indicated on the stand last week, through the 2012-2013 period, we were looking at alternatives to get additional generating capacity on the system. Up 'til I would say the end of 2012 when the generation issues report we spoke of was completed, we were concentrated on new technologies. As we moved into early 2013 and some of the events that transpired in January 2013, we turned our focus to what other alternatives might be out there in the market to get capacity on this system in a more timely fashion, and that's when we turned to grey market opportunities and we ended up with the combustion turbine that we do have today. That's how we got there. But there's no question that up 'til the end of 2012, we were considering new solutions and the timelines that we were looking at at that time were an in-service sometime in the last second half of 2015."[29]

[27] October 27, 2015 Transcript, page 84, line 23 to page 87, line 20.
[28] October 27, 2015 Transcript, page 65, lines 16-22.
[29] October 27, 2015 Transcript, page 67, line 17 to page 68, line 11.

> "Well, and again, what the analysis was indicating that in January, February, March of 2015, there was an increased risk. It wasn't significant compared to what we had seen if we go back to 2008, the case I talked about with Mr. O'Brien yesterday where we saw a step change from an LOLH of less than two up to over five. We were talking about just crossing the line between 2.8 and – crossing 2.8 line and it was comparable to situations that we had been through in the past, in 2002 and 2003, and that was the level of discussion that was carried and the level of thinking that went into the decision making at that time."[30]

Liberty specifically "found Hydro's decision not to move forward with the new CT until after the January 2014 outages to be prudent in the circumstances Hydro faced" and "moreover, had Hydro acted earlier to install new capacity, costs to customers would not likely have proven less than the amount for which Hydro seeks recovery.[31]

Hydro submits the record is clear that its decisions, actions and timing with respect to the ultimate acquisition of the new CT were prudent, and that acting to acquire the CT earlier could have well lead to a smaller and less cost effective solution. Hydro carefully evaluated its changing needs over time and ultimately acquired a least cost resource for its customers.

4. HOLYROOD UNIT 1 TURBINE FAILURE

For the reasons explained in Hydro's correspondence to the Board dated December 16, 2015 Hydro accepts responsibility for any cost consequences attributable to the failure of the Holyrood Unit 1 DC lube oil pumping system and subsequent turbine failure in January 2013. Hydro also reiterates its apology to the Board, its consultants and other parties for any inconvenience caused in this regard.

5. BLACK START

(a) Black Start Capability

Hydro submits that its decisions and actions with respect to the black start issue were prudent in the overall circumstances prevailing at the time such decisions and actions were made. Further, Hydro submits that Liberty's approach to any potential disallowance with respect to this issue is inappropriate

[30] October 30, 2015 Transcript, page 122, line 13 to page 123, line 2.
[31] Liberty Final Report, page 7.

regardless of the Board's finding with respect to the underlying issue. It is important for the Board to review this matter in its full context. That context is as follows:

1. Hydro's reliance on the Hardwoods generator for black start was always intended as an interim solution;[32]
2. The system requirements were changing during the relevant time period;[33]
3. Prior to January 2013, a black start scenario for Holyrood had only occurred once since 1991;[34]
4. The availability of local on-site black start during the January 2013 incident would have lessened the duration of that incident for certain customers by 11 hours;[35] and
5. Hardwoods was the only option for the winter of 2012-2013 because of the timing that it would take to implement any other potential options.[36]

With respect to the reliance on Hardwoods, Mr. Henderson for Hydro specifically explained as follows:

> "You're looking backwards in terms of looking back to 2008 to '12. At that time, the Hardwoods plant was -- first of all, I think it's clear that the option for that winter of 2011-12, Hardwoods was the only option and it was the only option for the winter of '12-13 because of the timing that it would take to do -- to implement the other options. So, first of all, the decision, as we discussed a few minutes ago, was to do that because there was no other option at that time. I'll say no other option that was in place at that time. So then when you look at the fact that Hardwoods was undergoing a multi-year refurbishment program in which we were investing considerable -- and we had put forward proposals in our capital program which were implemented at Hardwoods, that we were undergoing a life extension investment in that facility to improve its performance and we were in the middle of that at that time. I think the work on Hardwoods essentially was completed in 2013 with respect to its multi- year refurbishment program, although there will be continuing review of that, but I believe that was the three-year period for Hardwoods. So, it was undergoing that at the time, as well, so that's another consideration in the decision making that would have been known at the time, that that plant was going through that refurbishment. So again, we're looking at an interim solution using the Hardwoods plant until the new CT was in place in 2015. The Hardwoods plant was going through a refurbishment program to improve its reliability at that time."[37]

[32] October 27, 2015 Transcript, page 57, lines 17-19.
[33] See the section on Supply Planning above.
[34] PR-PUB-NLH-003, Attachment 1, page 1.
[35] October 27, 2015 Transcript, page 54, line 22 to page 55, line 4. See also Undertaking No. 72.
[36] October 27, 2015 Transcript, page 56, lines 11-22.
[37] October 27, 2015 Transcript, page 56, line 11 to page 57, line 22.

Board counsel then suggested to Mr. Henderson that Hardwoods was not a great interim option for Hydro looking at the evidence facing Hydro at the time in question. Mr. Henderson fully refuted this as follows:

> "I totally disagree, with all respect. I just explained that it was an interim option. I also explained that it was very rare for us to have a sustained long outage to the Holyrood plant. I agree that there have been outages to the transmission line into the plant. We had one incident during this recent time in which the black start would have been a benefit. That was in January 2013. In January 2013, the options that AMEC had put forward were not going to be implemented at that time in any event, but that wasn't -- we didn't know we were going to have an event. So that's not really, I'll say, part of decision making. The decision making was that we had a period where we weren't going to have an option there. Hardwoods was the backup option in any event. We did considerable amount of work to make sure that Hardwoods was -- we had all of the practices in place for the operators to be able to use Hardwoods. The Hardwoods plant was under a refurbishment program that would improve its reliability through that time. So all of those things are considerations and also considering that we had a new combustion turbine going to be located at Holyrood which, you know, it would end up being a cost to customers that would be in place in 2015. So, looking at the options, least cost supply, all of those considerations were undertaken at that time and I think you have to look at all the balance of those items in looking at this and to say that Hardwoods was not a good option, it was under refurbishment. It was the only option that was going to be available for that first 12-month period or 14-month period after that event. And we were in the middle of refurbishment, so we continued with that and then we had an interim. Basically, the Hardwoods was bridging us from, in essence, from when the -- I'll say what we had been presented by AMEC which would have come in play in the spring of 2013. We had from there to 2015 when the new CT was coming in. Hardwoods was bridging that period of time and Hardwoods was going through a refurbishment program to improve its reliability, improve its performance, and that was all part of the known things that would have been there for the people who were making the decisions at that time."[38]

As well, prior to this time, the last time Hydro experienced a sustained full loss of power to the Holyrood station was in 1994. As Mr. Henderson explained, the situation in 1994 was around the isthmus and the transmission lines coming into the Avalon, whereas in January 2013 it was related specifically to the Holyrood Terminal Station rather than the transmission lines coming into the station.[39]

[38] October 27, 2015 Transcript, page 58, line 15 to page 60, line 17.
[39] October 27, 2015 Transcript, page 52, lines 2-7.

The overall context is very important. At the time the prior black start option (the Holyrood gas turbine) was unable to be used for black start purposes, no immediate options were available to Hydro except for Hardwoods. After due consideration, Hardwoods continued to be relied on as an interim solution until the new CT was put in place. Hardwoods was undergoing a multi-year refurbishment program in order to increase its reliability. Hydro only had one prior operating experience with the full loss of the applicable transmission lines in the prior 20+ years, and that was as far back as 1994. Hydro weighed these considerations against the cost of other options. In the overall context, Hydro submits that its actions were reasonable.

Clearly Hydro would have preferred that the outage in January 2013 not have been extended for a number of its customers, but at the time of the relevant decisions past experience suggested that this "was a very unusual circumstance".[40]

Taking into account the circumstances as previously noted, La Capra Associates, Inc. ("La Capra") determined that Hydro's decision in the circumstances to rely on Hardwoods as an interim solution was reasonable. Hydro submits that when the Board looks at this in the full context it should reach the same conclusion. The test of prudence as noted in the Terms of Reference is not whether it was the perfect, or in fact even the best, decision, but rather was it one of the reasonably available options. Liberty concurred with this characterization in the context of what is required to be looked at in making prudence conclusions.[41]

Mr. Di Domenico from La Capra noted that Hardwoods was always part of Hydro's area restoration plan.[42] He also specifically noted that Hydro made the conscious decision to accept a lower level of reliability on an interim basis until they could procure the new CT.[43] He then went on during cross-examination to explain as follows:

> "Specifically around all the issues that go into that decision - recall again, I'm just trying to amplify here a little bit that when you're making a decision like this, you're not

[40] October 27, 2015 Transcript, page 55, lines 13-22.
[41] November 12, 2015 Transcript, page 76, line 10 to page 77, line 10.
[42] November 2, 2015 Transcript, page 128, lines 23-24.
[43] November 2, 2015 Transcript, page 133, lines 1-4.

> looking at this in a vacuum. You're not looking at it from a reliability only perspective. You're looking at the reliability benefit, you're looking at the cost, and you're looking at the probability of that benefit actually accruing to the customers that are paying for this.
>
> GREENE, Q.C.
> Okay.
>
> MR. DIDOMENICO:
>
> Of those three elements, only one is certain and that's the cost you're going to incur. Whether or not that reliability benefit ever actually accrues, it may, it may not. In this specific instance, we're dealing with an issue that had extremely low level of likelihood of occurring, and they made the call to accept some risk on an interim period until they could get the permanent long term solution. I mean, I think that embodies everything that we're saying."[44]

Hydro submits that La Capra's characterization is the correct approach to reviewing Hydro's decisions at the relevant time. The La Capra witnesses are senior electricity system experts and Hydro respectfully submits that their independent views on the black start issue should be given considerable weight by the Board. With respect, Hydro submits that La Capra's independent evidence appropriately reflects the decision making at the time in question. To otherwise look at the issue in hindsight (following the unlikely event) and without the full context of the CT procurement and Hydro's focus on balancing cost and reliability is not appropriate.

Mr. Di Domenico also explained as follows:

> "Do we want - I do want to mention because it strikes me when I go through the testimony here, the easiest solution for any utility is to spend money, right. The easiest thing any engineering staff can do is buy a new one, buy a new power plant, buy a new transmission, sure, why not, let me go buy it. If that's the only concern, if you're only concerned about reliability and not balancing reliability and cost, which is the job of every utility manager, that's the dilemma, that was the question, that's what they were faced with, that's what they were trying to justify."[45]

Mr. Athas from La Capra then followed up in discussion of the overall decision-making context as follows:

[44] November 2, 2015 Transcript, page 133, line 8 to page 134, line 7.
[45] November 2, 2015 Transcript, page 142, line 23 to page 143, line 11.

> "And I'd like to just add one thing too. Our understanding during the decision process was -- and as we mentioned on page five of nine on the item number three in Appendix B of the surrebuttal was that the -- a limited decrease in reliability was consciously known by the management at Hydro, the people making that decision, not the specific issue of an 11-hour outage for the warming and the like.
>
> Predominantly on their experience that most of the -- that the black start incidences have been from the grid and from -- and very short durations. So that that level of reliability, some reliability degradation was what was traded off in the issue of cost and exposure for the interim period, not a specific event. That specific event was of an additional 11 hours, as unfortunate as it was, is an outcome of the -- and not a specific input to the decision process.
>
> GREENE, Q.C.:
> Q. But the fact that the units would not be able to quickly generate power, the warming thing, that was a foreseeable thing, not just an outcome I assume?
>
> MR. ATHAS:
> A. It was foreseeable in the context of having a -- if you could foresee a weather event that would take all five lines down to the facility at Holyrood."[46]

La Capra viewed this without the benefit of hindsight (i.e., looking at it from the perspective of Hydro with the full context of information available to Hydro at the relevant time), and concluded that Hydro's decisions were reasonable.

In light of the very limited prior experience with the loss of all transmission into Holyrood prior to January, 2013, Hydro submits there was nothing unreasonable with the approach taken by it at the time its decisions were made and with the information then available. The record shows that in the circumstances in question, Hydro used appropriate and sound engineering and utility judgment to rely on Hardwoods as an interim least cost black start solution.

As La Capra indicated in its August 7, 2015 report, at page 14 of Appendix "B" to Hydro's Reply Evidence of August 7, 2015 (Revised, September 16, 2015) ("Hydro Reply Evidence"):

> "Operational philosophies often can and do vary across jurisdiction, it is the very reason that the North American Electric Reliability Corporation ("NERC") requires the

[46] November 2, 2015 Transcript, page 144, line 17 to page 145, line 21.

> development of system restoration plans, but leaves it to the respective regions to develop their own restoration plan which includes the designation of which units would be counted on for Black Start."

Liberty itself notes at page 48 of the Liberty Final Report, that to accommodate situations where a plant becomes detached from the transmission system "some power plants install a black start capability". The record is clear that what is required is an area restoration plan, how a utility arranges for such a plan is left to the utility. The record is also clear that not all power plants have on-site black start. That being said, in the current case, it was always Hydro's plan to replace the on-site black start capability for Holyrood, and that reliance on Hardwoods was only to be an interim solution. Hydro submits this was reasonable in the circumstances.

As La Capra explained:

> "it is important for accuracy in this discussion to realize that there is reliance on the Hardwoods generation to restart Holyrood only when the peninsula is isolated electrically from the remainder of the Island. La Capra discusses on pages 11 and 12 of its report that Hydro staff made the decision after due consideration of costs and risks involved, that its' Black Start plan for Holyrood and the Avalon peninsula provided sufficient reliability during the interim period where Holyrood would be without on-site black start generation."[47]
>
> (emphasis in original)

In contradistinction to Liberty's finding which focuses solely on the requirement for on-site black start, La Capra noted that:

> ". . . operating under Hydro's Black Start plan using Hardwoods in the interim, as part of an overall black start plan, to black start the Avalon peninsula cannot be judged as an unreasonable decision made by Hydro Staff."[48]

Hydro submits that the record supports this conclusion.

[47] La Capra Surrebuttal Evidence, October 14, 2015, at page 4 of 9 of Appendix "B" to Hydro's Surrebuttal Evidence of October 14, 2015.
[48] *Ibid.,* at page 5 of 9.

Hydro acknowledges that it should have kept the Board informed on a more timely basis regarding Holyrood's black start situation. La Capra likewise acknowledged this shortcoming.[49] However, La Capra concluded that the communication issue does not mean that Hydro's underlying decision process was flawed to the point of imprudence.[50] Hydro submits this is an appropriate characterization. Board counsel likewise confirmed with Mr. Di Domenico that Liberty did not use the communication issue as a factor contributing to its imprudence finding.[51]

(b) **Liberty's Proposed Disallowance**

For the foregoing reasons, Hydro submits that its decisions with respect to reliance on Hardwoods for an interim period were reasonable. If the Board, despite the overall context and the supporting evidence of La Capra, disagrees, then the issue of any potential disallowance comes into play. In this regard, Hydro submits that Liberty's suggested disallowance of the entirety of the amount subsequently incurred to provide black start is arbitrary and not reasonable.

Liberty's initial position was that the period for which the 8x2 MW diesel black start solution was in place was "too short to justify the recovery of the associated costs from customers".[52] Following receipt of Hydro's Reply Evidence, which challenged the support for any such regulatory conclusion, Liberty appeared to change its position to one where Hydro should be penalized for a purported lack of on-site black start capability at Holyrood.[53] Liberty maintains this position notwithstanding that Hydro's cost recovery claim is only for the actual costs associated with the 8x2 MW diesel black start solution, which solution Hydro implemented at the request of and with the concurrence of the Board. Liberty states their view that:

> "While determination of a fair and reasonable sanction may be difficult, it is our view that disallowing costs associated with the Black Start project comprises a reasonable means for incenting Hydro to avoid imprudent courses of action in the future."

[49] Hydro's Reply Evidence, Appendix "B", page 13 of 39.
[50] *Ibid.,* pages 13 and 14 of 39.
[51] November 2, 2015 Transcript, page 121, line 24 to page 122, line 5.
[52] Liberty Final Report, page 57.
[53] Liberty Reply Evidence, bottom of page 22, top of page 23.

And they go on to conclude that:

> "This approach is a useful means for attaching consequence to high-risk actions where good fortune has prevented bad outcomes. Otherwise, there would be no way to incent management to act prudently where failures do not lead directly to quantifiable damages. Liberty recently participated in a case in Nova Scotia in which the utility was sanctioned $2 million because the regulator felt is conduct in a rate case was inappropriate."[54]

With respect to Liberty's initial discussion in its Final Report regarding its proposed disallowance Hydro's Reply Evidence comments are equally applicable in this Closing Submission:

> "Liberty's proposal to disallow the 2014-2015 black start costs because this capability was only available for a limited period is inconsistent with the general application of the "used and useful" regulatory principle. In this case, Hydro incurred an investment to obtain black start capability (in accordance with a direction of the Board) that was "used and useful" during the 2014-2015 time period. Hydro is seeking recovery only for the amount it ultimately incurred for the service provided, not for any costs associated with the provision of the service over a longer time period.
>
> Liberty has not claimed that the black start capability was not required during the period nor that Hydro incurred excessive costs on behalf of its ratepayers to provide this service.
>
> It would not be appropriate for the Board to disallow costs that were legitimately incurred in accordance with Board direction solely due to the fact that another or similar investment could have potentially been made to provide the service at some earlier point in time. Further, prior in time Hydro had put in place what it viewed as appropriate capability based on its best information at the relevant times. [. . .]
>
> Thus, regardless of the Board's ultimate findings regarding Hydro's various actions to ensure black start capability following the determination that the then existing Holyrood black start turbine could not be continued to be used, with respect to the actual costs for which Hydro is seeking approval there is no grounds for disallowance."[55]

[54] *Ibid.*
[55] Hydro Reply Evidence, pages 26-27.

In La Capra's report filed as part of Hydro's Reply Evidence, La Capra specifically concluded as follows:

> ". . . We are not aware of any time requirement over which investment needs to be utilized in order to find the investment used and useful; the diesels have been in-service for a number of months and will continue to be until replaced by the new 123 MW CT, which produced first power on 1/2015 and is currently being prepared for Black Start.
>
> Hydro's ultimate actions were taken in response to a Board directive. Hydro did not have the option of simply ignoring the Board, in which case there would have been no costs to disallow. Hydro's following of that directive from the Board to the best of its ability should not now be considered imprudent."[56]

In PR-NLH-PUB-014 Liberty was asked whether it was aware of other regulators who have denied full recovery of a used and useful asset due solely to the period of time for which the asset was in service. Liberty responded that it had "not researched the practices of other regulators in this regard".

When asked by Board counsel about Liberty's approach to a penalty sanction for Hydro, Mr. Athas of La Capra specifically noted as follows:

> "No, that's right, and there's many utility practices that we've been involved with where there's been deferred recovery which is not guaranteed, and I didn't imply that it was guaranteed. I implied that it would get -- I would expect that at some time it would get, you know, some degree of review for whether the manner of which they acquired the diesels and the practicum of projects of putting them in place were all done prudently and the fact that those diesels did prove used and useful are the standards that we are more closely experiencing with a recovery of investment. So that, but associating recovery of the investment with an inaction at some other time is misleading, in my frame of mind."[57]

Mr. Di Domenico followed up as follows:

> "I think the concept or the notion that unless a utility is financially penalized they won't take action to correct past deficiencies is unfortunate. I think this very proceeding has shown that a great many changes have already taken place and are continuing to take place without any finding one way or the other on the level of imprudence. So, I don't see the connection between performance improvement -- and this is fundamental to

[56] Hydro Reply Evidence, Appendix "B", page 15 of 39.
[57] November 2, 2015 Transcript, page 159, line 12 to page 160, line 2.

> our position relative to Liberty's. On many fronts, we agree with many of the suggestions that Liberty has put forward. Where we disagree is at that level of imprudence. Performance improvement versus level of improvement. Hindsight versus progressively looking forward. We disagree on those elements, but we don't disagree that a number of actions can be taken and are in fact being taken by Hydro to improve their situation going forward."[58]

And then Mr. Athas continued as follows:

> "I also would just add that to infer – maybe if I misinterpreted your question -- to infer that there would be no reaction stigma associated with a finding of imprudence without a financial penalty, I think is mistaken. I would think -- I can't imagine a utility management that would seriously think about its business even more so than just is going on in this proceeding if they were labelled with the "P" word of questioning their prudence and so that I think is, in itself, prior to -- as my colleague mentioned, prior to monetary penalties itself is a profound statement to be made by the Board."[59]

Despite the background and context, Liberty is suggesting that Hydro face a penalty in excess of $6 million on the basis that Hydro should somehow be sanctioned, notwithstanding that Hydro was using its best engineering judgment to provide a least cost interim solution for black start and that the costs incurred provide used and useful service for customers.

The reliance on Hardwoods as an interim solution did lead to a furtherance of the January, 2013 outage by some 11 hours for a portion of Hydro's customers. Hydro submits that even if the Board were to find that its actions were unreasonable in the circumstances, which Hydro does not believe is supported by the record, a disallowance of the order of magnitude proposed by Liberty is disproportionate to the costs or impact that would have potentially prevailed under another course of action. Further, simply utilizing the costs of the separate 8x2 MW diesel black start solution as a proxy for the penalty because they both are related to the concept of black start has no validity. There is no meaningful nexus between the quantum of Liberty's proposed disallowance and the issue for which it believes Hydro should be penalized. As well, a portion of the capital costs related to the diesels have continued

[58] November 2, 2015 Transcript, page 160, line 14 to page 161, line 8.
[59] November 2, 2015 Transcript, page 161, lines 10-23.

usefulness for the potential new CT's connection to the Holyrood plant or with respect to the diesel units, depending on the outcome of Hydro's recent application to retain certain of the diesel units.[60]

As shown in PR-CA-NLH-014 (Revision 1, Oct 15-15), and during cross-examination, Liberty are suggesting a disallowance in the range of $6.2 million, made up of 2014 and 2015 operating cost disallowances and the entire deferred lease cost over their lifetime for the leased diesel units.[61] Mr. Antonuk of Liberty specifically confirmed that what Liberty was suggesting was the disallowance of the deferred lease amount for the full amortization period of the lease.[62]

As noted above, in its Reply Evidence Liberty referenced the example of the Nova Scotia Utility and Review Board ("UARB") sanctioning Nova Scotia Power ("NSP") for its conduct in a rate case. Even in the extraordinary circumstances which prevailed in that case,[63] the sanction by way of a penalty was $2 million, less than 1/3 what Liberty suggests should be a penalty imposed on Hydro for its alleged imprudence with respect to the black start issue.

With respect to the issue of an imposition of a penalty where there was no direct quantifiable loss, Mr. Antonuk was directed to a UARB case in which Liberty was involved.[64] Mr. Antonuk confirmed during cross-examination that the UARB was in agreement with what Liberty had observed in its audit, being that there was an unreasonable delay by NSP in the review and implementation of appropriate changes to its natural gas hedging program.[65] However, Liberty had recommended a sanction in the range of $750,000 in relation to this item, but the UARB disagreed.[66] In this case the UARB specifically concluded at paragraph 48 that (emphasis added):

> "In the circumstances, the Board finds, on the balance of probabilities that <u>the amount of additional costs resulting from NSPI's unreasonable delay has not been</u>

[60] Hydro Reply Evidence, page 27; PR-PUB-NLH-193; October 30, 2015 Transcript, page 151, line 16 to page 152, line 7; and Application to Purchase 12 MW of Diesel Generation filed November 20, 2015.
[61] November 12, 2015 Transcript, page 147, lines 6-18 and page 148, lines 12-15.
[62] November 12, 2015 Transcript, page 148, lines 12-15.
[63] November 12, 2015 Transcript, page 126, line 13 to page 128, line 18.
[64] Information No. 44 and November 12, 2015 Transcript, page 132, line 15 to page 133, line 18.
[65] November 12, 2015 Transcript, page 133, line 20 to page 134, line 8.
[66] See for the applicable paragraph references of Information No. 44 the November 12, 2015 Transcript, pages 133-135.

> demonstrated. The Board concludes that in the specific circumstances of this case no disallowance will be imposed on NSPI for its conduct."

Although Mr. Antonuk could not specifically confirm that this reference by the UARB refers back to Liberty's proposed sanction of $750,000 in reference to NSP's natural gas hedging program, Hydro submits that a reading of the relevant portion of the Decision (Section 4) makes it clear that is the case. Consistent with the La Capra's comments regarding regulatory sanctions discussed above, the UARB did not impose a sanction even where they had found certain of the behaviour of NSP was unreasonable. In the present case, although there was an extended outage for some customers in January 2013, there were no additional system costs incurred to be recovered.

The Terms of Reference state at page 3 that: "where actions are found to be imprudent, Liberty will examine where and by how much costs would have differed under a prudent course of action." Liberty's proposed disallowance however is an arbitrary figure and not in line with the requirements of the Terms of Reference.

Hydro submits that there is no sound regulatory basis on which to monetarily sanction Hydro in these circumstances, particularly at the level suggested by Liberty.

6. SUPPLY RELATED COSTS

With respect to this item, Liberty generally concluded that most of the outages in early January, 2014 were "either weather-related or reflected the typical types of failures one would expect" and they also "did not find a basis for imprudence with respect to supply planning and management of unit availability during the relevant period".[67]

Liberty then noted that, in its view, attention with respect to this issue should focus on the unavailability of Holyrood Unit 1 during the January 5-8, 2014 period, as loss of this Unit occurred due to the failure of the Holyrood breaker B1L17, which Liberty attributed to imprudence.

[67] Liberty Final Report, July 6, 2015, page 16.

For the reasons noted below, Hydro disagrees that failure of the Holyrood breaker B1L17 was due to its imprudence. If the Board finds that Hydro's actions in relation to the Holyrood breaker B1L17 were inappropriate (see discussion below), the question then remains as to what if any disallowance is appropriate in the circumstances. Liberty specifically notes that "no straight forward process for estimating the added costs attributable to the unavailability of Holyrood Unit 1 exists" and with respect to its proposed disallowance Liberty "stresses that this estimation is a rough one".[68]

The rough estimation that Liberty made was to approximate the costs attributable to what it determined as imprudently incurred costs as the increment of costs above the costs for the final four days of the 12-day emergency supply costs period of January 1-12, 2014.[69] As such, Liberty subtracted the emergency supply costs of the period January 9-12, 2014 of $671,271 from the emergency supply costs for the full four-day period of January 5-8, 2014 of $2,860,381 to arrive at an "Estimated Prudence-Related Costs" disallowance of $2,189,110.[70]

However, in this rough approximation, the four-day period which Liberty relied upon for comparison purposes of costs included the single warmest day in the entire January, 2014 through March, 2014 winter period.[71]

This obviously substantially impacts the supply related costs calculation. Liberty itself actually noted that the weather during the January to March, 2014 period, in which on 59 days of the quarter the temperature was less than the average of the worst annual temperature over the proceeding 30 years, was extraordinary.[72] This situation prevailed in nine days of the first 12 days of January, 2014 and for the first six days of January, 2014, in a row.[73]

Considering the limited additional supply costs in the January 9-12. 2014 period, which were impacted by the warmer weather, Hydro suggested that a more balanced approach would be to average the costs

[68] *Ibid.,* page 17.
[69] *Ibid*.
[70] *Ibid.*
[71] *Ibid.,* page 19, Figure 3.4.
[72] *Ibid.,* page 18. See also Transcript, November 12, 2015, pages 82-88.
[73] November 12, 2015 Transcript, page 87, line 19 to page 88, line 15.

from the four days prior to the January 5-8, 2014 period as well as the four days following. This approach would yield a disallowance of $984,674.[74]

Hydro acknowledges that the first four days of the applicable 12 day period were volatile and colder, but this does not discount utilizing that period to average it with the four days following the applicable January 5-8, 2014 period. In fact, it is such averaging that can provide a more balanced and representative result.

With respect to the issue of the data required to more specifically do the *ex-poste facto* calculation in question, Mr. Mazzini confirmed that:

> "Well, Hydro did not collect that data, and we've seen this elsewhere too that utilities don't always collect the data to the detail that it's needed, and in this case the data just wasn't there for Hydro or us to do the calculation."[75]

Liberty is also suggesting a disallowance to account for the unavailability of Holyrood Unit 1 for the entire period, January 5-8, 2014, notwithstanding that Unit 1 was back online by 3:30 p.m. on January 8, 2014. Liberty stated in response to Hydro that:

> "Therefore, the only partial day was January 8, and most of the peak was missed on that date. Given the 'rough' nature of the estimate, as noted in the report, a refinement for a few hours was not believed to be appropriate".[76]

Hydro submits that this rationale is weak at best, and that it would be inappropriate for the Board to impose a disallowance for a period of time in which Unit 1 was actually fully available. This is further support for use of the averaging approach suggested by Hydro.

A final issue with respect to this matter is that an amount of $504,610 proposed as part of Liberty's suggested disallowance on account of the supply-related costs issue, is also included in the disallowance with respect to the Holyrood Unit 1 turbine restoration costs. Liberty confirmed that the applicable

[74] Hydro Reply Evidence, page 7, line 24.
[75] November 12, 2015 Transcript, page 66, lines 18-23.
[76] PR-NLH-PUB-002, lines 25-27.

adjustment would need to be made to its proposed supply-related cost disallowance to avoid double-counting.[77]

7. SUNNYSIDE REPLACEMENT EQUIPMENT

(a) Causation

With respect to this issue Liberty has stated that since Hydro did not complete its transformer and breaker preventative maintenance ("PM") fully within Hydro's identified maintenance cycles, a causal connection should be drawn between this and the incidents that arose in relation to transformers or breakers whose preventative maintenance was beyond Hydro's identified maintenance cycle. However, neither Hydro nor Liberty were able to find any causal connection between the failure of the equipment in question and the fact that certain of the equipment had not had its most recent maintenance carried out within Hydro's then current maintenance cycle.

Liberty's view is that:

> "Where causation is not determinable, despite good faith and capable effort, it is sufficient to make the categorical level connection, as exists here, between conducting maintenance and avoiding malfunction."[78]

Hydro submits that it is inappropriate to conclude that where causation is not determinable it is sufficient to simply make a "categorical level connection" between conducting maintenance and avoiding malfunction.

In order to disallow recovery of costs, the Board must find both that (1) Hydro acted imprudently and (2) such imprudence resulted in harm to its customers. Harm to customers in relation to additional incurred costs requires proof of causation.

In *Public Service Commission of the State of Missouri*, 2013 Mo. PSC LEXIS 210, the Commission explicitly stated at page 11:

[77] Liberty Reply Evidence, September 17, 2015, page 16, lines 19-26.
[78] Liberty Final Report, page 28.

> In order for the Commission to direct a refund for any alleged imprudently incurred costs, it must apply a two-part test. The Commission must find both that: (1) the utility acted imprudently when incurring those costs and, (2) such imprudence resulted in harm to the utility's ratepayers. Harm to ratepayers in relation to imprudently incurred costs requires proof of causation, i.e., that the increased costs recovered from the ratepayers were causally related to the alleged imprudent action, and evidence as to the amount those expenditures would have been if the utility acted prudently.
>
> [emphasis added]

In the present situation, there is no evidence that the deferred maintenance caused any malfunction. The regulatory jurisprudence does not support Liberty's contention that where causation is not determinable it is sufficient to make a "categorical level connection" between conducting maintenance and avoiding malfunction. Proof of causation is required.

Liberty appears to rest its regulatory construct, at least in part, on its view that Hydro's failure to carry out all of the preventative maintenance called for during the general preventative maintenance cycles cost Hydro the opportunity to potentially have prevented the occurrences.[79] They further conclude that "it is proper to draw a cause/effect association in the absence of credible exculpatory reasons supported by substantial evidence".[80]

As noted above, in order to impose a disallowance upon a finding of imprudent behaviour it must be shown that the imprudence was a cause of the loss or cost in question. This is not the case in the current situation. Further, the jurisprudence in Canada surrounding negligence, which is akin in many regards to prudence[81], provides that "loss of chance" is not a proper foundation for causation.

The British Columbia Supreme Court has summarized the state of the law in Canada in this regard very succinctly as follows, citing to the applicable underlying Supreme Court of Canada jurisprudence:

> "The plaintiff cannot meet the onus upon him to prove causation by merely proving the loss of a chance (***Cottrelle***, *supra*, at para. 36). Similarly, it is not enough for a plaintiff to

[79] See for example Liberty Final Report, page 28.

[80] Liberty's Reply Evidence, at page 6, line 26 to page 7, line 1.

[81] Leonard Goodman in his text *The Process of Ratemaking* notes that the "prudent management" concept is related to the concept of "negligence". See *The Process of Ratemaking* (Public Utilities Reports, Inc., 1998) at page 856.

> prove that the defendants "created a risk scenario within which the plaintiff's pain, suffering and losses [have] occurred" (***Oliver (Public Trustee of) v. Ellison***, [1998] B.C.J. No. 589 (S.C.), at paras. 31-33; ***St-Jean v. Mercier***, [2002] 1 S.C.R. 491 at para. 116)"[82]

Canadian law requires evidence that on the balance of probabilities the conduct in question caused the costs to be incurred.

In relation specifically to the Sunnyside B1L03 air blast circuit breaker failure, Liberty concluded in its reply to Hydro's PR-NLH-PUB-003 that:

> "With the continued absence of Hydro's ability to demonstrate a cause not related to delay of appropriate maintenance, Liberty judged it appropriate to associate the failure with the lack of the conduct of appropriate maintenance."

Hydro submits this is inconsistent with the applicable jurisprudence. Liberty would essentially have Hydro held to the test of proving a negative.

The post-incident analysis did not identify any links between the failure to provide maintenance on the Sunnyside T1 transformer or the B1L03 air blast circuit breaker as a specific causal factor for the issues at Sunnyside. In response to PR-PUB-NLH-167 (Revision 1, June 10-15) Hydro specifically noted as follows:

> "Hydro's investigation, which involved third party expertise, did not determine that the deferred maintenance resulted in the equipment failures. In particular, the breakers involved in the transformer damage were examined and no cause for the misoperation was determined. Both breakers had been operated successfully prior to the events. Furthermore, the breaker in Western Avalon operated successfully following the event. The Sunnyside breaker was closely examined with no problems found. Despite extensive review, there has been no link found between the deferred maintenance and equipment failures experienced on January 4, 2014."

[82] *Jackson v. Kelowna General Hospital et al.*, 2006 BCSC 279, affirmed 2007 BCCA 129, leave to appeal to Supreme Court of Canada refused [2007] SCCA No. 212.

(b) **Breaker B1L03**

With respect to Sunnyside breaker B1L03, Liberty correctly noted that Hydro function-tested the breaker in 2011.[83] B1L03 was also operated successfully in August, 2013.[84] As such, there was no concern with the operability of the breaker at the relevant time. The breaker was outside of Hydro's general six-year maintenance cycle by only five months at the time of the Sunnyside incident, and as explained in detail by Hydro throughout the hearing, preventative maintenance was only deferred where it was necessary to carry out more critical maintenance activities.

The team studying the malfunction, including outside expertise, could not replicate the issue that occurred (i.e., that the breaker remained in closed position when it should have come open). As discussed above, it is important to bear in mind that Hydro experienced sustained cold weather during much of the outage period, which can have an impact on circuit breaker performance. Under cross-examination, Mr. Lautenschlager for Liberty confirmed ABB's conclusion that the cold temperatures that the breaker was experiencing for days up to the event was a factor affecting the breaker operation.[85]

In fact the ABB representative's report, which was an appendix to Hydro's root cause investigation report for the Sunnyside transformer, concluded as follows:

> "I believe that the cold temperatures that the breaker was experiencing for days up to the event, and the condition of the pole control boxes, are factors affecting the breaker operation. The pole control boxes should have operated under these conditions, but may be slow."[86]

And:

[83] Liberty Final Report, page 35.
[84] See PR-PUB-NLH-051.
[85] November 12, 2015 Transcript, page 103, line 18 to page 104, line 21.
[86] Undertaking No. 78, Appendix 7, to Schedule 8, to Hydro's March 2014 report, *A Review of Supply Disruptions and Rotating Outages, January 2-8, 2014*, page 69 of 78.

> "The problem is probably intermittent and I also believe temperature related. This would explain why things worked OK after with no problems."[87]

Newfoundland Power circuit breakers would have been exposed to the same weather conditions in the early January 2014 period, and Newfoundland Power states in its Interim Report on supply issues and power outage on the Island Interconnected System:

> "There were 9 substation breakers or reclosers which failed to operate correctly during the rotating power outages during January 2-8, 2014. These failures prolonged the duration of customer outages. The majority of the failures were due to the cold temperatures affecting the operating mechanisms."[88]

Liberty itself noted in its Interim Report dated April 24, 2014 on *Supply Issues and Power Outages Review of the Island Interconnection System*, at page 64:

> "Newfoundland Power also encountered another issue. Nine circuit breakers and reclosers would not close, because the cold weather had caused "stuck" mechanisms. Newfoundland Power determined that in some cases warn door seals allowed the heated air in the mechanism cabinets to escape. Repairs were made, sometimes after transferring loads to other feeders, where necessary."[89]

In relation to this issue, Mr. Moore for Hydro provided further background during cross-examination by counsel for Vale, Mr. Fleming, as follows:

> MR. FLEMING:
>
> Q. Based on the mechanism of failure, do you think that preventative maintenance would have had any effect on that type of failure?
>
> MR. MOORE:
>
> A. Not from the investigation that we did. We didn't find anything conclusive to indicate that if we had have completed the maintenance in the fall of 2013, that that would have definitely resulted in that breaker operating properly. That breaker did operate properly in 2013 on two occasions when we checked back

[87] *Ibid.*
[88] Information No. 41, page 25.
[89] Undertaking No. 136.

> through our records. It opened and closed as it should have in 2013. Like I indicated in PUB-NLH-174, there's a long list of preventative maintenance that's carried out in a terminal station, everything from monthly to quarterly to annual checks, and the six year PM is basically one portion of the maintenance that we do on these items, and it was the six year that was due in 2013 that we had to defer into 2014.
>
> MR. FLEMING:
>
> Q. I understand. I'm just wondering whether there's anything in that preventative maintenance that would have increased the ability of the breaker to work in a cold temperature?
>
> MR. MOORE:
>
> A. No."[90]

Despite this background, Liberty fell back on its suggested approach that where causation is not determinable it is sufficient to make the "categorical level connection" between conducting maintenance and avoiding malfunction. For the reasons discussed above, Hydro submits this is not a supportable regulatory conclusion, especially when breaker B1L03 had operated successfully prior to the January 2014 outages, and the post-incident testing could not replicate the issue that occurred, or for that matter, identify any incomplete maintenance that likely caused the breaker not to operate.

Notwithstanding the lack of any evidence supporting a finding that delaying breaker maintenance beyond the regular maintenance cycle specifically contributed to the Sunnyside issues, Liberty suggests a complete disallowance for the Sunnyside equipment capital costs (net of insurance proceeds) and the related net operating expenses.[91]

Hydro submits that this would be an extraordinary disallowance in the circumstances. For the reasons previously noted and below, Hydro does not believe its actions with respect to this matter were imprudent. However, if the Board makes a different finding, Hydro submits that: (1) in the circumstances and the context in which the decisions were made (i.e., balancing reliability and cost), and

[90] November 2, 2015 Transcript, page 80, line 10 to page 81, line 14.
[91] Liberty Final Report, pages 29-30 and Table 9.1 on page 44.

(2) in light of the lack of any evidential link between the deferred maintenance and the issues that arose, at most a partial disallowance would be justified if there was a finding of imprudence affecting this equipment.

It is important to also keep in mind that following the events of January 2014, Hydro followed up verbally with Altalink, BC Hydro, Hydro One, Hydro Quebec, Manitoba Hydro, NSP and SaskPower with respect to their maintenance practices. With respect to those utilities which responded, Hydro noted that for breaker PMs of similar scope the frequency ranged from two years to eight years, with the one exception being one utility that used an operation-frequency for frequently operated breakers rather than a time-based frequency. Regarding transformer PMs of similar scope, similarly, those utilities responding indicated a frequency ranging from three years to eight years. In both situations, Hydro's PM scope for transformers is in line with what other utilities are doing.[92]

Separate and apart from the lack of any direct causal evidence between the delayed PMs and the January 2014 transmission system issues, is the question of the requirement in any event to strictly adhere to the PM programs. Although Hydro certainly agrees that the preference and the ultimate goal was to complete PMs within the agreed upon PM cycle, this was not possible in all circumstances, particularly when there was significant critical break-in work, such as occurred in 2013 and 2014.

Hydro's plan for completion of the deferred breaker and transformer work was to be in alignment with its six-year preventative maintenance cycle by the end of 2015.[93] Hydro had recognised as early as 2009 that it was important to bring its preventative maintenance work into better alignment with its maintenance cycles[94], and it put in place a specific program to achieve this. However, as is fully documented in the record of this proceeding, a substantial amount of critical break-in work arose, particularly in 2013, requiring very extensive additional labour and overtime. PR-V-NLH-001 and 002 outline in detail the critical break-in work that arose in 2013 and 2014 and the extensive labour and overtime hours required to carry out that work (in the range of 10,000 hours for each of labour and overtime for each of 2013 and 2014).

[92] PR-PUB-NLH-074.
[93] PR-V-NLH-002.
[94] October 28, 2015 Transcript, page 15, line 21.

In the context of the extensive critical break-in work that arose, and the already significant increase in capital spending at Hydro in the period leading up to January 2014, it is not surprising that Hydro deferred certain preventative maintenance work to carry out more critical work. Liberty's contention is that as preventative maintenance work is by definition meant to be preventative in nature it must be carried out within the preventative maintenance cycle. But this would essentially have required sufficient additional revenue for Hydro to ensure that in all circumstances all critical break-in work that arose from time to time was completed (no matter how extensive) and the preventative maintenance cycle still strictly maintained.

Hydro submits that this was neither realistic nor appropriate in the context of the overall circumstances facing Hydro prior to January 2014. In response to PUB-NLH-039 in the Outage Inquiry[95] Hydro specifically also noted in part as follows:

> "Over the past five years, formal condition assessments were completed on Gas Turbines, Diesel Plants, Holyrood and Hydraulic Structures, and resulting recommendations were integrated into Hydro's capital plans. This was a key factor which has led to an increase in Hydro's capital budgets since 2005 of 170 percent to secure the long-term reliability of the system."

And further on in that response:

> "Holyrood's annual capital spending has approximately doubled in the last five years to advance recommendations from these assessments."

Hydro purposely carried out formal condition assessments, which informed its requirement to substantially increase its capital budget to secure long-term reliability of the system. Mr. Mazzini of Liberty confirmed during cross-examination that formal condition assessments are an appropriate way to assist in determining the conditioning of generating assets.[96] Mr. Mazzini then went on to concur that utilities have to prioritize their capital investment, and that each of safety, reliability and cost are primary factors in evaluating expenditures.[97]

[95] Information No. 42.
[96] November 12, 2015 Transcript, page 118, lines 10-16.
[97] November 12, 2015 Transcript, page 119, line 5 to page 120, line 6.

Within this overall context of increasing capital expenditures at Hydro to secure long-term reliability of the system, Mr. Moore noted during cross-examination that the decisions being made by Hydro with respect to the deferral of any preventative maintenance were made keeping in mind the provision of safe, reliable and cost-effective supply of electricity to customers, and that preventative maintenance was only deferred where more critical work arose.[98] He specifically noted that Hydro was "very committed to the balance between work execution, reliability, and least cost supply" for its customers.[99]

There has been no evidence that suggests that the critical break-in work carried out by Hydro was not at a priority criticality level. The question then becomes whether strict adherence to the PM cycles was required for Hydro's actions to be considered reasonable. In the context of the critical break-in work that arose, the extensive recent increase in capital spending, and the knowledge of the equipment known by Hydro's experienced engineering staff,[100] Hydro submits that the failure to strictly adhere to the PM cycle in certain circumstances, cannot, and should not, in and of itself be considered imprudent. In particular, the following evidence of Mr. Moore is instructive:

> "As a manager managing our operating budget, which we've clearly explained in previous testimony and in evidence, that on an annual basis we develop an operating budget based on the operating budget guidelines that are distributed to the corporation by finance, and we're very committed to working to our operating budget, and as we indicated, you know, that's one of our most effective tools that we have as operations managers to ensure we keep the rural deficit manageable, which is very important to us as a corporation. So we were working towards our recovery plan and fully committed to our preventative maintenance program, and as I indicated, the only thing that would take us off or cause us to re-prioritize any of our six year maintenance would be any capital or corrective work that was unplanned for that would be of a higher priority for our customers and the reliability to our customers, so at the end of 2013, we were four years into a six year plan, we had realized that we weren't as far along as we would have liked to have been in this six year recovery plan, and so then we put forward in our 2014 and 2015 test year a plan to be fully recovered by the end of 2015."[101]
>
> "As I indicated yesterday when we talked about this issue, I took the position that I'm currently in in 2011, and we looked at - well, that was two years then into our six year

[98] October 28, 2015 Transcript, page 28, lines 8-19.
[99] October 28, 2015 Transcript, page 24, lines 22-24.
[100] October 28, 2015 Transcript, page 31, line 23 to page 32, line 9.
[101] October 28, 2015 Transcript, page 21, line 4 to page 22, line 5.

> recovery plan. So we did have a plan put forward for 2012, an annual work plan, which included the most overdue maintenance in terminal stations for air blast circuit breakers and power transformers, as we talked about the numbers here in the RFI. So we did have a plan for 2012. There are a number of items that we documented in RFIs that were break in work that we've talked about that took us way from that plan. Then we put forward our 2013 annual work plan, and in 2013 we really wanted to focus on - the corporate target, as we talked about in a previous RFI, would have been 90 percent of PM in a given year, so that was the target at that time that as a manager we were accountable for. So we put forward a 2013 plan that included the most overdue maintenance, plus a portion of I'll call it the base maintenance that we do each year, so at that point we were four years into our six year recovery plan, realized that we were not as far along as we would have liked to have been in our six year plan, and it wasn't until we put forward the 2014/2015 test years that we formally requested additional budget and resources to achieve success by the end of 2015, which we will achieve by the end of this year."[102]
>
> "But, you know, in 2013, we were certainly tracking against our - actuals against our plan and we very clearly knew exactly where we were in 2013, and back at that time we would have been working towards thinking about a revised - because I think we did have a 2013 test year put forward, and Hydro realized at the time that, you know, we do need to put in a revised test year for 2014/2015, and we did make a very considered decision at that time to make sure that a full recovery plan was in place to the end of 2015."[103]

With respect to the rationale and process for deferral of PM work, Mr. Moore specifically noted:

> "The only reason we would re-prioritize any of our preventative maintenance activities would be for any unknown work, whether it be operating, corrective maintenance, or capital that is determined to be of a higher priority nature for immediate reliability supply to our customers, and that's the only reason we would in any way stretch out our plan to longer intervals because of anything that's of a higher priority, a more urgent nature for our customers supply."[104]
>
> "What I'll say is the people that make decisions about any work of a higher priority nature that would take us off our annual work plan is a very considered decision by very knowledgeable people taking into account, you know, reliability up to that time of the assets, the asset condition, any known operating issues with the assets, knowledge of what the manufacturer had recommended as maintenance for the assets and very considered decisions of anything that'll take you off plan. What we have in place now is a - we talked about it there yesterday, I'll call it a management of change form that is

[102] October 28, 2015 Transcript, page 23, line 9 to page 24, line 15.
[103] October 28, 2015 Transcript, page 26, lines 11-22.
[104] October 28, 2015 Transcript, page 28, lines 8-19.

> used now to document any of those decisions and an opportunity for every person involved with the decision to sign off. The amount of rigor that goes into the decision itself, I think, is still as strong and will continue to be as strong as it's always been. What we're doing now is ensuring that we have a documented record of that decision going forward.[105]

With respect to documentation regarding Hydro's decisions, Mr. Moore noted that the documentation at the time would have been reflected in Hydro's computerized maintenance system where target dates and years for preventative maintenance activities would have changed, and members of Hydro's Short Term Planning and Scheduling Group, who develop Hydro's weekly work schedules and annual work plans, would have kept track of any of those changes through their normal maintenance planning process.[106]

With the benefit of knowledge arising from the post-incident analysis carried out with respect to the January, 2014 issues, Hydro has now accelerated its air blast circuit breaker PM cycle to four years from six years. The target for completion of PMs moved to 100% and Hydro's annual work plan is now tracked on a weekly basis by way of a weekly report indicating what was achieved that week, what may not have been achieved that week, and what time the activity will be rescheduled within that calendar year, to allow Hydro to achieve its annual work plan for the year and its winter readiness target date of December 1.[107]

The incidents of January 2014 have allowed Hydro to improve upon its go forward processes to further enhance its capability to provide safe, reliable and cost-effective electricity supply to its customers. That being said, the move to further enhancements does not imply that the practices being carried out by Hydro prior to January 2014 were imprudent. Utilities consistently learn from experience, and modify practices where experience suggests such should occur.

For the reasons stated above, Hydro submits that its practices with respect to preventative maintenance were not imprudent in the overall context and considering the balance that always needs to be achieved

[105] October 28, 2015 Transcript, page 31, line 23 to page 32, line 19.
[106] October 28, 2015 Transcript, page 33, lines 1-13.
[107] October 28, 2015 Transcript, page 34, line 10 to page 35, line 9 and October 28, 2015 Transcript, page 13, lines 12-17.

between the competing priorities of reliability and cost. Hydro's evidence is clear that any decisions on deferring preventative maintenance were only done to accommodate more critical break-in work and fully took account of Hydro's knowledge and understanding of its asset base at the relevant times in question. There is no evidence suggesting the contrary.

Hydro further notes that breaker B1L03 was intended to be replaced in any event as part of Hydro's air blast circuit breaker replacement program. B1L03 was replaced by a new SF_6 breaker in accordance with this program at a cost of $527,740. Accordingly, even if the Board were to make an adverse finding in relation to the timing of this breaker's latest preventative maintenance, there is no rationale to disallow its replacement cost, particularly as all parties, including Liberty, agree that the air blast circuit breakers should be replaced over time.

Liberty contends that Hydro should not be able to recover the breaker replacement costs for breaker B1L03 on the basis that the record does not fully demonstrate that Hydro would have replaced breaker B1L03 in 2015.[108] However, it is clear that Hydro was in any event, as part of its ongoing breaker replacement program, replacing air blast circuit breakers in 2015. Since an air blast circuit breaker would have been replaced in 2015 there is no reason to deny recovery of the cost of the breaker chosen for replacement. This would simply deny Hydro recovery of the cost of a replacement breaker that is being installed for the benefit of its customers and which all parties agree should be replaced as part of the ongoing air blast circuit breaker replacement program. Hydro submits that there is simply no justification for disallowing this prudently incurred cost.

(c) **Transformer T1**

Liberty's conclusions with respect to transformer T1 appear to be based on its view stated at page 7 of its Reply Evidence that Hydro gave transformer maintenance at Sunnyside's T1 "essentially no priority". However, this is not supported by the record. Hydro described its transformer maintenance practices in PR-PUB-NLH-050 and noted that with the maintenance information which Hydro had at the relevant point in time, there was nothing directing Hydro to treat T1 transformer maintenance in preference to more critical maintenance, break-in work and capital work. Hydro's reply to PR-PUB-NLH-166

[108] Liberty Reply Evidence, page 11.

specifically explained that the Sunnyside T1 transformer was in the maintenance management system as a backlogged item to be added to the upcoming annual work plan, however, it failed before the work on the asset could be scheduled. Hydro noted that it fully intended to conduct the overdue six-year preventative maintenance on Sunnyside T1 in the 2014 annual work plan, and the annual work plan for 2014 was under development when T1 failed in January 2014. As a result the six-year preventative maintenance for T1 would not have been documented in the 2014 annual work plan.

The record is clear that Sunnyside T1 transformer, which was only overdue for maintenance by about three months of a six-year cycle, was fully intended to be addressed in the upcoming year had it not failed in the very short window following the scheduled six-year preventative maintenance program. Liberty's suggestion, which seems to be the basis for its conclusions with respect to T1, that Hydro gave it "essentially no priority" is not confirmed by the record. It also must be kept in mind that the failure of the transformer in and of itself would have caused limited system issues. As a result of breaker B1L03 failing to open the fault was present for an extended period of time and consequently a fire developed with the resultant impacts. As discussed above, Hydro submits that its actions in regard to breaker B1L03 were not determinative of the breaker's failure.

Liberty suggests that the simple failure to have strictly adhered to the six-year maintenance cycle, despite Sunnyside T1 being only about three months outside that cycle, suggests a cause/effect relationship can be implied on the basis that bushing problems are among those that scheduled preventative maintenance may detect.[109] As noted above, the post-incident review did not indicate that preventative maintenance would have determined the bushing issue. The preventative maintenance was only a short period outside of the general maintenance cycle and had only been deferred by one year due to the more critical work that had arisen.

Further, as Hydro explained, the Doble test for bushings is not a pass/fail test, rather it measures the amount of insulation degradation around the bushing, and thus hypothetically even if some level of degradation had been found, that could well have led to potential enhanced monitoring, or possibly placing the transformer in priority for eventual replacement of the bushing. Bushing replacement is a

[109] Liberty Final Report, pages 28-29.

very intrusive process to the transformer and therefore is carried out in a scheduled, planned and deliberate fashion. Thus, even hypothetically had there been some issue indicated by preventative maintenance, there is no evidence to suggest that it would have been of an order of magnitude to immediately replace the bushing, or to replace the bushing in the very short time period outside of the PM cycle.[110]

Mr. Moore described the Doble test process as follows:

> "Normally the way a Doble test works, I wouldn't really call it really say a pass/fail type test. It's a condition monitoring test which looks at the insulation integrity of the bushings on a power transformer, so the intent of the test is to get a data reading, I guess, and do a test of the insulation on the bushing and then you can monitor those levels over time to see how well the insulation is performing and if you do notice degradation in the readings, and we have, you know, expertise in Doble that our equipment engineers consult with to discuss any tests that start to look like they're showing, say degradation over time so we can address it in our planning process or asset management process."[111]

He then specifically noted as follows:

> "That's right, the intent of a Doble test is to test the condition of a bushing on a power transformer, but again, it's a longer term condition monitoring test, as opposed to a pass/fail test."[112]

Liberty also raised another item with respect to transformer T1, i.e., elevated gassing levels. To begin this discussion it is important to highlight that no party, including Liberty, has suggested that the gassing levels or the cause thereof were in any way a cause of the issues with transformer T1. As Mr. Moore made clear to Board counsel during cross-examination, there is no interplay between acetylene gassing and an indication that there is a problem with the bushing.[113]

Hydro had been monitoring the gassing levels in its transformers for some time. Hydro explained in PR-PUB-NLH-023 that variations in gas content in this particular transformer design had been seen since the

[110] Hydro Surrebuttal Evidence, October 14, 2015, page 6, lines 6-15.
[111] October 27, 2015 Transcript, page 171, line 16 to page 172, line 6.
[112] October 27, 2015 Transcript, page 172, lines 18-22.
[113] October 27, 2015 Transcript, page 183, lines 1-7.

early 1990's, and that the Original Equipment Manufacturer's ("OEM") opinion was that it appeared to be due to gas migrating from the tap changer component to the main transformer tank. For the reasons detailed in PR-PUB-NLH-023 Hydro's approach was to monitor the gas levels so that increasing levels could be identified and acted upon. Hydro's dissolved gas analysis reports showed that the level of acetylene gas increased from seven parts per million in March of 2012 to only 11 parts per million in September of 2013."[114]

Hydro indicated that the action it took was to talk to the transformer manufacturer and discuss the readings that had been trending for decades and get their expert opinion as to why Hydro was seeing these levels of gas in that transformer. The manufacturer of the transformer was of the opinion that there was some form of leakage happening between the two oil reservoirs that was causing some of the acetylene gas from the tap changer to migrate into the main transformer tank. Hydro had been actively reviewing and monitoring the gas levels since the early 1990s.[115]

Hydro also confirmed that it has subsequently completed a leak test on the Stony Brook T2 transformer, a similar transformer to Sunnyside T1, which test has confirmed the gas is migrating from the tap changer to the transformer tank, thus validating Hydro and the manufacturer's understanding of this issue with respect to transformers of the same design and vintage of Sunnyside T1.[116] Mr. Moore confirmed in redirect that the transformer at Stony Brook was exactly the same as the transformer in Sunnyside, Sunnyside being of the same age and design and rating.[117]

With respect to the September, 2013 lab analysis recommendation that there be additional testing due to the increase to 11 parts per million, Mr. Moore noted as follows:

> ". . . we would have gone back and done further testing in early 2014, had the transformer not failed, that would have been our normal course of action based on that

[114] October 27, 2015 Transcript, page 174, lines 18-21.
[115] October 27, 2015 Transcript, page 176, line 1 to page 177, line 10.
[116] Hydro Reply Evidence, page 12, lines 20-24 and October 27, 2015 Transcript, page 177, line 10 to page 178, line 6.
[117] November 2, 2015 Transcript, page 103, line 4 to page 104, line 7.

> recommendation, but we didn't get the opportunity, I guess, to go back and do further sampling and analysis on that transformer."[118]

Mr. Moore also explained that it is a time consuming and extensive job to effect repairs on the tap changer. He specifically noted that it involved removing the top of the transformer, pumping the oil level down and then doing intrusive maintenance to try to repair any seal between the two chambers. He noted that Hydro was looking at an estimate to do an internal inspection on a transformer at Vale to validate some of the readings and these jobs were ending up somewhere in the hundreds of thousands of dollars per job to go in and take apart a transformer, drain the oil down and do internal work.[119] Mr. Lautenschlager for Liberty indicated during cross-examination that he had been involved in gasket changes on tap changers in the 1990s and they had taken about 4 days to do with a cost of approximately $30,000 and he ballparked that this might be double today.[120] He however indicated that he had not done any analysis of the current cost of carrying out these activities today and that he had no familiarity with the Canadian requirements involving disposal for tap changer oil.[121]

In the circumstances and with the overall context there is nothing to suggest that Hydro's actions based on decades of experience with low level gassing was inappropriate. Most importantly in this regard there is no evidence that the gassing levels had anything to do with the failure of the transformer, and gassing levels are not indicative of a potential bushing failure.

8. WESTERN AVALON TERMINAL STATION T5 TAP CHANGER

With respect to this issue, Liberty approaches its suggested disallowance on the same basis as it did with the Sunnyside Replacement Equipment. The situation that prevailed at Western Avalon was that one phase of Breaker B1L37 failed to close when operators closed the breaker and this likely led to the eventual damages in question.

In this case, following the incident, Hydro was not able to replicate the breaker malfunction, and in fact the breaker operated successfully following the event in question.

[118] October 27, 2015 Transcript, page 179, line 20 to page 180, line 2.
[119] October 27, 2015 Transcript, page 178, line 8 to page 179, line 9.
[120] November 12, 2015 Transcript, page 159, lines 1-8.
[121] November 12, 2015 Transcript, page 159, lines 20-23 and page 160, lines 7-13.

Notwithstanding that the breaker in fact operated successfully following the event, Liberty suggests once again a complete disallowance of the replacement and repair costs for the T5 tap changer due to the fact that the scheduled maintenance on breaker B1L37 was outside of Hydro's general preventative maintenance cycle.[122]

For the same reasons as discussed above with respect to breaker B1L03, Hydro submits that the context does not support a disallowance particularly of the entire cost. This is particularly the case with respect to BL137 in that it operated successfully following the event.

Mr. Moore explained the issue with this breaker in detail:

> "It is a breaker that didn't operate as it should have that day. I'll say that since that time we did a full investigation into operation of that breaker, and it worked properly since then, and in 2014 after we had the event, we did the full maintenance inspection on that breaker and testing and it did work properly, and then further follow up to that as part of our overhaul program, we did as an extra level of diligence, I'll say, we did an overhaul of that breaker in 2015 and never did find any evidence as to why that breaker didn't operate that day. We also had the same issue when we talked about yesterday, B1L03 in Sunnyside, we brought in ABB at that time who would have been the breaker manufacturer to help us with a full root cause analysis of why we had an air blast circuit breaker on that day not perform as it should, and we did an exhaustive investigation and we even tested all the auxiliary systems since, like, the DC system and the compressed air system that's required to operate that breaker and never did find any conclusive evidence as to why the breakers didn't operate. Now ABB did offer an opinion in our root cause analysis report that we submitted to the Board, I think, back in March, 2014, that on two occasions in the report they indicated that the cold weather events that day may affect the operation of air blast circuit breakers."[123]

Again, despite follow-up analysis, and the fact that the breaker operated successfully following the event, there was no evidence found as to why the breaker did not operate on that day, although as previously discussed ABB did indicate that cold weather events that day may have affected breaker operation.

[122] Liberty Final Report, pages 33-34.
[123] October 28, 2015 Transcript, page 37, line 2 to page 38, line 8.

The maintenance on breaker B1L37 was, as indicated by Mr. Moore, deferred based on Hydro's criticality assessment, with the most important breakers being associated with generating equipment, and Hydro's plan was to complete the maintenance on that breaker in 2014.[124]

Mr. Henderson further indicated that his understanding was that B1L37 was in the work plan for 2013 but it got deferred because all of the additional critical work previously discussed going on in 2013.[125]

Thus the preventative maintenance work was simply deferred based on the criticality assessment process that Hydro continuously carried out.

9. HOLYROOD BREAKER B1L17

The post-incident investigation of Holyrood Breaker B1L17 determined that the most probable cause of the failure was moisture in the "A" phase receiver tank.[126]

Hydro had disassembled the breaker to permit application of a room temperature volcanizing ("RTV") protective coating on the breaker insulators to prevent future flashover events such as occurred in January 2013. Hydro had removed the breaker head columns and interrupting chambers in order to apply the RTV protective coating, and had secured waterproof covers over the then exposed receiver tank and the driving rod.[127]

Liberty concluded that "the receiver tanks remained exposed to weather for a long, one-month period".[128] Hydro submits that the record does not support this characterization. Hydro acknowledges that water apparently did at some point enter the tank; however, Hydro had taken prudent steps to prevent exposure to the weather for the duration that the breaker insulators and columns were removed.[129]

There was no indication to Hydro at the relevant times that the waterproof cover over the tank and the driving rod was insufficient. Mr. Moore specifically noted in this regard as follows:

[124] October 28, 2015 Transcript, page 40, line 19 to page 41, line 6.
[125] October 28, 2015 Transcript, page 41, line 20 to page 42, line 2.
[126] See PR-PUB-NLH-067.
[127] Hydro Reply Evidence, page 17, lines 14-18.
[128] Liberty Final Report, page 36.
[129] See PR-PUB-NLH-066 and PR-PUB-NLH-067.

> ". . . Now while we have the parts removed, we actually ensure that the breaker is secured with a weather tight, I'll call it cover in the switch yard and our very experienced terminal station employees, these are employees that have been working in our stations for many years, professional journeypersons, safely secure the breaker with a weather tight cover to ensure that any snow, wind type thing does not get involved or into the breaker while we have the parts removed for the coating."[130]
>
> "I have no reason to believe that our crews would not have secured that breaker in a very deliberate waterproof secure fashion."[131]
> "It would be a brand new suitable cover -- of suitable weather tightness and durability for our elements."[132]

He concluded in this regard that:

> ". . . We know that there was a weather-proof cover put in place. We know that it was in place a little longer maybe than we would have had hoped because of higher priority work, but we had no reason to believe that that resulted in moisture getting into the breaker, there's nothing conclusive at all. The only thing that we're a hundred percent sure on is that moisture at some point in time got into that breaker. [133]

As important is that after being reassembled, breaker B1L17 went through a complete set of tests to check timing and proper operations, and prior to re-installing the insulating columns and interrupting heads of the breaker, crews performed visual inspection of the tank from the top.[134]

Furthermore, Hydro exercises its breakers prior to putting them back into service utilizing clean dry air from the compressed air system, and has been performing regular dew point tests on its compressed air systems consistent with the practice of other utilities. Hydro had no reason to check for moisture in the receiver tank based on its prior experience and testing practices.[135]

[130] October 28, 2015 Transcript, page 46, lines 1-12.
[131] October 28, 2015 Transcript, page 51, lines 5-8.
[132] October 30, 2015 Transcript, page 99, lines 12-23.
[133] October 28, 2015 Transcript, page 213, lines 1-10.
[134] See PR-PUB-NLH-066 to PR-PUB-NLH-068.
[135] Hydro Reply Evidence, page 18, lines 22-25.

In this regard, Mr. Moore specifically noted during cross-examination as follows:

> ". . . When we put the parts back on the breaker, we go through a full test, like I just indicated, and the idea of the test, I guess, is two-fold. One is to confirm that the breaker operates as designed when we do our test. The other, I guess, goal of doing the test is that air blast circuit breakers operate on compressed air and we have a very extensive program to ensure that the compressed air supplied to the station is clean dry air, so that no moisture gets into the compressed air and into the breaker."[136]

Finally, although the breaker was dismantled for a longer period of time than initially anticipated, this was solely due to the fact that Hydro had to attend to higher priority work that intervened at that time which was of a more urgent nature for its customers.[137]

Hydro submits there were no imprudent actions taken with respect to this breaker. It was dismantled for servicing, Hydro was fully aware of and put in place waterproofing, and the period of time for which the breaker remained dismantled only existed due to the need to address higher priority work fully documented in PR-PUB-NLH-066. As well, the post-incident analysis did not indicate any failure on the part of Hydro or when the water actually entered the breaker.

Based on the post-incident analysis, Hydro has on a go-forward basis developed a new procedure to put new drain valves at the bottom of the compressed air tank on each phase of the breaker, and crews now open the drain valve as an additional check to make sure that there is no moisture present in the air system of the breakers.[138]

Thus, based on Hydro's prior experience and practice the actions it carried out at the relevant time were prudent. With the benefit of knowledge learned from this incident, Hydro has modified its procedures going forward to further enhance its return to service moisture checks. Positive modifications on a go-forward basis determined from post-incident analysis do not, however, suggest that the failure to have such modifications in place prior in time was imprudent.

[136] October 28, 2015 Transcript, page 46, lines 12-23.
[137] October 28, 2015 Transcript, page 50, lines 19-24 and PR-PUB-NLH-066.
[138] October 28, 2015 Transcript, page 52, line 13 to page 53, line 1.

10. BETTERMENT

With respect to both the Sunnyside Replacement Equipment and the Western Avalon Tap Changer Replacement, the issue arose during the review process as to the appropriate adjustment to be made, if the Board were to make an adverse finding against Hydro, with respect to the value of the replacement assets, recognizing that the replaced equipment had a shorter operating life than the new equipment.[139] Hydro retained Mr. Larry Kennedy of Gannett Fleming, an expert in matters related to public utility plant depreciation and plant accounting, to provide his opinion on how best to address this issue, if the Board did make an adverse finding against Hydro with respect to either the Sunnyside Replacement Equipment or Western Avalon T5 Tap Changer Replacement.

Mr. Kennedy concluded that the capital expenditures resulting from the requirement to replace certain components and associated infrastructure at Sunnyside and Western Avalon "clearly resulted in a betterment of the assets beyond the original expectation of the assets when they were originally installed".[140]

The study conducted by Mr. Kennedy was described in his Report as follows:

> "In making the calculations as provided in Part III of this report, Gannett Fleming required the original cost of installation of the assets; the estimated amount of accumulated depreciation of both the retired and remaining assets; and the estimated remaining life of the asset components. The original cost of the asset components were provided to Gannett Fleming by the company. The estimated amount of accumulated depreciation and estimated remaining life were determined by Gannett Fleming from the approved Iowa curve.
>
> Based on the inputs as described above, Gannett Fleming determined the remaining life of each of the asset components and then calculated the weighted average remaining life of the total asset including the replacement components. Through the development of the weighted average life, the rate-payers are only responsible for the consumption of the service value of the asset components providing utility service at any point in time."[141]

[139] Liberty Final Report, page 31.
[140] Mr. Kennedy's Betterment Report ("Betterment Report"), at page 7 of 14 of Appendix "A" to Hydro's Reply Evidence.
[141] *Ibid.,* at page 8 of 14.

The betterment determined by Mr. Kennedy for each of the Sunnyside Replacement Equipment and Western Avalon equipment capital represents the percentage consumed value of the retired asset multiplied by the applicable replacement cost. As such, the betterment only reflects the costs of the already consumed value of the replaced assets at the time they came out of service, and Hydro remains responsible for the portion of the replacement cost associated with what would have been the remaining undepreciated value of the assets at the time they came out of service. Mr. Kennedy explained this position succinctly in response to questions from Vice-Chair Whalen as follows:

> "I think that penalty comes in two forms. One is the utility is going to eat the cost of the loss on retirement on the old asset and that would in essence mean go to the net book value of that asset. So because that asset removed from service earlier than would otherwise have occurred, that loss on retirement is higher at this point in time than it would be had that asset stayed in service and retired for other causes later on. So it's a penalty in that aspect. Secondly, the utility is, as part of the calculations that I made in my report, is in essence applying the penalty against the cost of the new asset rather than the cost of the old asset. So not only is the utility, to some extent, eating the loss on retirement of the old asset, on that consumed portion of the asset, they're also eating the impact of inflation because that new asset is going to be, you know, two to three times more expensive than the old one would have been. So because we apply that percentage against the cost of the new, there's a hit there I think as well. I think the overall goal of the calculation -- it may not be apparent in the calculations, but the overall goal of the calculations is to ensure that really the customers over the long term are paying for the asset they have in service through that adjustment that we make on the page that Ms. Greene and I went through."[142]
>
> "The numbers on the page just put up on the screen, in essence the utility is eating, in this case, $961,000 of the cost of the new asset and in the case of the western Avalon, the utility would be absorbing $291,000 of the cost of the new asset. Quite honestly, that's kind of the penalty, if you will, that the utility is absorbing for the cause of the retirement to occur early. So the customers are gaining the benefit of approximately three million dollars of assets at Sunnyside, or if we take out the adjustment for breakers, 2.1 million dollars of asset, but are only going to absorb into rate base 1.1 million. So there is almost a million dollars of adjustment made to recognize that consideration. And I think in making this adjustment against the cost of the new, there is some impact that the company is absorbing that rate of inflation that's gone on from the old to the new asset. So I think -- and I understand your dilemma and I understand the dilemma that Mr. Johnson put forward. The intent was to deal with that dilemma through this cost adjustment if there was a finding of imprudence. Now, the utility is not only taking the loss on the old asset, they are also taking a loss on the capitalization of

[142] October 30, 2015 Transcript, page 55, line 19 to page 57, line 1.

> the new asset for almost a million dollars, which is in part the reflection of that coming out. What that does leave in the rate base hands is the expectation that this asset is going to live another whole life way beyond what that old asset would have and the approximately 1.1 million dollars of what I term as betterment is that reflection of that period of that extra life that the customers will get over the long term."[143]

Mr. Conway for Hydro noted that the approach suggested by Mr. Kennedy was consistent with Hydro's treatment of betterment calculations for similar situations, and concluded as follows:

> "So, just to kind of reiterate that point, the penalty is on the portion of the asset that is still alive and we would put in rate base the portion of the asset that would have been consumed because -- and that makes logical sense, if you think about it, because why would the penalty be on the portion of the asset that's already fully consumed. The rate payer has already got the full benefit of that consumed portion.
>
> So, Hydro completed the same process with regards to Sunnyside and Western Avalon. We took the asset and we calculated the percentage of how much the asset was consumed or dead versus how much was still in rate base and the portion of the asset, the percentage of the asset that was still subject to last longer, Hydro took that penalty and what we'd be suggesting is we'd be writing off that penalty. We'd be writing off that portion of the asset. So the rate payers or customers would only be getting their fair portion of the asset had it lasted so much longer. So everybody would be held whole."[144]

Thus, the approach suggested as appropriate by Mr. Kennedy, and which is consistent with Hydro's accounting practices, is for Hydro to take the loss on the old equipment, and to put into rate base the betterment portion of any equipment that the Board found to have been replaced prematurely due to Hydro's decisions or actions. Mr. Kennedy's report shows the 2014 actual costs including the betterment expenditure for Sunnyside and Western Avalon, and the Sunnyside 2015 Test Year costs plus the betterment expenditures.[145] The response to Undertaking No. 134 shows the total actual expenditures for the Sunnyside Replacement Equipment.

[143] October 30, 2015 Transcript, page 58, line 4 to page 59, line 17.
[144] November 9, 2015 Transcript, page 123, line 21 to page 124, line 20.
[145] Betterment Report, page 11 of 14.

Liberty expressed a concern with the approach taken by Mr. Kennedy and Hydro, in that including the addition of the betterment expenditure in the 2014 or 2015 Test Years did not in their view "ensure that customers pay no more than would have occurred absent" an adverse finding by the Board.[146] Mr. Johnson during cross-examination of Mr. Kennedy put the question as follows:

> "Would you accept the principle that we're aiming to get at is putting the customer in the place where they would have been but for utility inprudence?"[147]

Mr. Kennedy responded as follows:

> "I would think you're aiming to get there, but I don't think you can do it in one - in this year. I think you have to look at the life cycle of the fact the customers are gaining the benefit of an asset that's going to live an additional 40 years or 50 years."[148]

During cross-examination, Hydro sought clarification from Liberty as to what approach they would suggest instead of that put forward by Hydro, in light of the fact that the replacement equipment was going to provide value to customers in the long term above and beyond the equipment which was replaced. First, Mr. Antonuk explained that with respect to the undepreciated portion of the assets that had been replaced at Sunnyside and Western Avalon "they would be transformed into a regulatory asset at their current depreciated cost, amortizable over expected remaining life and that regulatory assets would be allowed for a return in current rates".[149]

He further clarified this point to state that the prior investment would be turned "into a regulatory asset that would mimic the remaining cost of the asset as it depreciates over its remaining expected life".[150] He went on with respect to how this would tie in to the recovery of the investment of the new equipment as follows:

[146] Liberty Reply Evidence, September 17, 2015, page 13, lines 22-23.
[147] October 30, 2015 Transcript, page 46, lines 3-6.
[148] October 30, 2015 Transcript, page 46, lines 8-13.
[149] November 12, 2015 Transcript, page 151, lines 9-13.
[150] November 12, 2015 Transcript, page 151, line 25 to page 152, line 3.

> "I agree with it. I think we're close, but I want to be precise. If the remaining expected life was ten years, then what you would do is you would continue on a regulatory asset basis to depreciate the value it had for ten years, that regulatory asset. You create a corresponding regulatory asset which consists of the installed cost of the replacement. For those ten years when it would not have been in service but for imprudence, you depreciate that regulatory asset. Then at the end of those ten years, you put it in at its then depreciated original cost."[151]

Thus, Liberty's suggested approach requires the creation of two regulatory assets for each of the Sunnyside and Western Avalon replacement equipment in question, and a determination of what the end of life of those assets would have been if they had survived past January, 2014. Hydro submits that this approach is not consistent with the accounting treatment for Hydro assets in similar situations, and requires the creation of further regulatory assets and life span determinations which are not required in the approach suggested by Mr. Kennedy.

Mr. Antonuk suggested that the assets that were replaced would otherwise have "a determinable expected remaining life,"[152] however Mr. Kennedy explained as follows why the practical application of the timing as recommended by Liberty is not possible to determine:

> "As identified in this evidence, the retirement of utility assets can be caused by a number of forces of retirement at any age. It is not correct to suggest that the retirement of the replaced assets at approximately age 40, is in any manner unexpected. Furthermore, as identified in Attachment 1 to this evidence, there is retirement activity anticipated at virtually every age from age 1 through age 80, with significant levels of retirement activity occurring at ages 20 through 80. As such, the timing of the potential inclusion into rates of the replacement assets can logically be considered at any age from the current through age 80, and in fact the logical timing, (in the view of the Liberty Reply) may have long passed, based on the currently Public Utilities Board approved retirement dispersion curve. In summary the practicable application of the logical timing as recommended in the Liberty Reply is not possible to determine."[153]

When specifically asked (based on the example Mr. Antonuk gave during cross-examination) if Liberty had previously made a judgment as to when an asset that had already terminated would have

[151] November 12, 2015 Transcript, page 156, line 21 to page 157, line 8.
[152] November 12, 2015 Transcript, page 154, lines 11-14.
[153] Surrebuttal Evidence of Larry Kennedy, October 13, 2015, at page 7 of 18 of Appendix "A" to Hydro's Surrebuttal Evidence of October 14, 2015.

terminated, absent the fact that it had already done so, Mr. Antonuk indicated that the assets in his example related only to assets in existence.[154]

If the Board makes an adverse finding with respect to either the Sunnyside or Western Avalon issues, Hydro submits that the betterment approach it has put forward appropriately deals with the situation at hand in a manner that accords with sound depreciation, plant accounting and regulatory practice. As discussed above, it is also consistent with such treatment by Hydro in similar situations. Hydro submits that it is more appropriate than the approach suggested by Liberty for the reasons noted above.

If the Board were to adopt Liberty's approach instead of that put forward by Hydro, Hydro would have to develop the various regulatory asset classes, and an appropriate determination would need to be made regarding when the replaced assets would otherwise likely have been replaced. There may also be significant accounting challenges with tracking a regulatory asset in relation to an asset of property, plant and equipment in the manner suggested by Liberty. Hydro will of course undertake such activities if required by the Board, but submits that its approach provides more valid regulatory and accounting treatment with respect to this issue.

In either case, the ultimate final accounting treatment will be applied as part of Hydro's compliance filing in the General Rate Application process.

With respect to the Sunnyside Replacement Equipment, Liberty itself concluded that the new 230 kV B1T1 transformer breaker and 230 kV breaker fail protection put in place as part of the Sunnyside Terminal Station projects were sound enhancements to the Sunnyside Terminal Station and were appropriate. Thus there has been no suggestion of any disallowance in regard to these enhanced assets. The replacement of breaker B1L03 was discussed previously in this regard.

The 138 kV breaker B2T1 was previously an air blast circuit breaker and like B1L03 was planned to be replaced with a new SF_6 breaker.[155] Thus Hydro submits it is appropriate for full cost recovery consistent with its air blast circuit breaker replacement program.

[154] November 12, 2015 Transcript, page 155, lines 1-25.

11. EXTRAORDINARY TRANSFORMER AND BREAKER REPAIRS

As previously discussed, Hydro had developed a target in 2010 to bring the maintenance of its breakers and transformers in line with its applicable maintenance cycle by the end of 2015. Due to more critical break-in work that arose, Hydro was not able to accomplish this at the planned pace expected through 2013. Hydro developed a plan with associated costs which it provided to the Board in 2014, and it is these catch-up costs for which Hydro is requesting recovery. Liberty's position is that Hydro should be denied recovery for costs related to catch-up work on transformer and air blast circuit breaker maintenance which are in excess of the costs to carry out such work at a normal level over the applicable maintenance cycle. Liberty's finding is based on its view that the additional catch-up costs were based on Hydro's imprudence in failing to adhere to the general PM maintenance cycles.[156]

For the reasons described in detail above Hydro submits that its actions in this regard were not imprudent. As previously noted, extensive critical break-in work arose. In order for Hydro to have complied strictly with its PM cycle, Hydro would have had to have incurred additional costs in prior years as well as in the 2014 and 2015 Test Years, which were the last two years of Hydro's recovery plan. All parties, including Liberty, are supportive of Hydro bringing all of its transformers and air blast circuit breakers current within the applicable go-forward preventative maintenance cycles.
Hydro submits that it is neither appropriate nor warranted to disallow costs to carry out deferred work specifically desired by all parties simply because the work is outside the general PM cycle, for reasons outside of Hydro's control, i.e., extensive and more critical break-in work that was not anticipated.

Hydro acknowledges that the catch-up work is extraordinary in nature in that it will be completed within the 2014 and 2015 Test Years and therefore recommended its deferral and recovery over a five year period. Hydro submits that this is the appropriate regulatory approach in these circumstances.

[155] PR-PUB-NLH-203.
[156] Liberty Final Report, page 38.

Liberty's underlying suggestion is premised on the view that despite the criticality and amount of break-in work that may arise for reasons beyond Hydro's control, the general PM maintenance cycle must be strictly adhered to. But now Liberty goes further with respect to the catch-up work and suggests that the dollars necessary to achieve the catch-up, which would have been incurred in any event if Hydro were to have previously carried out all of the required break-in work and scheduled maintenance, should not even be recovered. This is despite the work being done to bring Hydro in line with its PM maintenance cycle, which Liberty supports. Hydro submits there should be no disallowance of these prudently incurred costs.

12. 2014 REVENUE DEFICIENCY

Liberty appears to take the position that since, in their view, the January, 2014 outages resulted from or were extended by certain imprudence on behalf of Hydro, 100 percent of all professional services costs related to the inquiry should be disallowed. Liberty suggests that certain costs in Hydro's 2014 revenue deficiency account should be disallowed as in their view these costs would not have occurred "but for" Hydro's imprudent decisions or actions.[157]

Even if the Board finds that some of Hydro's decisions or actions in relation to the January, 2014 outages were imprudent, Hydro does not believe Liberty's suggested disallowances are appropriate as explained below.

(a) Outage Inquiry Legal Fees

Liberty initially suggested that all of the legal fees which they had reviewed should be disallowed. As Hydro was not able to anticipate what Liberty may have suggested in its Final Report, following receipt of that report Hydro provided a breakdown of the legal fees which Liberty had reviewed. Hydro noted that the legal fees constituted Phase 1 of the Outage Inquiry, Phase 2 of the Outage Inquiry, Supplemental Capital Applications and Supply Costs.[158]

[157] Liberty Final Report, page 45.
[158] Hydro Reply Evidence, page 21, lines 10-20.

Liberty subsequently reviewed the applicable invoices and Mr. Vickroy noted Liberty's position as of the date of the Hearing as follows:

> "Liberty generally agrees with the allocation of the legal fees into four separate categories, that that makes sense; however, we do conclude the following, that the full amount of Phase 1 legal fees, as classified, could have been avoided in the absence of imprudence, so those should not be recovered. Secondly, the Phase 2 legal fees also could have been avoided in the absence of imprudence, and would fall into the same category. The supplemental capital work appears to be related to projects that would have or should have occurred in the absence of imprudence and so we would not category them in the imprudence category for that third category. The final category is for supply costs; however, we believe that that category is mislabelled, in our opinion, and when we looked at the notes behind that particular category, we believe that it's actually related to outage work, and we conclude that this legal fee category was caused by the outages and also should not be recovered." [159]

Even if the Board finds that the Phase 1 Outage Inquiry legal fees would not have been incurred absent the January, 2014, outages, and that some portion of those outages were caused by Hydro's imprudence, which Hydro does not believe is appropriate, Hydro submits that it would be inappropriate to disallow the portion of these legal fees related to Phase 2 of the Outage Inquiry. Mr. Vickroy indicated that the Phase 2 Outage Inquiry legal fees also could have been avoided in the absence of imprudence and would fall into the same category. He did not explain why this would be the case. Phase 2 of the Outage Inquiry deals with the Board's review considering reliability post-Muskrat Falls. It is separate from the Phase 1 Outage Inquiry. As the Board will recall, at the initial preliminary motion on February 5, 2014 regarding the nature of the inquiry, Hydro specifically noted that it did not believe the Outage Inquiry should deal with unrelated aspects of post-Muskrat Falls reliability. Other parties (in particular Newfoundland Power, the Consumer Advocate and Mr. Dumaresque) pushed for a review of this matter,[160] and Hydro submits it would be clearly inappropriate for Hydro to be disallowed recovery of costs related to a forward looking reliability review process, which from the record is unrelated to any of the activities for which Liberty suggests imprudence as part of the January 2013 or 2014 incidents.

[159] November 12, 2015 Transcript, page 71, line 18 to page 72, line 15.
[160] See Order P.U. No. 3(2014), page 3.

The Board determined that to "effectively assess adequacy and reliability of the Island Interconnected System, it is [was] necessary to consider planned future changes to the system".[161] Those matters however are unrelated to any potential prudence findings in the Prudence Review and there is no reason to deny Hydro's recovery of its costs incurred to support the wider forward looking review specifically requested by other parties.

With respect to the Supplemental Capital Applications, Liberty confirmed that work would or should have occurred in the absence of any imprudent actions or decisions of Hydro in any event.
With respect to the final category for Supply Costs, Mr. Vickroy indicated that Liberty believes that category is mislabelled in their opinion, and when Liberty looked at the notes behind that particular category they felt it was actually related to Outage Inquiry work and concluded that it was caused by the outages and should not be recovered. However, this work was clearly supply related in that it was work carried out particularly in relation to the development of Hydro's Supply Related Costs Application to the Board. In this regard, Liberty specifically concluded as noted previously that they "did not find a basis for imprudence with respect to supply planning and management of unit availability during the relevant period".[162]

With respect to Hydro's overall Supply Related Costs Application for $9.79 million, Liberty only found a portion of these costs to be, in their view, related to imprudence, being the delay in restoration of Holyrood Unit 1 to service. The vast majority of replacement costs being requested by Hydro are in relation to actions for which there has been no evidence, or even claim by Liberty, of imprudence. Hydro submits that as there would have been a requirement to put forward a Supply Related Costs Application in any event, there is no regulatory basis to disallow professional services costs related to applications for the recovery of prudently incurred costs. Hydro submits that the information made available to Liberty clearly shows that these costs were on account of that application and were not mislabelled.

[161] *Ibid.*

[162] Liberty Final Report, page 16.

(b) **Sunnyside Environmental Remediation**

At page 15 of Liberty's Reply Evidence, and during direct examination, Liberty confirmed that there is an adjustment required regarding Sunnyside consulting fees, as Liberty's suggested disallowances captured this disallowance in both the Sunnyside Replacement Equipment – consulting category and under the Professional Services – consulting fee category.[163] If the Board finds that there is a disallowance required in relation to the Sunnyside Replacement Equipment, which for the reasons stated above Hydro submits is not appropriate, there should not be a similar duplicative disallowance with respect to the Professional Services – consulting fees related to this item.

There was a further invoice of approximately $14,000 which Liberty had suggested for disallowance for which Hydro provided additional supporting information. Mr. Vickroy confirmed during direct examination that Liberty reviewed this information and it supported the conclusion that the work was not Outage Inquiry related and should be removed from the list of 2014 costs that would have been avoided in the absence of imprudence.[164] Thus, Liberty does not suggest a disallowance in this regard.

(c) **2014 Overtime**

Liberty compared the overtime in 2014 to Hydro's annual average overtime hours for the period 2011-2013 and recommended a disallowance of approximately $3.6 million on the basis that this incremental overtime would not have been required but for the actions of Hydro which Liberty had determined not to be prudent. In determining their proposed adjustment, Liberty noted that a portion of the overall incremental overtime dollars spent by Hydro was in relation to the capital projects that Liberty was examining and thus was appropriately removed from the overtime calculation to avoid double counting.[165]

However, as explained in Hydro's Reply Evidence, Liberty's development of their disallowance figure is based upon a comparison of 2014 actual expenditures versus 2011-2013 average actuals. Hydro is of course not applying for recovery of 2014 actuals but is applying for recovery based on its 2014 Test Year filing. It is not appropriate to impose a disallowance based on actual dollars spent where those are not

[163] See also November 12, 2015 Transcript, page 70, lines 5-8.
[164] November 12, 2015 Transcript, page 72, line 24 to page 73, line 11.
[165] Liberty Final Report, pages 45-46.

the dollars being sought for recovery in the first place. Any such proposed disallowance must only relate to the costs being sought for recovery by Hydro from its customers.[166]

Utilizing the same methodology as Liberty, by using 2014 Test Year revenue requirement instead of 2014 actuals, the revised calculation (excluding total capital overtime) yields a comparable figure of $493,145. As with Liberty's analysis, this calculation is net of capital in relation to capital projects Liberty was reviewing to avoid double counting. As well, Hydro does not believe there is any rationale to disallow costs for capital overtime in relation to prudently incurred capital projects.[167] As such, if the Board accepts Liberty's rationale for a disallowance in this regard, Hydro submits that the final calculation to be carried out as part of an ultimate compliance filing must reflect the points noted in Hydro's Reply Evidence, as to do otherwise would be imposing a disallowance in relation to costs that were either prudently incurred or not requested for recovery from customers in the first place. Such disallowances would be inappropriate.

In this regard, and with respect to the wider issue of the formatting of Liberty's disallowance in relation to actual versus test year revenue requirements, Mr. Vickroy explained Liberty's approach during direct examination as follows:

> "As I noted, we used 2014 actual audited financial data, and we received that upon request through RFIs from Hydro, and placed them in our report. We reported all the prudence financial data in the report in this format; in other words, 2014 actuals, and we did not determine or attempt to determine revenue requirements or translate the report financial data in terms to be consistent with Hydro's revenue deficiency filing. So we did not attempt or even intend to attempt to do that. We have understood that other participants in this case, Grant Thornton, will be responsible for converting the financial data that's in Liberty's Report for GRA usage in the proceeding, and that would be following a Board order to do so. So as a result, we really don't have any comments on Hydro's reply evidence or in its surrebuttal of estimates of the GRA impacts of what is in our report in our recommendations."[168]

During cross-examination Mr. Antonuk expanded on this as follows:

[166] Hydro Reply Evidence, page 23, lines 21-27.
[167] *Ibid.,* page 24, lines 1-6.
[168] November 12, 2015 Transcript, page 68, line 21 to page 69, line 16.

> "I think, less everybody think we were just sort of abandoning a sinking ship here, it was our understanding that if we presented the actual information, then Grant Thornton would be able to use that actual information and then conform it, adjust it, use it, toss it out, however they determined to be appropriate with respect to corresponding items offered in the GRA or in respect of explaining the 2014 deficiency calculation."[169]

Where Hydro was aware of disallowances quantified by Liberty in relation to actual dollars that had not been requested as part of the relevant test years, Hydro pointed this out in its evidence and particularly in PR-CA-NLH-014 (Revision 1, October 15-15). In PR-CA-NLH-014 (Revision 1) Hydro specifically noted that it did not agree with the disallowances suggested by Liberty for the reasons it has expressed. However, in order to be responsive to the question, it provided the analysis requested by the Consumer Advocate, which took Liberty's proposed disallowances and adjusted them for issues such as betterment calculations, double counting, depreciation, recovery not requested from customers, etc. This information was simply indicative of the issues raised by Liberty's approach, and Hydro noted that the information and quantifications provided may have to be adjusted as part of any ultimate compliance filings for the 2014 and 2015 Test Years.

Thus Hydro's position is consistent with Liberty's comments at the Hearing, that the compliance filing will have to specifically account for the Board's ultimate findings, and ensure there is no double counting of any potential disallowances, and that disallowances, if any, are appropriately made to the test year revenue requirement as opposed to actual costs where full actual cost recovery was not sought by Hydro in the first place. Hydro agrees that the ultimate resolution of these matters should be dealt with as part of the compliance filing based on the Board's ultimate decision on the underlying issues.

(d) **Board and Intervenors Outage Inquiry Costs**

With respect to the Board Outage Inquiry costs, Liberty was unable to confirm the portion of those costs in relation to Phase 2 of the Outage Inquiry.[170] At the time of filing the response to PR-PUB-NLH-101, the Board had indicated Board-accumulated costs relating to the Outage Inquiry of approximately

[169] November 12, 2015 Transcript, page 172, line 18 to page 173, line 2.
[170] PR-NLH-PUB-010.

$1.275 million. The Board has also confirmed to Hydro that this amount includes Liberty's costs, legal costs and other costs.[171]

As noted in Hydro's Reply Evidence and above, with respect to such portion of the Board's costs as may be related to the review of Hydro versus Newfoundland Power's activities, regardless of the Board's findings with respect to the Outage Inquiry, costs related to Phase 2 should be fully recoverable as they are not related to any imprudence on behalf of Hydro. A breakdown of Liberty and other Board chargeable costs, if any, between Phases 1 and 2 of the Outage Inquiry would be required as part of the ultimate compliance filing in this process in order to make the appropriate adjustments.[172] Similarly, with respect to Intervenor Outage Inquiry costs which Hydro may incur, if any, such costs referable to Phase 2 Outage Inquiry issues should be fully recovered for the reasons stated above.

(e) **Salary Transfers**

Liberty has suggested a disallowance of $511,000 on account of executive leadership and finance cost transfers. As set out in Hydro's response to V-NLH-088 in its 2013 General Rate Application, Hydro has only sought recovery of $424,000 for inter-company salaries and thus any disallowance would only be in relation to this amount.[173]

Hydro indicated that additional executive leadership and related inter-company resources would have been engaged in a review of the early January 2014 situation that led to the rotating outages even absent the transmission related issues.[174] To disallow 100 percent of these costs is not supported, since the record indicates that not all of these costs are attributable to issues related to Liberty's view of Hydro's prudence.[175] Also, as discussed above, a portion of this cost category is in relation to Hydro's response to matters related to Phase 2 of the Outage Inquiry, which by necessity has required extra executive leadership and associated involvement.

[171] Hydro Reply Evidence, page 22, lines 11-16.
[172] *Ibid.,* lines 16-21.
[173] Hydro Reply Evidence, page 24, lines 12-15.
[174] *Ibid.,* page 24, line 31 to page 25, line 2.
[175] PUB-NLH-379 in the 2013 GRA proceeding. See also September 15, 2015 Transcript, page 5, line 13 to page 6, line 20; September 17, 2015 Transcript, page 51, line 3 to page 53, line 9; and November 23, 2015 Transcript, page 215, line 16 to page 216, line 24,

Mr. Henderson specifically confirmed during redirect as follows:

> "Well, the integrated action plan was developed by Hydro as a result of the investigation that we undertook for the many things that happened in January 2014 and they're also reflective of things that we learned from January 2013. So we had established an action plan, if you like, to deal with those. Those items were going to be incurred by Hydro in any event, regardless of whether there was a prudence review or not. Those were items that Hydro was doing. They were to bring future enhancements to the system, enhancements to the way we operate. So they are all items that will bring further benefit to customers on a long term basis and they were items that many of which Hydro had identified and was doing in any event as a result of its own reviews and related to all the different things that we learned from the event, many of which would have not related to any of Liberty's related prudence related expenses. These are all items that will provide long term benefit to customers that we feel is appropriate for recovery."[176]

At page 46 and 47 of its Final Report, Liberty noted with respect to Hydro's 2014 Integrated Action Plan that Liberty's review of Hydro's costs incurred to implement the plan did not identify any costs falling into their so called "but for" category. The Integrated Action Plan addressed actions Hydro proposed to (and has) taken in response to the 2014 supply disruptions and power outages, and lessons learned therefrom. Liberty itself concluded that the majority of the costs were either costs that Hydro would experience even in the absence of the need to respond to the outages or which would be justified by good utility practice. The only exception was catch-up maintenance work on critical transformers and air blast circuit breakers which issue has been discussed above.

As noted by Hydro, the development of the Integrated Action Plan in response to the supply disruptions and power outages engaged executive leadership and associated resources.[177] To simply disallow all of the salary transfers which engaged Nalcor executive leadership to respond to the outages and lessons learned (as Liberty suggests), the majority of which had nothing to do with issues raised as a concern by Liberty in any event, would not be appropriate. Hydro will of course carry out the necessary specific adjustments to any potential disallowance as part of the ultimate compliance filing in the general rate application if the Board determines any disallowance is required with respect to this issue.

[176] November 9, 2015 Transcript, page 126, line 18 to page 127, line 16.
[177] Hydro Reply Evidence, page 25, lines 20-22.

(f) **Capital Expenditures**

With respect to potential capital cost disallowances, Hydro has addressed the points raised by Liberty in regard to the 2014 Test Year revenue requirement above.

(g) **General**

As noted above under the heading 2014 Overtime, the ultimate compliance filing in this process will have to specifically account for the Board's findings and ensure there is no double counting of any potential disallowances, and that if any such disallowances they are appropriately made to the test year revenue requirement as opposed to actual costs where full actual cost recovery was not sought by Hydro in the first place.

13. CONCLUSION

Liberty in its Interim Report on the Outage Inquiry characterized the situation in which Hydro operates as follows:

> "The geography of Newfoundland and Labrador poses significant challenges to providing and operating a reliable electric system. The region is blessed with hydro resources, but weather, concentration of load in one area, isolation of the system from the rest of North America, and relatively higher costs to provide high reliability, challenges the utility servicing the region in ways that few others face."[178]

Mr. Antonuk confirmed during the prudence review hearing that remained Liberty's opinion.[179] Hydro submits for the reasons explained in detail above, that in the full context surrounding its circumstances and decision making, its actions were as described above reasonable and prudent. Hydro sought at all times to appropriately balance reliability and cost and to ensure the provision of safe, reliable and least cost electricity to its customers.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

[178] Information No. 26, page 17.
[179] November 12, 2015 Transcript, page 122, lines 13-15.

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SUPREME COURT OF CANADA

CITATION: Ontario (Energy Board) *v.* Ontario Power Generation Inc., 2015 SCC 44

DATE: 20150925
DOCKET: 35506

BETWEEN:

Ontario Energy Board
Appellant
and
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

CORAM: McLachlin C.J. and Abella, Rothstein, Cromwell, Moldaver, Karakatsanis and Gascon JJ.

REASONS FOR JUDGMENT: (paras. 1 to 121) Rothstein J. (McLachlin C.J. and Cromwell, Moldaver, Karakatsanis and Gascon JJ. concurring)

DISSENTING REASONS: (paras. 122 to 161) Abella J.

NOTE: This document is subject to editorial revision before its reproduction in final form in the *Canada Supreme Court Reports*.

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ONT. (ENERGY BOARD) *v.* ONT. POWER GENERATION

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*

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

2015 SCC 44 (CanLII)

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, 1998, S.O. 1998, c. 15, Sch. B, ss. 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 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

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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.

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.

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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.

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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 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

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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 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*

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Energy Board Act, 1998 places the burden on the applicant utility to establish that payments 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.

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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 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. Since the costs at

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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 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 these costs from scrutiny, but it does include a presumption that the costs were prudently incurred.

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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

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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 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.

The appeal should accordingly be dismissed, the Board's decision set aside, and the matter remitted to the Board for reconsideration.

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By Rothstein J.

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By Abella J. (dissenting)

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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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APPEAL from a judgment of the Ontario Court of Appeal (Rosenberg, Goudge and Blair JJ.A.), 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.), setting aside a decision of the Divisional Court (Aitken, Swinton and Hoy JJ.), 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.), and setting aside a decision of the Ontario Energy Board, EB-2010-0008, March 10, 2011 (online: http://www.ontarioenergyboard.ca/oeb/_Documents/Decisions/dec_reasons_OPG_Payment_20110310.pdf), 2011 LNONOEB 57 (QL), 2011 CarswellOnt 3723 (WL Can.). Appeal allowed, Abella J. dissenting.

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.

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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.

The judgment of McLachlin C.J. and Rothstein, Cromwell, Moldaver, Karakatsanis and Gascon JJ.was delivered by

ROTHSTEIN J. —

[1] 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

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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 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.

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[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 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.

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[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.

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Accordingly, the Board must ensure that it regulates with an eye to balancing both consumer interests and the efficiency and financial viability of the 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".

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[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 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 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.

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[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.

[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

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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

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of its employees in its regulated 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*

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(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 (the "Board 2008-2009 Decision") (online), at pp. 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. (the "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).

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[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).

[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.

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[30] A substantial portion of OPG's wage and compensation expenses were 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.

III. Judicial History

A. *Ontario Energy Board: EB-2010-0008, Decision With Reasons, March 10, 2011 (the "Board Decision") (Online)*

[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

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and reasonable rates" (p. 18). 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" (p. 86). 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 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

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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 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

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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).

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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?

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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 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

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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

> 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).

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[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 Kaiser and Heggie, 35, at p. 51. A review of three appellate decisions suffices to establish the rationale behind this shift.

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[47] In *Goodis*, the Children's Lawyer urged the court to refuse or limit the standing of the Information and Privacy Commissioner, whose decision 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 to what extent the tribunal should be permitted to make submissions: paras. 36-38.

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[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.)*,

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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 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

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interpretation of a statutory provision might impact other provisions within the regulatory scheme, or to 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 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.

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[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.

[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 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

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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.

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[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. jurisdictional or merits arguments, while the bootstrapping issue concerns the content of those arguments.

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[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

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may be undermined if, when attacked in court, a tribunal can simply offer different, better, or even contrary reasons to 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.

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[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 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.

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[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 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.

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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 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*

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[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".

[78] As a contrasting example, s. 6(2) 4.1 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": s. 6(2)4.1. 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.

[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.

[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

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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 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.

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[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.

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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 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.

[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

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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.

[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 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

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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 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

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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.

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[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.

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[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), 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

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[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,

> (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, 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*)": at p. 856. That is, the regulator, under this statute, must ensure that the public pays only fair and

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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 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.

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[98] The NSUARB reaffirmed its endorsement of the prudent investment test in 2012: *Re 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.
>
> – 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]

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[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 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.

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(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 exists 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 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).

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[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.

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(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.

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[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.

[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

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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 p. 86) shows that it had the ongoing effects of its disallowance squarely in mind in issuing its decision in this case.

[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 p. 87. 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

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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.

[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.

[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 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.

[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

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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 p. 19. 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.

[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.

[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

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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 pp. 18-19, 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 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 p. 86). 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

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[122] 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 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,*

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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*, ss. 1(1)1 and 1(1)2.

[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 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.

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[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 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.

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[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 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]

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[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.

[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 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": p. 19.

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

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(*Enersource Hydro Mississauga Inc. (Re)*, 2012 LNONOEB 373 (QL), at para. 55, citing *Enbridge Gas Distribution (Re)*, 2002 LNONOEB 4 (QL), at para. 3.12.2).

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[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.
>
> 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). [p. 19]

[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. [p. 19]

[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]

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[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 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". 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" (pp. 85 and 87), 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

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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.

[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

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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 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 three per cent on January 1, 2011, two per cent on January 1, 2012, and a further one 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

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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: p. 85. 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.

[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* 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.

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[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]

[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 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 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

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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": p. 19.

[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

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the exercise, namely, to determine 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.

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[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 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.*

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SUPREME COURT OF CANADA

CITATION: ATCO Gas and Pipelines Ltd. *v*. Alberta (Utilities Commission), 2015 SCC 45

DATE: 20150925
DOCKET: 35624

BETWEEN:

ATCO Gas and Pipelines Ltd. and ATCO Electric Ltd.
Appellants
and
Alberta Utilities Commission and
Office of the Utilities Consumer Advocate of Alberta
Respondents

CORAM: McLachlin C.J. and Abella, Rothstein, Cromwell, Moldaver, Karakatsanis and Gascon JJ.

REASONS FOR JUDGMENT: (paras. 1 to 66)
Rothstein J. (McLachlin C.J. and Abella, Cromwell, Moldaver, Karakatsanis and Gascon JJ. concurring)

NOTE: This document is subject to editorial revision before its reproduction in final form in the *Canada Supreme Court Reports*.

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ATCO Gas and Pipelines Ltd. and
ATCO Electric Ltd. *Appellants*

v.

Alberta Utilities Commission and
Office of the Utilities Consumer Advocate of Alberta *Respondents*

Indexed as: ATCO Gas and Pipelines Ltd. *v.* Alberta (Utilities Commission)

2015 SCC 45

File No.: 35624.

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 ALBERTA

Public utilities — Gas — Electricity — Rate-setting decision by utilities regulator — Utilities seeking to recover pension costs in utility rates set by Alberta Utilities Commission — Whether regulatory framework prescribes certain methodology in assessing whether costs are prudent — Whether Commission's

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interpretation and exercise of its rate-setting authority was reasonable — Electric Utilities Act, S.A. 2003, c. E-5.1, ss. 102, 121 and 122 — Gas Utilities Act, R.S.A. 2000, c. G-5, s. 36.

The Alberta Utilities Commission denied the request by ATCO Gas and Pipelines Ltd. and ATCO Electric Ltd. ("ATCO Utilities") to recover, in approved rates, certain pension costs related to an annual cost of living adjustment ("COLA") for 2012. Instead of approving recovery for an adjustment of 100 percent of annual consumer price index ("CPI") (up to a maximum COLA of 3 percent), the Commission ruled that recovery of only 50 percent of annual CPI was reasonable. The Alberta Court of Appeal dismissed the ATCO Utilities' appeal from the decision of the Commission.

Held: The appeal should be dismissed.

A key principle in Canadian regulatory law is that a regulated utility must have the opportunity to recover its operating and capital costs through rates. This requirement is reflected in the *Electric Utilities Act* and the *Gas Utilities Act* of Alberta, as these statutes refer to a reasonable opportunity to recover costs and expenses so long as they are prudent. The Commission must therefore determine whether a utility's costs warrant recovery on the basis of their reasonableness — or, under the *Electric Utilities Act* and the *Gas Utilities Act*, their "prudence". Where costs are determined to be prudent, the Commission must allow the opportunity to recover them through rates.

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The prudence requirement is to be understood in the sense of the ordinary meaning of the word: for the listed costs and expenses to warrant a reasonable opportunity of recovery, they must be wise or sound; in other words, they must be reasonable. Nothing in the ordinary meaning of the word "prudent" or the use of this word in the statute as a stand-alone condition says anything about the time at which prudence must be evaluated. Thus, neither the ordinary meaning of "prudent" nor the statutory language indicate that the Commission is bound by the legislative provisions to apply a no-hindsight approach to the costs at issue, nor is a presumption of prudence statutorily imposed in these circumstances. In the context of utilities regulation, there is no difference between the ordinary meaning of a "prudent" cost and a cost that could be said to be reasonable. It would not be imprudent to incur a reasonable cost, nor would it be prudent to incur an unreasonable cost. Further, the burden of establishing that the proposed tariffs are just and reasonable falls on public utilities, which necessarily imposes on them the burden of establishing that the costs are prudent. The impact of increased rates on consumers cannot be used as a basis to disallow recovery of such costs. This is not to say that the Commission is not required to consider consumer interests. These interests are accounted for in rate regulation by limiting a utility's recovery to what it reasonably or prudently costs to efficiently provide the utility service. That is, the regulatory body ensures that consumers only pay for what is reasonably necessary.

Though the *Electric Utilities Act* and the *Gas Utilities Act* do contain language allowing for the recovery of "prudent" costs, the statutes do not explicitly

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impose an obligation on the Commission to conduct its analysis using a particular methodology any time the word "prudent" is used. Thus, the Commission is free to apply its expertise to determine whether costs are prudent (in the ordinary sense of whether they are reasonable), and it has the discretion to consider a variety of analytical tools and evidence in making that determination so long as the ultimate rates that it sets are just and reasonable to both consumers and the utility.

The standard of review of the Commission's decision in applying its expertise to set rates and approve payment amounts is reasonableness. Under this standard of review, the Commission's interpretation of its home statute is entitled to deference. In this case, it was not unreasonable for the Commission to decide, without applying a no-hindsight analysis, that 50 percent of CPI (up to a maximum COLA of 3 percent) represented a reasonable level for setting the COLA amount for the purposes of determining the pension cost amounts for regulatory purposes: the Commission was not statutorily bound to apply a particular methodology to the costs at issue in this case; the use of the word "prudent" in the *Electric Utilities Act* and the *Gas Utilities Act* cannot by itself be read to impose upon the Commission a specific no-hindsight methodology; and the disallowed costs were forecast costs. Accordingly, it was reasonable for the Commission to evaluate the ATCO Utilities' proposed revenue requirement in light of all relevant circumstances. Further, because the Commission did not use impermissible methodology, it was not unreasonable for the Commission to direct the ATCO Utilities to reduce their pension costs incorporated into revenue requirements by restricting the annual cost of living adjustment.

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Cases Cited

Referred to: *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44; *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186; *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190; *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140; *Shaw v. Alberta Utilities Commission*, 2012 ABCA 378, 539 A.R. 315; *ATCO Gas and Pipelines Ltd. v. Alberta Utilities Commission*, 2009 ABCA 246, 464 A.R. 275; *Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61, [2011] 3 S.C.R. 654; *Power Workers' Union, Canadian Union of Public Employees, Local 1000 v. Ontario Energy Board*, 2013 ONCA 359, 116 O.R. (3d) 793; *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006), 210 O.A.C. 4; *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67, [2013] 3 S.C.R. 895; *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27; *TransCanada Pipelines Ltd. v. National Energy Board*, 2004 FCA 149, 319 N.R. 171.

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Employment Pension Plans Act, S.A. 2012, c. E-8.1, ss. 13, 35(2), 52(2)(b).

Employment Pension Plans Regulation, Alta. Reg. 35/2000, ss. 9, 10, 48(3).

Employment Pension Plans Regulation, Alta. Reg. 154/2014, ss. 48, 49, 60(2)(b), (3).

Gas Utilities Act, R.S.A. 2000, c. G-5, ss. 36, 37(3), 44(1), (3).

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APPEAL from a judgment of the Alberta Court of Appeal (Costigan, Martin and Slatter JJ.A.), 2013 ABCA 310, 93 Alta. L.R. (5th) 234, 556 A.R. 376, 7 C.C.P.B. (2d) 171, 584 W.A.C. 376, [2013] A.J. No. 989 (QL), 2013 CarswellAlta 1984 (WL Can.), affirming a decision of the Alberta Utilities Commission, 2011 CarswellAlta 1646 (WL Can.), [2011] A.E.U.B.D. No. 506 (QL). Appeal dismissed.

John N. Craig, Q.C., Loyola G. Keough and *E. Bruce Mellett*, for the appellants.

Catherine M. Wall and *Brian C. McNulty*, for the respondent the Alberta Utilities Commission.

Todd A. Shipley, *C. Randall McCreary*, *Michael Sobkin* and *Breanne Schwanak*, for the respondent the Office of the Utilities Consumer Advocate of Alberta.

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The judgment of the Court was delivered by

ROTHSTEIN J. —

[1] In its decision of September 27, 2011, the Alberta Utilities Commission denied the request by ATCO Gas and Pipelines Ltd. and ATCO Electric Ltd. (collectively the "ATCO Utilities") to recover, in approved rates, certain pension costs related to an annual cost of living adjustment ("COLA") for 2012. Instead of approving recovery for an adjustment of 100 percent of the annual consumer price index ("CPI") (up to a maximum COLA of 3 percent), the Commission ruled that recovery of only 50 percent of annual CPI (up to a maximum COLA of 3 percent) was reasonable. The Alberta Court of Appeal dismissed the ATCO Utilities' appeal from the decision of the Commission. The ATCO Utilities now appeal to this Court.

[2] This matter was heard together with *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44 ("*OEB*"), which also concerns the review of a rate-setting decision by a utilities regulator. Although the facts of the cases are different, both involve issues of methodology, and, in particular, when — if ever — a

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regulator is required to apply a particular regulatory tool known as the "prudent investment test" in assessing a utility's costs.

[3] The ATCO Utilities submit that the Commission is bound to first assess costs put forward by a utility for prudence, and that prudently incurred costs must be approved for inclusion in the utility's "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. The approved revenue requirement is then to be allocated to customers in the form of just and reasonable rates. The ATCO Utilities argue that the Commission failed to properly address the prudence of such costs. They say that in the absence of an explicit contrary finding, costs are presumed to be prudent. Further, the Utilities assert that prudence is to be established based on circumstances as of the date of the cost decision — not based on hindsight and the use of information not available to the utility when the decision to incur the cost was made.

[4] The Office of the Utilities Consumer Advocate of Alberta argues that the Alberta regulatory framework does not impose a specific rate-setting methodology on the Commission; it falls to the Commission to decide upon the specific test and methodology to employ. Specifically, the Consumer Advocate argues that there is no obligation on the Commission to utilize a particular prudence test methodology when

reviewing costs on a forecast basis. Nor is there a presumption of prudence. On the contrary, the onus is on the utility to demonstrate that the tariff it proposes is just and reasonable.

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[5] As in *OEB*, the relevant statutory framework does not impose upon the Commission the "prudence" methodology urged by the ATCO Utilities. Further, following the approach set out in *OEB*, the methodology adopted by the Commission and its application of this methodology were reasonable in view of the nature of the costs in question. I would dismiss the appeal.

I. Regulatory Framework

[6] In Alberta, the Commission sets "just and reasonable" tariffs for electric and gas utilities seeking recovery of their prudent costs and expenses: s. 121(2)(a) of the *Electric Utilities Act*, S.A. 2003, c. E-5.1 ("*EUA*"); and s. 36(a) of the *Gas Utilities Act*, R.S.A. 2000, c. G-5 ("*GUA*").

[7] In Canadian law, "just and reasonable" rates or tariffs are those that are fair to both consumers and the utility: *Northwestern Utilities Ltd. v. City of Edmonton*, [1929] S.C.R. 186, at pp. 192-93, per Lamont J. Under a cost of service model, rates must allow the utility the opportunity to recover, over the long run, its operating and capital costs. Recovering these costs ensures that the utility can continue to operate and can earn its cost of capital in order to attract and retain investment in the utility: *OEB*, at para. 16. Consumers must pay what the

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Commission "expects it to cost to efficiently provide the services they receive" such that, "overall, they are paying no more than what is necessary for the service they receive": *OEB*, at para. 20.

II. Facts

A. *The Pension Plan*

[8] Employees of the ATCO Utilities benefit from the Retirement Plan for Employees of Canadian Utilities Limited ("CUL", the parent company of the ATCO Utilities) and Participating Companies (the "Pension Plan"). The Pension Plan is administered by CUL, which is not itself regulated by the Commission. As the Pension Plan administrator, CUL acts in a fiduciary capacity in relation to Plan members and other Plan beneficiaries: s. 13(5) of the *Employment Pension Plans Act*, R.S.A. 2000, c. E-8.[1]

[9] The Pension Plan includes a defined benefit plan (the "DB plan"), which was closed to new employees on January 1, 1997, and a defined contribution plan. The COLA applies only to the DB plan. The *Employment Pension Plans Act* requires that the DB plan be subject to actuarial calculations filed periodically with the Superintendent of Pensions for Alberta: ss. 13 and 14;[2] and ss. 9 and 10 of the

[1] This provision has since been replaced by s. 35(2) of the *Employment Pension Plans Act*, S.A. 2012, c. E-8.1.
[2] These provisions have since been replaced by s. 13 of the *Employment Pension Plans Act*, (2012).

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Employment Pension Plans Regulation, Alta. Reg. 35/2000.[3] Actuarial calculations determine, *inter alia*, the contributions that an employer must make to cover a DB plan's liabilities.

[10] The assets of the CUL Pension Plan are pooled between all CUL member companies, regardless of whether they are regulated utility companies (like the ATCO Utilities) or not. The required employer funding is determined on an aggregate basis. If special payments must be made to address unfunded liabilities, the aggregate funding requirement is apportioned among the member entities of the Pension Plan.

[11] No employer contributions to the Pension Plan were required between 1996 and the end of 2009 because the Pension Plan was in surplus position, and thus the ATCO Utilities did not have to include such contributions in their revenue requirement applications to the Commission. In the wake of the 2008 financial crisis, the market value of the Pension Plan's assets dropped and a large unfunded liability resulted, forcing the employers participating in the Pension Plan, including the ATCO Utilities, to resume making employer contributions in 2010.

B. *The Pension Plan Funding Obligations*

[12] Section 48(3) of the *Employment Pension Plans Act*, (2000)[4] requires that the Pension Plan be funded in accordance with actuarial valuation reports. The

[3] These provisions have since been replaced by ss. 48 and 49 of the *Employment Pension Plans Regulation*, Alta. Reg. 154/2014.

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actuarial valuation report relevant to this appeal (the "2009 Actuarial Report") was filed with the Superintendent of Pensions for Alberta on June 29, 2010 by Mercer (Canada) Limited, the Pension Plan's actuary. The report indicated that two types of payments were required. First, it determined the estimated payments required to address the projected benefits owed to beneficiaries for 2010, 2011 and 2012. These are also called "current service costs". Second, it determined that the DB plan had an unfunded liability of $157.1 million across all CUL entities, requiring all the employers participating in the Pension Plan, including the ATCO Utilities, to make minimum annual special payments in the aggregate amount of $16.4 million until December 31, 2024 to address the liability. The ATCO Utilities alone were liable for approximately $13.9 million of the annual aggregate special payment amount.

[13] The cost of living adjustment issues in this case involve both the contributions that the ATCO Utilities must make into the DB plan and the benefits paid to retirees out of the plan. With regard to the ATCO Utilities' contributions into the plan, the 2009 Actuarial Report included a provision for "post retirement pension increases" that is based on the DB plan's COLA formula and the actuarial report's assumption for inflation. This provision affects the payments that the ATCO Utilities are required to make into the DB plan for the three-year period covered by the report. In this case, this increase was 2.25 percent per year for all three years.

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[4] This provision has since been replaced by s. 52(2)(b) of the *Employment Pension Plans Act* (2012).

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[14] With regard to the payment of benefits to retirees under the DB plan, the ATCO Utilities' parent company CUL sets the COLA annually. Sections 6.9(a) and 6.12(a) of the DB plan prescribe that CUL determines the COLA by taking into consideration annual percentage changes in the Consumer Price Index for Canada and any previous adjustments paid. These provisions cap the adjustment set by CUL at 3 percent per annum.

III. Decisions Below

A. *Alberta Utilities Commission: ATCO Utilities, Re (2010), 84 C.C.P.B. 89 (the "Decision 2010-189")*

[15] On July 10, 2009, the ATCO Utilities filed an application with the Commission to determine, *inter alia*, the amount of employer pension contributions that would be included in their revenue requirements in 2010. The ATCO Utilities' proposed contributions reflected a COLA set at 100 percent of annual Canada CPI (up to a maximum of 3 percent), as CUL had used for a number of years. However, in the Commission's view, setting COLA at 100 percent of CPI year after year was not required by the wording of the Pension Plan. It concluded "that ratepayers should not bear any incremental pension funding costs" that arise from CUL's practice of setting COLA "where it [was] demonstrated that such incremental costs prove to be unreasonable or imprudent in the circumstances": para. 118.

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[16] However, the Commission did not find the evidence filed in this application to be sufficient to draw conclusions with respect to whether the COLA was prudent. As a result, it did not reduce the COLA of 100 percent of annual CPI (up to a maximum of 3 percent) for the ATCO Utilities' 2010 revenue requirements. Nonetheless, the Commission stated that it "would like to investigate the possibility of adjusting COLA as a mechanism in prudently managing utility pension expense" for the years 2011 onward: para. 123. It directed the ATCO Utilities to prepare a 2011 pension common matters application to address issues related to COLA and CUL's discretion in setting COLA.

B. *Alberta Utilities Commission: 2011 Carswell Alta 1646 (WL Can.) (the "Decision 2011-391")*

[17] On December 15, 2010, the ATCO Utilities filed a pension common matters application pursuant to the Commission's direction in *Decision 2010-189*. The Commission published its *Decision 2011-391* on September 27, 2011. It is this decision that is the subject of appeal in this Court.

[18] In reviewing the COLA included in the ATCO Utilities' revenue requirement application, the Commission wrote that the reasonableness of setting it at 100 percent of CPI had to be evaluated "in the circumstances applicable at the time that ATCO Utilities apply to include pension expense in revenue requirement": *Decision 2011-391*, at para. 87. The significant unfunded liability of the Pension Plan was such a circumstance. The Commission was of the view that the DB plan

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permitted CUL to exercise its discretion in setting the COLA, and that this discretion was "an available tool" for CUL to actively manage the DB plan unfunded liability as it carried out its fiduciary and contractual obligations: para. 83. "[T]he availability of that discretion and the exercise, or lack thereof, of that discretion [was] a relevant and material consideration" in determining whether the ATCO Utilities' pension expenses were reasonable and should be included in revenue requirements: para. 83.

[19] The Commission found that the ATCO Utilities' practice of awarding an annual COLA of 100 percent of CPI every year was not "an acceptable standard practice", in light of benchmark evidence showing a wider range of COLA percentages used by defined benefit pension plans among other entities in a comparator group: *Decision 2011-391*, at para 87. The majority of the entities set COLA between 50 percent and 75 percent of CPI. The Commission also found that a reduction in COLA would not undermine the Utilities' ability to attract new employees, nor would it encourage current employees to leave.

[20] The Commission concluded that the COLA included in current service costs to be recovered through tariffs after January 1, 2012 and until the next actuarial valuation should be 50 percent of the annual Canada CPI, to a maximum of 3 percent. The ATCO Utilities' revenue requirements for 2012 were to be reduced accordingly.

[21] However, with regard to the special payments addressing the unfunded liability for 2012, the Commission stated that it would not require that the ATCO Utilities file an updated actuarial report reflecting a lower COLA and that it would

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only begin disallowing a COLA of 100 percent with regard to special payment costs from 2013 onward. This decision resulted from the Commission's conclusion that filing a new actuarial report "would be costly, and consume an undue amount of company, intervener and Commission resources given the time remaining in 2011 to complete a new report and file it for approval with the Commission and subsequently with the Superintendent of Pensions", especially as a new report would be filed by January 1, 2013 as it stood: *Decision 2011-391*, at para. 99. The Commission did not reduce special payments to be recovered in 2012 because it was not "in the best interest of ATCO Utilities, ratepayers or pensioners to implement a change to the COLA calculation [at this time] given the uncertain pension funding impacts that may result from a new actuarial valuation and report": para. 100. Reductions in liability as a result of a reduction of COLA would be captured in ongoing special payments set for 2013 onward.

C. *Alberta Utilities Commission: ATCO Utilities, Re (2012), 97 C.C.P.B. 298 (the "Decision 2012-077")*

[22] On November 2, 2011, the ATCO Utilities filed a review and variance application of *Decision 2011-391*. The ATCO Utilities requested that the Commission vacate its direction to reduce the amount of COLA to 50 percent of CPI for regulatory purposes.

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[23] The Commission found that the arguments raised by the ATCO Utilities did not give rise to a substantial doubt as to the correctness of *Decision 2011-391* and denied the ATCO Utilities' request for review and variance.

D. *Alberta Court of Appeal: 2013 ABCA 310, 93 Alta. L.R. (5th) 234*

[24] The Alberta Court of Appeal granted leave to appeal *Decision 2011-391*. Conducting a reasonableness review, the court held it was open to the Commission to reduce the ATCO Utilities' revenue requirements to reflect a COLA of 50 percent of CPI. The Court of Appeal dismissed the Utilities' appeal.

IV. Issues

[25] This appeal raises three issues:

1. What is the standard of review?

2. Does the regulatory framework prescribe a certain methodology in assessing whether costs are prudent?

3. Was it reasonable for the Commission to refuse to incorporate 100 percent of CPI to a maximum of 3 percent into the ATCO Utilities' COLA revenue requirements?

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V. Analysis

A. *Standard of Review*

[26] The standard of review of the Commission's decision in applying its expertise to set rates and approve payment amounts in accordance with the *Electric Utilities Act* and the *Gas Utilities Act* is reasonableness: *OEB*, at para. 73; see *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] S.C.R. 190, at paras. 53-54.

[27] Nonetheless, the ATCO Utilities argue that the jurisprudence favours applying a standard of correctness. However, the cases they cite — *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140 ("*Stores Block*"), *Shaw v. Alberta Utilities Commission*, 2012 ABCA 378, 539 A.R. 315, and *ATCO Gas and Pipelines Ltd. v. Alberta Utilities Commission*, 2009 ABCA 246, 464 A.R. 275 — are not analogous to the matter at hand. They each were said to involve "true questions of jurisdiction", where the regulator was called on to determine whether it had the statutory authority to decide a particular question. This Court's recent jurisprudence has emphasized that true questions of jurisdiction, if they exist as a category at all, an issue yet unresolved by the Court, are rare and exceptional: *Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61, [2011] 3 S.C.R. 654, at para. 34. In any event, this case involves ratemaking. As Bastarache J. noted in *Stores Block*, ratemaking is at the heart of a regulator's expertise and is therefore deserving of a high degree of deference: para. 30.

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[28] To the extent that an appeal also turns on the Commission's interpretation of its home statutes, a standard of reasonableness also presumptively applies: *Alberta Teachers' Association*, at para. 30. The presumption is not rebutted in this case.

B. *Methodology for Determining Costs and Just and Reasonable Rates Under the Electric Utilities Act and the Gas Utilities Act*

[29] The application by the ATCO Utilities, one of which is an electric utility and the other a gas utility, involves both the *EUA* and the *GUA*. Both statutes direct the Commission to set just and reasonable rates. The *EUA* requires the Commission to "have regard for the principle that a tariff approved by it must provide the owner of an electric utility with a reasonable opportunity to recover" various "prudent" or "prudently incurred" costs: s. 122; see also s. 102. A gas utility, on the other hand, is "entitled to recover in its tariffs" costs that the Commission determines to be "prudent": s. 4(3) of the *Roles, Relationships and Responsibilities Regulation*, Alta. Reg. 186/2003 ("*RRR Regulation*"); see also s. 36 *GUA*.

[30] The ATCO Utilities argue that the guarantee of a reasonable opportunity to recover their costs requires that the Commission must first examine whether the decisions to incur costs were prudent and must apply a presumption of prudence in favour of the utility. Unless these costs are found not to be prudent, they are to be included in the utility's revenue requirement. The ATCO Utilities say that in conducting its prudence inquiry, the Commission is required to use the prudence test as described by the Ontario Court of Appeal in *Power Workers' Union, Canadian*

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Union of Public Employees, Local 1000 v. Ontario Energy Board, 2013 ONCA 359, 116 O.R. (3d) 793, which is the subject of the companion appeal to this case. In that case, the Ontario Court of Appeal relied on a formulation of prudence review set out in *Enbridge Gas Distribution Inc. v. Ontario Energy Board*, (2006), 210 O.A.C. 4, at para. 10:

> - 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. [para.16]

[31] The ATCO Utilities argue that the statutes' express use of the word "prudent" to qualify the costs and expenses that electric and gas utilities are entitled to recover necessarily mandates the use of that prudence test. I will refer to it as the "no-hindsight" test.

[32] The language of the relevant provisions of the *EUA* and *GUA* differs from the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B, in the companion *OEB* appeal. While the *EUA* and the *GUA* contain specific references to "prudence", the

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Ontario Energy Board Act, 1998 does not. Further, regulations passed under the *Ontario Energy Board Act, 1998* expressly permit the Ontario Energy Board to establish a methodology to determine whether revenue requirements are just and reasonable. The *EUA* and *GUA* do not include a direct grant of methodological discretion. However, like the statutory scheme in *OEB*, neither the *EUA* nor the *GUA* impose a specific methodology[5] and, as will be explained, their references to "prudence" do not impose upon the Commission the specific methodology advanced by the ATCO Utilities.

(1) Prudence Under the *EUA*

[33] The question before this Court is whether the Commission's interpretation and exercise of its rate-setting authority was reasonable. The ATCO Utilities argue that the statutory framework supports its assertion that it was entitled to a no-hindsight prudence review. Under the reasonableness standard of review, the Commission's interpretation of its home statute is entitled to deference. In this case, the Commission did not expressly address the question of whether the statutory regime mandated a no-hindsight approach. Rather, its decision to proceed without using a no-hindsight prudence test implies that it understood the relevant statutes not to mandate the ATCO Utilities' desired methodology. It is thus necessary to examine the terms of the relevant statutes to determine whether the Commission's approach

[5] The *GUA* does provide some methodological guidance to the Commission with regard to calculating a utility's return on its rate base by specifying what information may be considered in this process: "In fixing the fair return that an owner of a gas utility is entitled to earn on the rate base, the Commission shall give due consideration to all facts that in its opinion are relevant"; (s. 37(3)). However, it does not provide any further methodological guidance for assessing the recoverability of a utility's costs.

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was reasonable. In doing so, this Court may make use of the traditional tools of statutory interpretation with the goal of determining whether the Commission's approach was reasonable: see *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67, [2013] 3 S.C.R. 895, at paras. 37-41.

[34] The words of a statute are to be interpreted "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21, quoting E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87. Because, as will be discussed, the meaning of "prudence" is the focus of much of the debate in this case, it is helpful to start by examining the ordinary meaning of the word as a baseline for the subsequent analysis. Pertinent dictionary definitions give a range of meanings for "prudent", including "having or exercising sound judgement in practical affairs" (*The Oxford English Dictionary* (2nd ed. 1989), vol. XII, at p. 729), "acting with or showing care and thought for the future" (*Concise Oxford English Dictionary* (12th ed. 2011), at p. 1156), or "marked by wisdom or judiciousness [or] shrewd in the management of practical affairs" (*Merriam-Webster's Collegiate Dictionary* (11th ed. 2003), at p. 1002). While these definitions may vary in their nuance, the ordinary sense of the word is such that a prudent cost is one which may be described as wise or sound.

[35] However, these dictionary definitions are not so consistent and exhaustive as to provide a complete answer to the question of the meaning of "prudent" costs in

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the context of the Alberta utilities regulation statutes. As such, a contextual reading of the statutory provisions at issue provides further guidance. In the context of utilities regulation, I do not find any difference between the ordinary meaning of a "prudent" cost and a cost that could be said to be reasonable. It would not be imprudent to incur a reasonable cost, nor would it be prudent to incur an unreasonable cost.

[36] The *EUA* provides that an "owner of an electric distribution system must prepare a distribution tariff for the purpose of recovering the prudent costs of providing electric distribution service by means of [its] electric distribution system": s. 102(1). To receive approval for the distribution tariff, the owner must apply to the Commission: s. 102(2) *EUA*. When considering a tariff application, the Commission must ensure, *inter alia*, that the tariff is "just and reasonable" (s. 121(2)(a) *EUA*), a requirement for which the burden of proof "is on the person seeking approval of the tariff" (s. 121(4) *EUA*).

[37] Section 122 of the *EUA* provides that the Commission "must have regard for the principle that a tariff approved by it must provide the owner of an electric utility with a reasonable opportunity to recover" a series of eight types of costs and expenses:

> a) the costs and expenses associated with capital related to the owner's investment in the electric utility, . . .
>
> . . .
>
> if the costs and expenses are prudent . . .

b) other prudent costs and expenses associated with isolated generating units, transmission, exchange or distribution of electricity . . . if, in the Commission's opinion, they are applicable to the electric utility,

c) amounts that the owner is required to pay under this Act or the regulations,

d) the costs and expenses applicable to the electric utility that arise out of obligations incurred before the coming into force of this section and that were approved by the Public Utilities Board, the Alberta Energy and Utilities Board or other utilities' regulatory authorities if, in the Commission's opinion, the costs and expenses continue to be reasonable and prudently incurred,

e) its prudent costs and expenses of complying with the Commission rules respecting load settlement,

f) its prudent costs and expenses respecting the management of legal liability,

g) the costs and expenses associated with financial arrangements to manage financial risk associated with the pool price if the arrangements are, in the Commission's opinion, prudently made, and

h) any other prudent costs and expenses that the Commission considers appropriate, including a fair allocation of the owner's costs and expenses that relate to any or all of the owner's electric utilities.

[38] Section 122 refers to prudence in two different ways. Most frequently, the adjective "prudent" qualifies the expression "costs and expenses", which indicates that a utility enjoys a reasonable opportunity to recover costs and expenses that are prudent. Absent a definition of the word "prudent" or a clear inference that it refers to a no-hindsight rule as described in *Enbridge*, this prudence requirement is to be understood in the sense of the ordinary meaning of the word: for the listed costs and expenses to warrant a reasonable opportunity of recovery, they must be wise or sound; in other words, they must be reasonable.

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[39] By contrast, certain provisions use the adverb "prudently" to qualify the utility's decision to incur costs: s. 122(1)(d) speaks of costs and expenses that are "reasonable and prudently incurred" and s. 122(1)(g) refers to costs and expenses associated with financial arrangements that were "prudently made". Though this case does not call upon this Court to evaluate the types of expenses covered by s. 122(1)(d) or (g), statutory language referring to "prudently incurred" costs appears to speak more directly to a utility's decision to incur costs at the time the decision was made. Such language may more directly implicate the no-hindsight approach urged by the ATCO Utilities in this case than language that merely speaks of "prudent costs". This issue is further complicated for costs arising under s. 122(1)(d), where costs must both "continue to be reasonable and prudently incurred". The proper interpretation of these provisions is a question best left for a case in which the issue arises.

[40] In their submissions, the ATCO Utilities do not parse the different contexts in which the word "prudent" is used in s. 122. They argue more generally that the references to "prudence" imply that a no-hindsight test is required, and that a utility's costs must be presumed to be prudent.

[41] However, the different uses of "prudence" in s. 122 are instructive. If the statute requires the Commission to approve "prudently incurred" expenses, it may be unreasonable for the Commission to fail to apply a no-hindsight methodology in reviewing such expenses. However, the costs at issue in this case do not fall within

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the categories of costs for which the statute grants recovery of "prudently incurred" costs. The use of the adjective "prudent" to qualify "costs and expenses" elsewhere in s. 122 does not itself imply a specific methodology. Nothing in the ordinary meaning of the word "prudent" or the use of this word in the statute as a stand-alone condition says anything about the time at which prudence must be evaluated.

[42] Further, s. 121(4) of the *EUA* provides that the burden of establishing that the proposed tariffs are just and reasonable falls on the public utility. The requirement that tariffs be just and reasonable is a foundational requirement of the tariff-setting provisions of the *EUA*. Tariffs will not be just and reasonable if they do not comply with the statutory requirement of s. 122 that the costs and expenses be prudent. Thus, contrary to the ATCO Utilities' proposed methodology, the utilities' burden to establish that tariffs are just and reasonable necessarily imposes on the utilities the burden of establishing that costs are prudent.

[43] In sum, neither the ordinary meaning of "prudent" nor the statutory language indicate that the Commission is bound by the *EUA* to apply a no-hindsight approach to the costs at issue, nor is a presumption of prudence statutorily imposed in these circumstances.

(2) Prudence Under the *GUA*

[44] The *GUA* requires, *inter alia*, that on application by the owner of a gas utility, the Commission "fix just and reasonable" rates that "shall be imposed,

observed and followed afterwards by the owner of the gas utility": s. 36(a). Section 44(1) provides that changes in rates must be approved by the Commission, and the "burden of proof to show that the increases, changes or alterations are just and reasonable is on the owner of the gas utility seeking to make them": s. 44(3). Further, s. 4(3) of the *RRR Regulation* provides that

> [a] gas distributor is entitled to recover in its tariffs the prudent costs as determined by the Commission that are incurred by the gas distributor . . . .

[45] While the *RRR Regulation* makes a specific reference to the recovery of "prudent" costs, I do not read this prudence requirement as implying a presumption of prudence and application of a no-hindsight rule. Regarding the "no hindsight" element, the statutory provisions do not use "prudent" to describe the decision to incur the costs, but rather to describe the costs themselves. Although s. 4(3) of the *RRR Regulation* uses the term "incurred", it is used to indicate that the provision applies to costs incurred by the utility. No temporal inference can be drawn from the use of "incurred" in this context; it is not used in a manner that calls for examination of the prudence of the decision to incur certain costs. The inquiry under s. 4(3) of the *RRR Regulation* rather asks whether the costs themselves can be said to be "prudent". The *GUA* does not include a requirement that a no-hindsight rule must apply in assessing whether costs are prudent, nor does the text of the *GUA* or the *RRR Regulation* imply such a rule. Regarding a presumption of prudence, s. 44(3) of the *GUA* stipulates that the utility has the burden to establish that the rates are just and

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reasonable. Like the *EUA*, this in turn places the burden of establishing the prudence of costs on the utility.

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(3) Conclusion With Respect to Statutory Requirements of the *EUA* and *GUA*

[46] Though the statutes do contain language allowing for the recovery of "prudent" costs, the *EUA* and the *GUA* do not explicitly impose an obligation on the Commission to conduct its analysis using a particular methodology any time the word "prudent" is used. Further, reserving any opinion on whether the term "prudently incurred" might require a particular no-hindsight methodology, in this particular case the bare use of the word "prudent" does not, on its own, mandate a particular methodology.

[47] It is thus apparent that the relevant statutes may reasonably be interpreted not to impose the ATCO Utilities' asserted prudence methodology on the Commission. The existence of a reasonable interpretation that supports the Commission's implied understanding of its discretion is enough for the Commission's decision to pass muster under reasonableness review: *McLean*, at paras. 40-41. Thus, the Commission is free to apply its expertise to determine whether costs are prudent (in the ordinary sense of whether they are reasonable), and it has the discretion to consider a variety of analytical tools and evidence in making that determination so long as the ultimate rates that it sets are just and reasonable to both consumers and the utility.

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C. *Characterization of the Costs at Issue: Forecast or Committed*

[48] As explained in *OEB*, understanding whether the costs are committed or forecast may be helpful in reviewing the reasonableness of a regulator's choice of methodology: see para. 83. Committed costs are those costs that a utility has already spent or that were committed as a result of a binding agreement or other legal obligation that leaves the utility with no discretion as to whether to make the payment in the future: para. 82. If the costs are forecast, there is no reason to apply a no-hindsight prudence test because the utility retains discretion whether to incur the costs: para. 83. By contrast, the no-hindsight prudence test may be appropriate when the regulator reviews utility costs that are committed: paras. 102-05.

[49] Determining whether particular costs are committed or forecast turns on factual evidence relevant to those costs as well as on legal obligations that may govern them. Factual evidence may take the form of details regarding the structure of the utility's business, relevant conduct on the part of the utility, and the factual context in which the costs arise. Legal issues may relate to any contractual, fiduciary or regulatory obligations that grant or bar discretion on the part of the utility in incurring the costs at issue. Where the regulator has made an assessment of whether the costs are committed or forecast, that assessment is owed deference by this Court.

[50] On the basis of the evidence and the arguments before it, the Commission found that the "COLA amount ha[d] not yet been awarded for 2012 because consideration of the COLA adjustment occurs towards the end of the calendar year":

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Decision 2011-391, at para. 93. The Commission concluded that there was enough time from the date *Decision 2011-391* was published on September 27, 2011 to the end of the calendar year for the ATCO Utilities and their parent CUL "to prospectively decide whether to separately fund any difference CUL may choose to pay beyond the COLA level approved for regulatory purposes for 2012 onwards": para. 93. This finding supports a characterization of the disallowed COLA costs as forecast because their disallowance left it open to CUL to reduce the COLA that would apply to the 2012 benefit payments to 50 percent of CPI or to incur the COLA of 100 percent of CPI regardless, knowing that the differential would ultimately be borne by the utilities: *OEB*, at para. 82.

[51] However, the Commission did not disallow the use of a COLA of 100% of CPI (up to a maximum of 3 percent) with regard to the special payments intended to address the unfunded liability and fixed by the 2009 Actuarial Report for the year 2012. The Commission did so by reasoning that any consumer overpayment that resulted in 2012 would be compensated through reduced special payments once a new report was prepared for 2013 onward.

[52] In their factum in this Court, the ATCO Utilities submitted that the COLA costs were committed in the same way as the costs fixed by binding collective agreements were in the companion *OEB* appeal. In oral argument, counsel for the ATCO Utilities explained that the pension actuary prepares an actuarial report at intervals of a maximum of three years and files it with the Superintendent of

Pensions: see ss. 13 and 14 of the *Employment Pension Plans Act* (2000)[6] and ss. 9 and 10 of the *Employment Pension Plans Regulation*, (2000).[7]

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[53] In this case, the 2009 Actuarial Report applied for the years 2010, 2011 and 2012. The pension actuary determined the employer's required contribution to fund projected benefits owed to beneficiaries and to address any unfunded liability in the DB plan. For each of the three years covered by the report, the actuary assumed a post retirement pension increase of 2.25 percent per year to be included in required contributions[8]. It was argued by the ATCO Utilities that the employer is required by law to make such contributions: s. 48(3) of the *Employment Pension Plans Regulation* (2000)[9]. Accordingly, the ATCO Utilities submitted that once the actuarial report covering 2010, 2011 and 2012 had been filed, the amounts identified in that valuation, including a post retirement pension increase of 2.25 percent, should be understood as committed.

[54] To address this argument, a distinction must be drawn between the COLA that is used to determine the post retirement pension increases applied to employer contributions paid into the DB plan, and the COLA applied to benefit payments paid out of the plan. While the ATCO Utilities were legally bound to make contributions

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[6] These provisions have since been replaced by s. 13 of the *Employment Pension Plans Act* (2012).
[7] These provisions have since been replaced by ss. 48 and 49 of the *Employment Pension Plans Regulation* (2014).
[8] For clarity, the 2009 Actuarial Report and the DB plan use two separate terms to describe annual pension benefit increases, though they are conceptually linked: the DB plan refers to cost of living adjustment (or COLA), while the 2009 Actuarial Report refers to "post retirement pension increases". The 2009 Actuarial Report's post retirement pension increase figure of 2.25 percent was based on the DB plan's formula for COLA and the actuarial report's assumption for inflation.
[9] This provision has since been replaced by ss. 60(2)(b) and 60(3) of the *Employment Pension Plans Regulation* (2014).

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including a post retirement pension increase of 2.25 percent into the plan for 2012, the actual COLA paid out to beneficiaries was set by CUL on an annual basis. The ATCO Utilities' information responses to the Commission in preparation for their 2011 pension common matters application show that the actual COLA set by CUL for 2010 was 0 percent and for 2011 was 1.7 percent.

[55] The ATCO Utilities' argument that the costs are committed rests on the notion that if the Commission reduces the recoverable COLA to 50 percent of CPI (up to a maximum of 3 percent), they risk incurring a shortfall because the COLA recovered through rates will be less than the post retirement pension increases of 2.25 percent that they were legally obliged to contribute.

[56] However, while both the employer contributions into the DB plan and the benefit payments made to beneficiaries are subject to cost of living adjustments, the portion of *Decision 2011-391* at issue in this appeal was concerned specifically with the reasonableness of the COLA to be set by CUL for the 2012 benefit payments. As such, the Commission's disallowance was with respect to the COLA benefits to be paid out to beneficiaries in 2012 — not to the employer contributions into the DB plan.

[57] Contrary to the submissions of the ATCO Utilities, the facts of this case are different from those in *OEB*. In *OEB*, the utility was bound to pay certain costs by virtue of collective agreements with separate counterparties, the employee unions. In this case, the Commission found that the COLA applied to benefit payments from the

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DB plan was set by the ATCO Utilities' parent, CUL, and that CUL retained discretion over the setting of the COLA for the test period. DB plan members would ultimately receive benefits reflecting a COLA of 100 percent in 2012 only if CUL decided to set the COLA at that level.

[58] CUL may have exercised that discretion in such a way as to avoid saddling its regulated subsidiary with costs it knew would not be recovered. Accordingly, while the ATCO Utilities were required to make contributions reflecting a post retirement pension increase of 2.25 percent into the DB plan pursuant to the 2009 Actuarial Report, the COLA applied to benefit payments for 2012 was not committed when the Commission issued its *Decision 2011-391*. This is so because at the time *Decision 2011-391* was published, CUL had yet to set COLA for 2012.

[59] It was not unreasonable for the Commission to decide, without applying a no-hindsight analysis, that 50 percent of CPI (up to a maximum of 3 percent) "represent[ed] a reasonable level for setting the COLA amount for the purposes of determining the pension cost amounts for regulatory purposes" in 2012: *Decision 2011-391*, at para. 92.

D. *Considering the Impact on Rates in Evaluating Costs*

[60] The ATCO Utilities argue that in considering the prudence of the COLA costs the Commission was preoccupied with the aim of reducing rates charged to customers.

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[61] As discussed above, a key principle in Canadian regulatory law is that a regulated utility must have the opportunity to recover its operating and capital costs through rates: *OEB*, at para. 16. This requirement is reflected in the *EUA* and *GUA*, as these statutes refer to a reasonable opportunity to recover costs and expenses so long as they are prudent. A regulator must determine whether a utility's costs warrant recovery on the basis of their reasonableness — or, under the *EUA* and *GUA*, their "prudence". Where costs are determined to be prudent, the regulator must allow the utility the opportunity to recover them through rates. The impact of increased rates on consumers cannot be used as a basis to disallow recovery of such costs.[10] This is not to say that the Commission is not required to consider consumer interests. These interests are accounted for in rate regulation by limiting a utility's recovery to what it reasonably or prudently costs to efficiently provide the utility service. In other words, the regulatory body ensures that consumers only pay for what is reasonably necessary: *OEB*, at para. 20.

[62] In this case, the Commission did emphasize the effect that reducing the COLA would have on the ATCO Utilities' unfunded liability. It is also true that a lower unfunded liability based on an actuarial report using a 50 percent COLA instead of 100 percent would mean a lower revenue requirement, and thus lower rates passed on to consumers. However, I do not agree with the ATCO Utilities' submission that the Commission, in considering the effect of COLA on the utilities'

[10] Regulators may, however, take into account the impact of rates on consumers in deciding *how* a utility is to recover its costs. Sudden and significant increases in rates may, for example, justify a regulator in phasing in rate increases to avoid "rate shock", provided the utility is compensated for the economic impact of deferring its recovery: *TransCanada Pipelines Ltd. v. National Energy Board*, 2004 FCA 149, 319 N.R. 171, at para. 43.

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unfunded pension liability, was basing its disallowance on concerns about rate hikes for consumers. Regulators may not justify a disallowance of prudent costs solely because they would lead to higher rates for consumers. But that does not mean a regulator cannot give any consideration to the magnitude of a particular cost in considering whether the amount of that cost is prudent.

[63] Indeed, it seems axiomatic that any time a regulator disallows a cost, that decision will be based on a conclusion that the cost is greater than ought to be permitted, which leads to the inference that consumers would be paying too much if the cost were incorporated into rates. But that is not the same as disallowing a cost *solely* because it would increase rates for consumers. In this case, the Commission found it unreasonable for the ATCO Utilities to receive payments to cover a COLA of 100 percent while they carried a large unfunded liability on their books, in part because of evidence from comparator companies that COLA figures of less than 100 percent were common, and because of the Commission's finding that a COLA of 100 percent was not necessary to ensure that the ATCO Utilities could attract and retain employees. While this conclusion carries with it the consequence that rates will be lower as a result, the Commission reasoned from the prudence of the costs themselves, not from a desire to keep rates down, to arrive at its conclusion to disallow costs. I find nothing unreasonable in the Commission's reasoning in this regard.

VI. Conclusion

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[64] The Commission was not statutorily bound to apply a particular methodology to the costs at issue in this case. The use of the word "prudent" in the *EUA* and *GUA* cannot by itself be read to impose upon the Commission the specific no-hindsight methodology urged by the ATCO Utilities.

[65] While there are undoubtedly situations in which a failure to apply a no-hindsight methodology may result in unjust outcomes for utilities, and thus violate the statutory requirement that rates must strike a just and reasonable balance between consumer and utility interests, the Commission did not act unreasonably in this case. The disallowed costs were forecast costs. Accordingly, it was reasonable in this case for the Commission to evaluate the ATCO Utilities' proposed revenue requirement in light of all relevant circumstances. Further, because the Commission did not use impermissible methodology, it was not unreasonable for the Commission to direct the ATCO Utilities to reduce their pension costs incorporated into revenue requirements by restricting annual COLA to 50 percent of CPI (up to a maximum of 3 percent) for current service costs from 2012 onward and for special payments addressing the unfunded liability from 2013 onward.

[66] For these reasons, I would dismiss the appeal.

Appeal dismissed.

Solicitors for the appellants: Bennett Jones, Calgary.

Solicitors for the respondent the Alberta Utilities Commission: Alberta Utilities Commission, Calgary.

Solicitors for the respondent the Office of the Utilities Consumer Advocate of Alberta: Reynolds, Mirth, Richards & Farmer, Edmonton; Michael Sobkin, Ottawa.

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Ag Processing, Inc., a Cooperative, Complainant,
v.
KCP&L Greater Missouri Operations Company, Respondent.
AG Processing, Inc., Complainant,
v.
KCP&L Greater Missouri Operations Company, Respondent

File No. HC-2010-0235; File No. HC-2012-0259

PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

2013 Mo. PSC LEXIS 210

February 27, 2013, Issued; March 5, 2013, Effective

CORE TERMS: hedging, customer, burden of proof, natural gas, preponderance, prudence, steam, refund, evidence standard, effective, imprudently, imprudence, imprudent, fuel, expenditure, evidentiary record, failed to meet, serious doubt, quarterly, permanent, prudently, hedge, reopen a case, burden to prove, prudent manner, rate case, temporary, ratepayers, decrease, deadline

PANEL: [*1] Gunn, Chm., Jarrett, R. Kenney, Stoll, and W. Kenney, CC., concur; Stearley, Deputy Chief Regulatory Law Judge

OPINIONBY: STEARLEY

OPINION: ORDER REGARDING REMAND

Background on file No. HC-2010-0235
At a session of the Public Service Commission held at its office in Jefferson City on the 27th day of February, 2013.

Prior to the merger between Great Plains Energy Incorporated and Aquila, Inc. d/b/a Aquila Networks - L&P ("Aquila"), which then became KCP&L Greater Missouri Operations Company ("GMO"), a sister subsidiary of Kansas City Power and Light Company, Aquila had a program in place to hedge natural gas price volatility for its steam operations. n1 Aquila engaged in this program because they used two fuels to generate steam - coal was the primary fuel and natural gas was used as a swing fuel when load exceeded the capacity of the coal-fired boiler. Natural gas prices were highly volatile, in part, because of the effects of Hurricanes Rita and Katrina in 2005. The hedging program was a 1/3rd, 1/3rd, 1/3rd program. Thus, 1/3rd of the required natural gas was

not hedged and was to be bought on the spot market; 1/3rd was hedged with futures contracts and 1/3rd was hedged with call options. **[*2]** In 2006-2007, the hedging program resulted in losses because the amount of natural gas was over-hedged based upon forecasts for usage from Aquila's customers and because the price of gas fell.

n1 The merger was approved by the Commission in File No. EM-2007-0374, *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc. with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief* in its Report and Order issued on July 1, 2008, Effective, July 11, 2008.

Aquila has five industrial steam customers: AG Processing, Inc. ("AGP"), Triumph Foods, L.L.C. (a new customer coming on line just before the 2006 hedges were placed), Albaugh Chemical, Nestle/Purina PetCare, and Land O' Lakes - Omnium Division (a chemical company). A sixth customer, Silgan Containers, left the system towards the end of 2006, apparently after the 2006 hedges were placed. Gains and losses from the hedging program **[*3]** were passed through to Aquila's customers by means of Quarterly Cost Adjustments ("QCA") for fuel expenses. The pass through is an 80/20 adjustment where the customers pick up 80% of the fuel costs. The QCA is similar to a fuel adjustment clause mechanism.

During the period of April 2006 through December 2007, Aquila purchased hedge positions for approximately 2,000,000 mmBtus of natural gas for steam production. During the same period, its actual burn was 1,500,000 mmBtus. The net cost of the hedging program for 2006 was $ 1,164,960 and for 2007 was $ 2,441,861. Consequently, with the 80% pass through, Aquila's customers paid $ 936,968 of these costs for 2006, and $ 1,953,488 for 2007. The hedging program ceased in October of 2007.

On January 28, 2010, AGP filed its complaint in File No. HC-2010-0235 claiming that GMO was imprudent for initiating such a hedging program and that the program was imprudently designed and imprudently managed or operated. AGP sought a refund of the money lost in the hedging program.

The Commission issued its Report and Order in HC-2010-0235 on September 28, 2011, effective October 8, 2011. In that order, the Commission determined that:

(1) it was not **[*4]** imprudent for GMO to adopt a natural gas hedging program;

(2) GMO's hedging program was prudently designed,

but

(3) GMO failed to meet its burden to prove that it operated its hedging program in a prudent manner.

When reaching its decision that GMO failed to meet its burden to prove that it operated its hedging program in a prudent manner, the Commission examined the presumption of prudence the utility receives in relation to its expenses. That presumption is applied as follows in a general rate case:

> A utility's expenditures are presumed to be prudently incurred, but, if some other participant in the proceeding creates a serious doubt n2 as to the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the questioned expenditure to have been prudent. n3

Applying the presumption, the Commission determined that:

(1) AGP had raised serious doubt about the prudence of GMO's decisions regarding the hedging program;

(2) GMO had the burden of proving it operated its hedging program in a prudent manner;

and

(3) GMO failed to meet that burden.

The Commission went on to say that GMO failed to establish that any **[*5]** part of the cost of operating the hedging program was prudently incurred and the entire net cost of operating its natural gas price hedging program for steam production in 2006 and 2007 was imprudently incurred.

n2 The legal standard for overcoming a presumption is the production of substantial controverting evidence. It should be noted that in HC-2010-0235 the Commission did not articulate this standard when finding that AGP raised serious doubt so that finding is not adequately supported. On remand this won't necessarily matter, because the Court of Appeals

made it clear that the Complainant, AGP, has the burden of proof at the preponderance of the evidence standard. The burden-shifting presumption is not applicable.

n3 This presumption is routinely applied in rate cases, but it should be kept in mind that legal presumptions are not the same as a burden of proof. A full legal analysis of the burden of proof in a "prudence review" versus a complaint case appears in the Report and Order in File No. EO-2011-0390 that was issued on September 4, 2012.

[*6]

The Commission made another important decision in HC-2010-0235. The Commission decided that since this action was a full prudence review, it applied to all of GMO's steam customers, and the relief ordered by the Commission, a refund, should apply to all of Aquila's steam customers, not just AGP, the only party that complained.

GMO pursued an appeal of the Commission's decision to the Missouri Court of Appeals, Western District. By November 12, 2012, while awaiting the issuance of the mandate of the Court of Appeals, GMO had completed the Commission-ordered refund of the entire amount at issue to its customers through the QCA.

The Court of Appeals reversed the Commission's decision, finding that the Commission incorrectly applied the burden of proof. The Court determined that AGP, as the complainant who initiated the action, had the burden to prove its claims of imprudence regarding the company's expenditures on the natural gas hedging program at the preponderance of the evidence standard. The court stated: "Granting relief without requiring Ag Processing to prove the allegations in its complaint is reversible error." "Accordingly, we reverse the order and remand the cause for further **[*7]** consideration under the appropriate burden of proof."

The Court of Appeals Mandate was issued on November 21, 2012, making its order final. The Court had overruled motions for rehearing filed by the Commission and AGP. No motions for transfer to the Supreme Court of Missouri were filed.

Background on file No. HC-2010-0235

File Number HC-2012-0259 is another complaint initiated by AGP against GMO raising allegations of imprudence with GMO's hedging program, but it involves a different quarterly cost adjustment period - 2009. It also involves different allegations of imprudence. This case was nearing its hearing date when GMO filed a motion to stay it pending the Court of Appeals decision in HC-2010-0235. The Commission granted that motion and stayed the case because the proper burden of proof will be identical for both of these cases.

The Commission's Review Following Remand

After discussing these two matters at the Commission's December 5, 2012 Agenda session, the Commission decided the initial step was to have the parties to HC-2010-0235 re-brief that case, based on the present record, applying the preponderance of the evidence standard. Those briefs were filed **[*8]** on January 7, 2013. GMO responded to AGP's brief on January 15, 2013. AGP replied to GMO's response on January 25, 2013. In that reply, AGP raised another argument claiming that even if it failed to meet the burden of proof, the customers cannot be compelled to refund the money to GMO as a matter of law. The Commission set a response deadline for February 4, 2013 to give the parties an opportunity to respond to this new legal argument. Responses were filed by GMO on February 8, 2013, and by the Commission's Staff on February 11, 2013.

On February 12, 2013, AGP filed a notice of its intent to reply to GMO's and Staff's responses. And on February 13, 2013, following a case discussion on these matters at the Commission's Agenda session, the Commission established a response deadline for AGP of March 19, 2013. n4

n4 Responses were filed by both AGP and GMO. Neither response adds to the analysis.

Following the re-briefing of HC-2010-0235, the Commission undertook an extensive review of its September 28, 2011 Report and **[*9]** Order. When reviewing its prior decision, the Commission kept in mind the preponderance of the evidence standard, the prudence standard and the proof of harm standard as articulated below.

Preponderance of the Evidence Standard

In order to meet the preponderance of the evidence standard, AGP must convince the Commission it is "more likely than not" that its allegations of imprudence against Aquila/GMO are true. n5 There must be enough evidence to tip the scales in favor of a party in order for them to meet this burden. The preponderance of the evidence must support the complainant's allegations and demonstrate that GMO violated the prudence standard in relation to the company's hedging program.

n5 *Byous v. Missouri Local Government Employees Retirement System Bd. of Trustees*, 157 S.W.3d 740, 746 (Mo. App. 2005); *Holt v. Director of Revenue, State of Mo.*, 3 S.W.3d 427, 430 (Mo. App. 1999); *McNear v. Rhoades*, 992 S.W.2d 877, 885 (Mo. App. 1999); *Rodriguez*, 936 S.W.2d at 109 -111; *Wollen v. DePaul Health Center*, 828 S.W.2d 681, 685 (Mo. banc 1992).

[*10]

If the evidence is equally balanced, the litigant having the burden of proof loses. n6 Similarly, a submissible case is not made if it depends solely on evidence which equally supports two inconsistent and contradictory inferences. n7

n6 *Dill v. Dill*, 304 S.W.3d 738, 743 (Mo. App. 2010).

n7 *Steward v. Baywood Villages Condominium Ass'n* 134 S.W.3d 679, 682 (Mo. App. 2004).

Prudence Standard

The "prudence standard" further qualifies how AGP must meet its burden of proof in relation to its allegations. To determine if GMO's conduct was imprudent, the Commission looks at whether the utility's conduct was reasonable at the time, under all of the circumstances, considering that the company had to solve its problem **prospectively** rather than in reliance on hindsight. n8 More specifically, AGP must prove, by the preponderance of the evidence, that GMO's conduct was unreasonable at the time, under all of the circumstances, from a prospective viewpoint, **[*11]** not in hindsight. Additionally, "[i]f the company has exercised prudence in reaching a decision, the fact that external factors outside the company's control later produce an adverse result do not make the decision extravagant or imprudent." n9

n8 *State ex rel. GS Technologies Operating Co., Inc. v. Public Service Comm'n*, 116 S.W.3d 680, 694 (Mo. App. 2003); *State ex rel. Associated Natural Gas Co. v. Public Service Comm'n*, 954 S.W.2d 520, 528 -529 (Mo. App. 1997).

n9 *State ex rel. Missouri Power and Light Co. v. Public Service Comm'n*, 669 S.W.2d 941, 947 -948 (Mo. App. 1984).

Proof of Harm

In order for the Commission to direct a refund for any alleged imprudently incurred costs, it must apply a two-part test. The Commission must find both that: (1) the utility acted imprudently when incurring those costs and, (2) such imprudence resulted in harm to the utility's ratepayers. n10 Harm to ratepayers in relation **[*12]** to imprudently incurred costs requires proof of causation, i.e., that the increased costs recovered from the ratepayers were causally related to the alleged imprudent action, and evidence as to the amount those expenditures would have been if the utility acted prudently. n11

n10 *State ex rel. Associated Natural Gas Co. v. Public Service Comm'n*, 954 S.W.2d 520, 529 -530 (Mo. App. 1997).

n11 *Id.*

Analysis and Decision

After a complete review of the evidence in HC-2010-0235, the Commission determines that it will vacate its Report and Order in its entirety as a matter of due process. When AGP presented its case to the Commission it was operating under the assumption that the burden of proof would shift to GMO if it raised serious doubt as to GMO's adoption and management of the hedging program.

To ensure due process, the Commission will reopen the evidentiary record in HC-2010-0235 to take **additional** evidence n12 with all of the parties being fully informed of the **[*13]** proper burden of proof and who bears that burden. n13 AGP bears the burden of proof of its allegations at the preponderance of the evidence standard. All of the parties will be afforded the opportunity to present evidence so there will be no unfair advantage to any party.

n12 The parties do not have to re-introduce evidence already admitted into the record.

n13 As the Court of Appeals has elucidated:

> The trial court is afforded wide discretion in determining whether to reopen a case to allow the admission of additional evidence. The trial court's decision as to whether to reopen a case will be reversed only upon a showing of abuse of discretion. However, when there is no inconvenience to the Court or unfair advantage to one of the parties, there is an abuse of discretion and a new trial will be directed upon a refusal to reopen a case and permit the introduction of material evidence, that is evidence that would substantially affect the merits of the action and perhaps alter the Court's decision. (Internal citations omitted).

Foster v. Village of Brownington, 76 S.W.3d 281, 287 (Mo. App. W.D. 2002).

Because the Court of Appeals has reversed and remanded this case to the Commission, the Commission believes that it has the same discretionary authority as the courts to re-open the evidentiary record.

[*14]

Additionally, the Commission failed to properly apply the proof of harm standard. The Commission even noted this in its decision stating: "The record is not clear about how much net hedging costs Aquila would have incurred if it had properly forecast the amount of natural gas it need to purchase supply steam to its customers." There was no evidence produced as to what the hedging costs might have been if more accurate forecasted load had been used, but presumably there still would have been costs passed through the customers. There was also no evidence produced providing a breakdown of each customer's portion of the hedging costs. Consequently, when the Commission ordered the refund in HC-2010-0235, it did not have any evidence in the

record to determine the correct amount of the award.

Current Status of the Quarterly Cost Adjustment

Having determined the Commission must reopen the record in HC-2010-0235, and having determined that its prior decision was in error because it did not apply the proper burden of proof, the Commission must make a determination with regard to the refund the Commission ordered to GMO's customers. The Commission must make this ruling now pursuant **[*15]** to Section 386.520.2(3), RSMo Supp. 2011, which provides:

> 2. With respect to orders or decisions issued on and after July 1, 2011, that involve the establishment of new rates or charges for public utilities that are not classified as price-cap or competitive companies, there shall be no stay or suspension of the commission's order or decision, however:
>
> (3) **If the effect of the unlawful or unreasonable commission decision was to** increase the public utility's rates and charges by a lesser amount than what the public utility would have received had the commission not erred or to **decrease the public utility's rates and charges in a greater amount than would have occurred had the commission not erred, then the commission shall be instructed on remand to approve temporary rate adjustments designed to allow the public utility to recover from its then-existing customers the amounts it should have collected plus interest at the higher of the prime bank lending rate minus two percentage points or zero.** Such amounts shall be calculated for the period commencing with the date the rate increase or decrease took effect until the earlier of the **[*16]** date when new permanent rates and charges consistent with the court's opinion became effective or when new permanent rates or charges otherwise approved by the commission as a result of a general rate case filing or complaint became effective. Such amounts shall then be reflected as a rate adjustment over a like period of time. **The commission shall issue its order on remand within sixty days unless the commission determines that additional time is necessary to properly calculate the temporary or any prospective rate adjustment, in which case the commission shall issue its order within one hundred twenty days.** (Emphasis added).

The Commission determines that additional time, beyond 60 days, is necessary to properly calculate the temporary rate adjustment that must be made in relation to its September 28, 2011 Report and Order determined to be unlawful by the Court of Appeals. It required more than 60 days to allow the parties to re-brief the matter and allow the Commission to fully review the evidentiary record applying the proper burden of proof.

Even though the Commission has decided that the record must be reopened, Section 386.520.2(3) RSMo Supp. 2011 **[*17]** , mandates the Commission to make a determination on rate adjustments within a maximum deadline of 120 days upon remand. Because the Court of Appeals'

mandate issued on November 21, 2012, the Commission must make this adjustment no later than March 21, 2013. There is insufficient time for the Commission to conduct a new hearing in this matter and render a new decision within that time frame, so the Commission will order a rate adjustment during the pendency of the new hearing. This rate adjustment will not prejudice any party because the QCA is a two-way cost adjustment mechanism. n14 If it is later determined that GMO actions were imprudent, any amounts returned to GMO that should have been retained by the customers can simply be flowed back through the QCA to the customers.

n14 The Commission has reviewed all of the parties' filings in relation to this issue and agrees with the positions of its Staff and GMO, as articulated fully in their filings. See EFIS Docket Entry No. 120, Legal Analysis of KCP&L Greater Missouri Operations Company, filed on February 8, 2013 and EFIS Docket Entry No. 121, Response to Order Directing Filing, filed on February 11, 2013. EFIS is the Commission's electronic Information and Filing System. The Commission adopts these legal analyses as if fully set out in this order.

[*18]

Consolidation with HC-2012-0259

File No. HC-20120-0259 has been stayed pending a determination in HC-2010-0235. Because the Commission is going to reopen the record in HC-2010-0235, as a matter of administrative economy and to prevent unnecessary delay and avoid unnecessary costs, the Commission will consolidate the two actions. While the allegations in the two complaints advance different theories of imprudence, they involve related questions of law and fact. n15

n15 See Commission rule 4 CSR 240-2.110(3).

Procedural Schedule

The parties will need to coordinate the presentation of the evidence for these two matters and the Commission is unaware of potential conflict dates for counsel to the parties. Consequently, the Commission will direct the joint filing of a proposed procedural schedule.

THE COMMISSION ORDERS THAT:

1. The Commission's September 28, 2011 Report and Order in HC-2010-0235 is vacated.

2. The Commission re-opens the evidentiary record **[*19]** in HC-2010-0235 for further proceedings as delineated in the body of this order.

3. KCP&L Greater Missouri Operations Company shall, within 20 days of the effective date of this order, file a new Quarterly Cost Adjustment Tariff that initiates the return of the improvidently ordered refund to its steam customers in the manner described in Section 386.520.2(3), RSMo Supp. 2011, which states: "Such amounts shall be calculated for the period commencing with the date the rate increase or decrease took effect until the earlier of the date when new permanent rates and charges consistent with the court's opinion became effective or when new permanent rates or charges otherwise approved by the commission as a result of a general rate case filing or complaint became effective. Such amounts shall then be reflected as a rate adjustment over a like period of time." The Commission's Staff shall review the company's tariff filing to ensure statutory compliance and file a recommendation on whether to approve it as being in conformity with this order no later than five days after the tariff filing is made.

4. The Commission lifts the stay and reactivates **[*20]** File Number HC-2012-0259.

5. File Numbers HC-2010-0235 and HC-2012-0259 are consolidated. File No. HC-2012-0259 shall be designated as the lead case and File No. HC-2010-0235 shall be closed. All future filings in these matters shall be made in File NO. HC-2012-0259.

6. No later than March 14, 2013, the parties shall jointly file a proposed procedural schedule for the consolidated cases.

7. This order shall become effective on March 5, 2013.

BY THE COMMISSION

Gunn, Chm., Jarrett, R. Kenney, Stoll, and W. Kenney, CC., concur.

Stearley, Deputy Chief Regulatory Law Judge

The

PROCESS

OF

RATEMAKING

Volume II

By

Leonard Saul Goodman

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DEFINITION. The attention of courts and commissions was drawn to "value" of the rate base, rather than its cost, in the early part of this century because (among other reasons) there was general distrust of the costs shown on the books of regulated companies like the railroads. Decades before the Supreme Court would throw off the "fair value" judgmental rate base burdening early ratemaking, Justice Brandeis urged that fair value be replaced by a "prudent investment" rate base. His purpose was broader than mere review of company management; he sought to substitute cost-based rates for judgmental ratemaking, and "prudent investment" was the term he used in the 1920s to introduce cost subject to the general distrust of book costs.

When the intricacies and confusions surrounding fair value multiplied, and confidence gained in the companies' investment books and records, so that attention was given once again to original cost, it was generally done so with the caveat that the net investment worthy of consideration was only the prudently invested capital and not any or every cost claimed by the regulated company.

"Prudent" management implies reasonable management. It is related to "negligence" and does not require any showing of fraud or actual dishonesty. In seeking a definition of negligence, for example, the Supreme Court has invoked the word "prudence." Its definition is a helpful starting point for understanding the type of management here under scrutiny:[1]

> negligence consists of doing that which a person of reasonable prudence would not have done, or of failing to do that which a person of reasonable prudence would have done under like circumstances. Issues of negligence, therefore, call for the exercise of common sense and sound judgment under the circumstances of particular cases.

A similar negligence test has long applied in stockholder derivative actions, where corporate directors are expected to have acted with the degree of care "ordinarily prudent and diligent men would exercise under similar circumstances."[2]

Justice Brandeis in an early opinion,[3] to which we will later return, cited law review articles by Prof. Goddard of the University of Michigan when discussing the subject of prudent investment. Prof. Goddard, who taught and wrote near the turn of the century, when it was still felt necessary to find common law precedent for administrative action, developed a casebook linking the law of bailments and common carriers in which "the innkeeping relation, the telegraph and the telephone, take their places in a natural way."[4] The law of "bailments" involved the study of negligence in relation to property and the liability of one in whose care the property is held. In other words, Justice Brandeis would have allowed a value-based rate base subject only to a prudence test rooted in the law of negligence.

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[1] Schulty, Administratrix v. Penna. R.Co., 350 U.S. 523, 525 (1956).

[2] Briggs v. Spaulding, 141 U.S. 132 (1890).

[3] Missouri ex rel. Southwestern Bell Tel.Co. v. PSC of Mo., 262 U.S. 276, 289-92, 306-07 (1923).

[4] Goddard, Edwin C., Cases on the Law of Bailments and Carriers of Service by Public Utilities, Callaghan and Co., Chicago, preface (1904, republ. 1928). The casebook is cited and discussed in more detail in Burns, Robert E., Poling, Robert D., Whiniban, Michael J., and Kelly, Kevin, "The Prudent Investment Test in the 1980s," NRRI, Columbus, Ohio, pp. 24-26 (1985).

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: ***Jackson v. Kelowna General Hospital et al.,***
2006 BCSC 279

Date: 20060216
Docket: S73673
Registry: New Westminster

Between:

Nigel Jeremy Jackson

Plaintiff

And

Kelowna General Hospital, Carol Czech, Connie Gabert, Jill Headington a.k.a. Jill Hunt and Jane Doe 1 to 5

Defendants

Before: The Honourable Madam Justice Beames

Reasons for Judgment

Counsel for the Plaintiff:	K.S. Garcha, H. Doig and J. Dhillion, Articled Student
Counsel for the Defendants:	C.L. Woods and D. Bell
Date and Place of Trial:	June 14-17, 2005; June 20-24; 2005; and June 27-29, 2005 Kelowna, B.C.

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INTRODUCTION

[1] In the early morning hours of April 18, 2001, outside a bar in Vernon, British Columbia, the plaintiff was injured when he was sucker punched in the head. After spending the night in the Vernon Jubilee Hospital, he was admitted to the Kelowna General Hospital for surgery on his fractured jaw. That surgery finally took place shortly after 7 p.m. on April 19, 2001. Approximately four hours after the surgery was completed, the plaintiff was found by nursing staff unresponsive and in respiratory distress. A code blue was called; he was resuscitated and transferred to the intensive care unit, from which he was discharged on April 23, 2001. He was discharged from the hospital on April 24, 2001.

[2] The plaintiff has brought this action against three nurses, Carol Czech, Connie Gabert, and Jill Hunt (formerly Jill Headington), who provided nursing care for him after his surgery and until the code blue was called, and against the Kelowna General Hospital as the employer of those nurses.

POSITION OF THE PARTIES

[3] The plaintiff submits that the defendant nurses were negligent in seven respects, as follows:

1. they failed to follow the Patient Controlled Analgesia ("PCA") monitoring orders;

2. they failed to monitor or assess the plaintiff's nausea, pain and sedation levels;

3. they failed to provide antiemetic (nausea control) medication;

4. they failed to evaluate or monitor the plaintiff's use of the PCA pump provided to him;

5. they failed to reinforce any patient teachings with respect to the PCA pump and with respect to oral suctioning;

6. they failed to chart or document the plaintiff's vital signs; and

7. they failed to provide the plaintiff with a call bell.

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[4] The defendants submit that they met the standard of care expected of them in the circumstances, and that even if there was a failure to meet the standard of care, any such failure did not cause or materially contribute to the injuries and loss suffered by the plaintiff.

FACTS

[5] Many of the background facts are not in dispute. The plaintiff and three other people went out for dinner and then to a bar, in Vernon, on April 17, 2001. It was an early celebration of the plaintiff's 21st birthday, which was on April 18, 2001. At the bar, the plaintiff and a former boyfriend of the plaintiff's girlfriend became involved in a verbal altercation which started inside the bar and then carried on outside the bar. As the plaintiff turned around to walk back into the bar, he was punched in the head. He was driven to the hospital by his girlfriend and admitted to the Vernon Jubilee Hospital at 1:33 a.m. On admission he was diagnosed as having a fractured lower jaw and he was noted to have superficial wounds above and below his left eye. As

surgery was not available in Vernon, arrangements were made for him to be transferred to the Kelowna General Hospital for surgery. The plaintiff remained over night in the Vernon Jubilee Hospital, and throughout the night he was administered morphine for pain control.

[6] The plaintiff's mother drove the plaintiff to Kelowna in the morning, and the plaintiff was admitted to the Kelowna General Hospital at approximately noon. On admission, he was noted to be alert and oriented, and his behaviour pattern was noted as being appropriate and reliable. It was originally planned that he would have surgery on April 18, but his surgery was cancelled, apparently as a result of other more urgent cases. He was administered morphine for pain control, together with gravol for nausea control, periodically throughout the day. He vomited at approximately 6 p.m.

[7] On April 19, 2001, the plaintiff continued to wait for surgery. He was apparently prepared for surgery which was subsequently postponed at least once during the day. He continued to receive periodic doses of morphine and gravol throughout the day with no further episodes of vomiting. At approximately 7 p.m. he was finally taken in for surgery, which commenced at 7:20 and finished at 8:20 p.m. From surgery he was discharged into the postanesthesia recovery room (the "PAR"), where he was attended to by PAR nurse Leslie Poulen.

[8] The anesthesiologist for the surgery was Dr. Wickett. Dr. Wickett wrote two medication orders for the plaintiff. The first was the PAR order recorded on the anesthesia record contained in the Kelowna General Hospital records. The PAR

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order directed that the plaintiff have morphine, 1 to 3 milligrams administered by i.v. as required; zofran, an antiemetic, as required; and droperidol, another antiemetic, as required.

[9] The second order is referred to as the PCA standing order. The PCA pump was set up in the PAR. As its name suggests, the PCA pump system is a system which permits the patient to administer morphine to himself, as required, within the limits programmed into the machine. The PCA standing order written by Dr. Wickett provided for a dose of 1.5 milligrams of morphine not more than every 6 minutes, for an hourly limit of morphine of 15 milligrams. The PCA standing order provided that the patient's pulse, respiratory rate and blood pressure were to be monitored "q1h for 2 hours, then q4h unless ordered otherwise", which means once per hour for two hours and then once every four hours. The PCA standing order provided other directions for the nurses, including steps to be taken in the event of inadequate pain control; reduced respiratory rates or excessive sedation; nausea and/or vomiting; and other possible problems including itch and urinary retention. With respect to nausea or vomiting, the standing order provided that the patient could be administered one of three antiemetics, namely droperidol, gravol or zofran, as required.

[10] Ms. Poulen provided the nursing care for the plaintiff while he was in the PAR. She testified that she followed the PAR order, and that the PCA order did not apply while the plaintiff was in the PAR. Ms. Poulen assessed the plaintiff six times in just under one hour. On each occasion, save the first, the plaintiff was scored as 10 out of 10 on the PAR score criteria, which assesses respiration, circulation,

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consciousness, movement and sensation, and color. She administered 3 milligrams of morphine at 8:47 and again at 8:49. At 8:55, she set up the PCA machine. After the PCA machine was set up, the administration of morphine doses remained in the control of Ms. Poulen, rather than the plaintiff, through the PCA. Ms. Poulen administered 3 milligrams of morphine at each of 9:17, 9:20, 9:21 and 9:23. While the plaintiff was in the PAR, he was instructed about the use of the PCA and he was taught by Ms. Poulen to suction secretions from his mouth. He was discharged from the PAR after his final assessment at 9:30 p.m.

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[11] After discharge from the PAR the plaintiff was returned to the surgical ward he had been on since admission to the hospital, 4 West. There were 15 patients on 4 West on the night of April 19, 2001. The ward was staffed by Ms. Czech, a registered nurse who was the assessment nurse that night; Ms. Gabert, who was the medications nurse that shift; Ms. Hunt, a student nurse completing her last preceptorship before graduating from the nursing program at Okanagan University College, who was under the supervision of Ms. Gabert; Veronica McParland, a licenced practical nurse; and a floating nurse, not identified by name during the trial, who performed duties on both 4 West and 4 East during that shift.

[12] The plaintiff arrived on 4 West at 9:45 p.m. On arrival, he was assessed by Ms. Czech and Ms. McParland. Ms. Czech completed a column in the nurse's assessment record, which forms part of the hospital records, showing the results of that assessment. Ms. Czech testified that in the course of her assessment, after admitting the plaintiff back onto the ward, she set up suctioning for the plaintiff, asked him to demonstrate what he had learned about suctioning while he was in the

PAR, explained the PCA pump, and set up the call bell, explaining to the plaintiff that if he had nausea or pain he was to ring.

[13] That instructions were provided to the plaintiff with respect to suctioning and the PCA pump is confirmed by the evidence of the plaintiff's former girlfriend, Cathy Wood, who testified that while she was in the room with the plaintiff, after his return from the operating room, a nurse explained to the plaintiff both suctioning and the process of pushing the button on the PCA pump to administer morphine to himself. However, with respect to the call bell, Ms. Wood testified that there was no call bell visible on the night of April 19, and that before she left the hospital late that evening she specifically looked for a nurse to inquire as to the whereabouts of the call bell. On the evidence, I consider it more likely than not that there was a call bell in the plaintiff's room, but it is less clear that the call bell was placed within easy reach of the plaintiff while he was being assessed on his readmission to 4 West.

[14] While Ms. Czech and Ms. McParland were completing the assessment of the plaintiff, Ms. Gabert and Ms. Hunt attended in the plaintiff's room to check the PCA machine and its settings. That check involved ensuring that the settings on the machine conformed with the doctor's standing order in terms of dose and delay. Ms. Gabert testified that before she checked the machine, she printed off the PCA sheet, entered the doctor's orders on the sheet in handwriting, and took the sheet to the machine. She testified that she checked the settings and then taped the sheet to the machine. It was her evidence and the evidence of Ms. Hunt that this check took place at 10:00 p.m. and the timing of the check is corroborated by other evidence, including that Ms. Czech and Ms. Hunt were still in the room, performing the formal

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assessment of the plaintiff when the PCA machine check occurred. However, the evidence of Ms. Gabert is clearly inaccurate with respect, at least, to the printing of the sheet and the taping of the sheet to the machine, as the sheet in the hospital records was not printed until 11:33 p.m. that night.

[15] There is some conflict in the evidence with respect to the nursing care the plaintiff received after the 9:45 formal assessment.

[16] Ms. Gabert testified that she was not in the plaintiff's room between 10 p.m., when she checked the settings on the PCA machine, and the time the code blue was called, after midnight.

[17] Ms. Hunt was inconsistent in her evidence. She said on one hand that she was not in the plaintiff's room between 10 p.m. and shortly before midnight, when she performed rounds. On the other, she testified that she was in and out of the plaintiff's room between 10 p.m. and midnight. Similarly, she said on the one hand that she did not see the plaintiff's girlfriend after 10 or 10:30 at night, and on the other hand said every time she was in the room, which she was in and out of all evening, she observed the plaintiff and his girlfriend talking.

[18] Ms. Czech testified that after her formal assessment, which started at 9:45 p.m., she was not in the plaintiff's room again until 11:15, at which time she changed the plaintiff's i.v. bag; and that she was not in the plaintiff's room again after that until she found the plaintiff unresponsive and in respiratory distress, after midnight.

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[19] I did not hear evidence from Ms. McParland or from the floating nurse. Although the evidence of the nurses who did testify was that there was a practice on 4 West of performing hourly rounds, I heard no evidence about whom, if anyone, performed rounds at 11 p.m., unless it was during rounds that Ms. Czech changed the plaintiff's i.v. bag. There is nothing in the plaintiff's hospital records which would indicate anyone attended in his room between 10 and 11:15 p.m., or between 11:15 and approximately 12:15, when the plaintiff was discovered in obvious respiratory distress.

[20] Ms. Wood says that no nurses attended in the plaintiff's room after the formal assessment and before she left the hospital shortly before midnight. I conclude that she must be mistaken, at least with respect to Ms. Czech's attendance in the room at 11:15, but I accept that her general observation with respect to the minimal number of nurse attendances into the room is in accord with what happened on the night shift of April 19, 2001.

[21] Ms. Wood was with the plaintiff from shortly after he returned to his ward room from surgery until shortly before midnight. She testified that the plaintiff was drifting off to sleep and waking up throughout the time she was with him after his return to the ward and that they chatted when he was awake. The evidence in this case makes it clear that it is normal for a patient to sleep on and off following surgery, and particularly for a patient taking morphine via a PCA pump. Indeed that is one of the ways in which a patient using a PCA pump is protected against overdosing on morphine. Morphine has a sedative affect, and it is rare that a patient

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will be able to stay awake and alert enough to be able to administer the maximum hourly dosage permitted by the machine.

[22] Ms. Wood confirmed that the plaintiff was asleep when she left the hospital. She also confirmed that if the plaintiff had not seemed fine to her she would have alerted the nurses as, indeed, she had done on at least one earlier occasion before the plaintiff had surgery. Ms. Wood testified that before she left, she looked for a nurse so she could advise she was leaving the hospital, and specifically to ask the nurse to locate the call bell as she had been unable to find one. She testified that she ran into a nurse coming out of one of the other patient's rooms, and that she was told by the nurse that the nurse would have to retrieve a flashlight. She waited approximately 10 minutes for the nurse to return, but when the nurse did not return she left.

[23] All three defendant nurses testified that Ms. Hunt did hourly rounds at approximately midnight. Ms. Hunt testified that she volunteered to do rounds on the patients at approximately midnight because Ms. Czech was on her break. She testified that rounds consisted of checking every patient to see if the patient was breathing. If the patient was awake, she would ask if the patient had pain. In addition, she would check urinals, check i.v.'s, and take other steps depending on each individual patient. She remembers that everyone she checked on the ward that night was fine. As the overhead lights were off, she had a flashlight so that she could shine the flashlight on the patient to confirm the patient was breathing, and so that she could check i.v. sites. It is her evidence that she shone a flashlight on the

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plaintiff, that he was sleeping, that he appeared to be comfortable, and that he had easy respirations. She had no concerns about his condition at that time.

[24] In cross-examination, she confirmed that he could have been sedated, rather than sleeping, and that she made no effort to arouse him to see how sedated he was. She did not check the PCA machine to see how much morphine the plaintiff had administered to himself, nor how many attempts he had made to access morphine. It was her evidence that she stood at the plaintiff's bedside for "probably" one minute, and that she could say that his breathing was easy, not laboured, and regular. She did not perform a formal assessment. She performed only hourly rounds, which she testified the nurses did every hour, every night on every patient. She did not know whether anyone else had checked the plaintiff's sedation level, and she was not instructed by anyone to check the plaintiff's PCA machine.

[25] Ms. Gabert testified that Ms. Hunt performed the hourly rounds at midnight and that she had reported back that all of the patients were fine. Ms. Czech testified that she went on her break from 11:30 p.m. until midnight. On her return she was advised that Ms. Hunt had just done the rounds and that everyone was fine. Approximately 15 minutes later she decided to check her patients' i.v. lines. When she entered the plaintiff's room, sometime between 12:10 and 12:15 a.m., she found the plaintiff slumped over in the bed, with noisy grunting respirations. He was unresponsive to her attempts to arouse him. Consequently, she summoned the other nurses on the ward and a code blue was called.

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[26] I heard evidence from one doctor and several nurses who attended the code blue. I am satisfied that the plaintiff did not suffer a respiratory arrest, or a complete cessation of breathing, at any time when there were medical personnel in his room. However, it is clear that he suffered from a significant reduction of oxygen in his system, referred to as hypoxia, as a result of his inability to breathe normally.

[27] None of the expert evidence before me was focused on the cause of the plaintiff's respiratory distress, but rather was focused on either the issue of the defendants' negligence or on the issue of damages.

[28] The plaintiff's main theory appears to be that the plaintiff vomited, and then aspirated the vomit, causing respiratory arrest or, as I have found, respiratory distress. Alternatively, the plaintiff appears to suggest that the respiratory distress was caused by oversedation due to morphine. The defendant's neurologist, Dr. Keyes, opined that the plaintiff developed aspiration pneumonia after inhaling blood and oral secretions into his lungs. The defendant's anesthesiologist, Dr. Parsons, opined that the plaintiff likely had a relative overdosage of opiate (morphine), became sedated, and perhaps vomited or regurgitated leading to aspiration and eventual oxygen desaturation. The plaintiff's neurologist, Dr. Cameron, while not directly addressing the cause of the plaintiff's respiratory problems, implies that they were due to excessive morphine intake. Dr. Blair, the plaintiff's anesthesiologist, said that "patient's code blue was a result of narcotic depression of his respiration leading to a respiratory arrest, narcotic suppression of his level of consciousness and coincident loss of protective pharyngeal and laryngeal reflexes, leading to an episode of his aspirating secretions, or a combination of the two".

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[29] The attending physician at the code blue ordered that the plaintiff receive narcan, a narcotic antagonist, which reverses the affects of morphine; his jaw wires were cut; and he was provided oxygen, originally through bagging and subsequently through intubation. Once he was stable, he was transferred to the intensive care unit, where he was provided with intensive medical support. He was kept intubated and heavily sedated for over a day. Tests confirmed that he had aspirated and that there was infiltrate in his right lung, and he was treated for aspiration pneumonia. He was transferred back to a regular ward on April 23, 2001 and discharged from hospital on April 24, 2001.

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[30] I am satisfied that the plaintiff has never fully recovered from the events of April 18 to 24, 2001. The significant changes in the plaintiff are perhaps best illustrated by the evidence of Ms. Wood and the evidence of David Ryll, an employer of the plaintiff both before and after April of 2001. Mr. Ryll's testimony was compelling, and was confirmed in all respects by the other work-related witnesses called by the plaintiff. I reject any suggestion that the plaintiff is malingering or consciously exaggerating his symptoms.

APPLICABLE LEGAL PRINCIPLES

[31] As McLachlin J., as she then was, said in ***Arndt v. Smith***, [1997] 2 S.C.R. 539 at para. 33:

> It is a fundamental rule of tort law that the plaintiff must prove two things. First, the plaintiff must prove that the defendant breached a duty owed to the plaintiff. Second, the plaintiff must prove that the breach caused the loss for which the plaintiff claims damages…

[32] If the plaintiff proves on a balance of probabilities that the defendants' negligence caused or contributed to an unfavourable medical outcome, the plaintiff has established causation. On the other hand, if the plaintiff fails to prove that an unfavourable medical outcome would have been avoided with proper treatment, the plaintiff's claim fails as causation has not been established (***Laferrière v. Lawson***, [1991] 1 S.C.R. 541; ***Athey v. Leonati***, [1996] 3 S.C.R. 458; ***Cottrelle v. Gerrard***, [2003] O.J. No. 4194 (Ont. C.A.)).

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[33] The plaintiff cannot meet the onus upon him to prove causation by merely proving the loss of a chance (***Cottrelle***, *supra*, at para. 36). Similarly, it is not enough for a plaintiff to prove that the defendants "created a risk scenario within which the plaintiff's pain, suffering and losses [have] occurred" (***Oliver (Public Trustee of) v. Ellison***, [1998] B.C.J. No. 589 (S.C.), at paras. 31-33; ***St-Jean v. Mercier***, [2002] 1 S.C.R. 491 at para. 116).

NEGLIGENCE

[34] There is no issue in this case that the defendant nurses owed a duty of care to the plaintiff, and that the standard of care they were obliged to provide was that of reasonable and prudent nurses in the circumstances. The issue is whether the defendant nurses breached the duty of care. The plaintiff submits that they did, in a number of specified ways. I will deal with each in turn.

1. Failure to Follow PCA Monitoring Orders

[35] I have described above the two orders written by the anesthesiologist for the plaintiff's care after surgery, the PAR order and the PCA standing order. The

defendant nurses had different interpretations of their obligations pursuant to the PCA standing order. Ms. Czech testified that she understood that the PCA standing order started as soon as the PCA was set up and the plaintiff's vitals had been taken in the PAR at 9 p.m., that she took the plaintiff's vitals at 9:45 p.m, or approximately 10 p.m., and that plaintiff's vitals should have been taken again at 11 p.m. and every four hours thereafter. Ms. Gabert suggested that the first hour of vitals monitoring is when the PCA was set up, the second assessment would be one hour later (or approximately 10 p.m.), and then assessments would be done every four hours.

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[36] The plaintiff's nursing experts, Ms. Lane and Mr. Senner, both expressed the opinion that the PCA standing order required monitoring when the plaintiff arrived on the ward, one hour later, a further hour later, and then every four hours thereafter. I accept their evidence. It is clear from Ms. Poulen, the PAR nurse, that all of the care that she provided to the plaintiff was pursuant to the PAR order. Although she set up the PCA machine, there was no patient administration of analgesics by the plaintiff while he was in the PAR room. There is, in my view, no overlap of the two orders, rather they must be consecutive.

[37] The evidence before me is clear that the plaintiff was properly assessed, pursuant to the PCA standing order, at 9:45. However, there is no evidence whatsoever that would satisfy me that there was any formal assessment of the plaintiff after that time, as was required by the PCA standing order. As I have said, Ms. Gabert, as the medications nurse, did not perform any formal assessments of the plaintiff. Similarly, Ms. Hunt performed no formal assessments of the plaintiff. Ms. Czech has admitted that she performed no formal assessment of the plaintiff,

and indeed did not see the plaintiff, between 9:45 and 11:15 p.m. Ms. Czech suggested in her evidence that although she did not know whether a formal assessment had been done after her assessment of 9:45, Ms. McParland or the floating nurse might have done vitals. She said they used a system of team nursing, and suggested a formal vitals assessment might have been performed by someone else. There is no indication in the hospital records of such an assessment having been performed, and the defendant hospital did not call any of its other employees to confirm such an assessment had been performed. I am satisfied that there was, in fact, no assessment of the plaintiff, as required by the PCA standing order, at 10:45 or 11:45 p.m. on April 19, 2001, or indeed at any time after 9:45 and before the code blue was called.

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[38] The anaesthesiologist was entitled to rely on the nursing staff of 4 West to carry out his PCA standing order. I am satisfied that the nurses on 4 West failed to carry out the order, and by doing so, failed to meet the standard of care required of them.

2. Failure to Monitor or Assess the Plaintiff's Nausea, Pain and Sedation Levels

[39] Unlike the specific obligation pursuant to the PAR standing order to monitor pulse, respiratory rate and blood pressure, there is no specific requirement in the PAR standing order to monitor nausea, pain levels, or sedation levels. It was conceded by the defendant nurses that it was important that a post-operative patient, on a PCA pump, with a wired jaw, be monitored with respect to nausea and sedation levels. I am satisfied that the plaintiff was made aware that he should alert

the nurses if he had concerns about nausea or pain control. I am also satisfied that the nurses made observations, and likely inquiries, with respect to his sedation level at 9:45 (Ms. Czech), 10:00 (Ms. Gabert and Ms. Hunt), and at 11:15 (Ms. Czech).

[40] In the absence of any specifically mandated monitoring frequency for nausea, sedation and pain level, I am not prepared to find that the monitoring that was done fell below the level expected of a reasonable and prudent nurse.

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3. Failure to Provide Antiemetic Medication

[41] The plaintiff urges me to conclude that the plaintiff should have been administered an antiemetic, specifically gravol, after he returned to the ward. However, there is no evidence before me that the plaintiff, at any time following surgery and before the code blue, was suffering from any nausea, or made any complaints of nausea. Ms. Wood was with him throughout the evening. There is no question that if he had made any complaints, Ms. Wood would have heard them and reported them.

[42] The nurses on 4 West were aware that the plaintiff had received a powerful and long-lasting antiemetic while he was in the operating room. Given the potential sedative affect of any antiemetic that could have been administered to the plaintiff, it was reasonable, in my view, for the defendant nurses to determine that an antiemetic should not be provided to the plaintiff unless he complained of nausea. The standing order specifically called for an antiemetic for nausea and/or vomiting, as required. Given the absence of any complaints of nausea, and given that none of

the witnesses who attended the code blue saw or smelled vomit, I am not prepared to conclude that the plaintiff ever needed an antiemetic.

[43] Under all of the circumstances, I am not prepared to find the defendants in breach of their duty for not having provided the plaintiff with an antiemetic after surgery.

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4. Failure to Evaluate or Monitor the Plaintiff's use of the PCA Pump

[44] The features of the PCA machine the plaintiff was using on the night of April 19, 2001 included an ability to determine how many doses of morphine the plaintiff had administered to himself, as well as the number of attempts he had made to access morphine at times he was locked out, or before each six minute delay had expired. The defendant nurses testified that their normal practice was to check the readings from PCA machines once per shift, or once every four hours. There is no evidence before me that such frequency was inappropriate.

[45] The plaintiff's expert nurse, Ms. Lane, is critical of the defendants' failure to obtain information from the PCA machine after its use was discontinued when the code team responded to the code blue, but given the chaotic events which followed upon the code blue being called, I am not prepared to find any fault with respect to a failure to obtain information from the machine after its use had been discontinued.

[46] I have already found that the defendants were not in breach with respect to the monitoring of the plaintiff's levels of nausea, pain or sedation. I am satisfied that nothing arose from that monitoring which would or should have lead the defendants

to believe they should check the PCA machine readings more frequently, or in advance of the normal monitoring schedule. Consequently, I am not prepared to find any breach of duty in this regard.

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5. Failure to Reinforce any Patient Teachings with Respect to the PCA Pump and with Respect to Oral Suctioning

[47] It is generally conceded by the defendants that it is important that post-operative patients who have had jaw wiring, such as the plaintiff, receive instructions with respect to the use of the PCA pump, suctioning equipment, and the call bell.

[48] The evidence of Ms. Poulen is that she provided instructions to the plaintiff, in the PAR, with respect to the PCA pump and with respect to suctioning. The evidence is clear that those patient teachings were reinforced with the plaintiff when he was readmitted to 4 West, during the formal assessment performed by Ms. Czech at 9:45. I have her evidence in that regard, and confirmation of her evidence from Ms. Wood, who recalls hearing the plaintiff being given instructions with respect to both the PCA pump and the suctioning equipment.

[49] With respect to the call bell, I consider it more likely than not that the plaintiff was provided with a call bell. He had spent almost two full days in the hospital before his return to 4 West on the evening of April 19, 2001, and I am not satisfied that any teachings with respect to the use of the call bell needed to be reinforced after his return to 4 West.

6. Failure to Chart or Document the Plaintiff's Vital Signs

[50] It is safe to say that the charting performed by the nurses working on 4 West during the night shift of April 19, 2001, does not inspire confidence. It is clear from the evidence before me that it is critical that patient's hospital charts be fully maintained and that they accurately document the care provided to the patient. This is particularly the case, in my view, on a ward which employs team nursing. Each patient's hospital chart is an important method of communication between nurses and other health care professionals with respect to the patient.

[51] In this case, it is clear that there was insufficient charting. Just one example relates to the allegation of the failure to assess and monitor the plaintiff's vital signs any time between 9:45 and the time the code blue was called. As I said earlier, Ms. Czech suggested that vital sign monitoring may have been conducted by Ms. McParland or the floating nurse and was simply not documented. It is incomprehensible that something as important as doctor ordered vital sign monitoring would not be charted. Similarly, as a result of the lack of charting, the evidence of the defendants is unconvincing with respect to when, and indeed whether, hourly rounds were done on that shift, prior to the rounds done by Ms. Hunt at midnight. No notes were made with respect to the periodic assessments, formal or informal, of the plaintiff's pain level, sedation level or nausea level. While I heard much evidence about "charting by exception", which involves the practice of making no chart notes unless something abnormal is noted, it seems contrary to good practice, in my view, to not at least note that rounds were performed or informal assessments were made, even if no abnormal findings were noted.

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[52] I accept the evidence of Ms. Lane, Mr. Senner and Dr. Cameron with respect to the insufficiencies of the charting performed.

[53] I am satisfied that the charting performed by the defendant nurses failed to meet the standard expected of reasonable and prudent nurses.

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7. Failure to Provide the Plaintiff with a Call Bell

[54] As I have said above, I am satisfied that it is more likely than not that the plaintiff was provided with a call bell and the plaintiff has not proved this alleged breach.

CAUSATION

[55] Having concluded that the plaintiff has proved the defendants were negligent in failing to follow PCA standard order with respect to monitoring and in failing to adequately chart, the next issue is whether or not there is a causal connection between those breaches and the respiratory distress and the aspiration suffered by the plaintiff.

[56] There is no evidence before me, to which I can give any weight, that the defendants' breaches caused or materially contributed to the plaintiff's injuries.

[57] Dealing first with the PCA standing order, had the nurses not been negligent, the plaintiff's vital signs would have been monitored at 10:45 and 11:45 p.m. The plaintiff effectively asks me to assume that such monitoring would have demonstrated a trend or shown a deterioration in the plaintiff's condition that the defendants could have acted upon, so that the aspiration or the respiratory distress

could have been avoided. However, with the exception of bare statements by Ms. Lane that "the Defendant nurses … should have been able to prevent this occurrence if monitoring … were completed" and by Mr. Senner that "… the incident … could have been prevented if monitoring would have been carried out …", there is no opinion evidence before me as to what might have been detected by monitoring, or how that might have assisted in the prevention of aspiration or respiratory distress.

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[58] Dr. Cameron, the plaintiff's neurologist, said that it was unlikely that the plaintiff had suffered the respiratory arrest due to excessive morphine intake for more than several minutes prior to being found. Dr. Keyes, the defendant's neurologist, stated that the plaintiff developed aspiration pneumonia after inhaling blood and oral secretions into his lungs, which aspiration was a totally unpredictable event. Ms. Czech, in cross-examination, testified that it does not take long for a patient on morphine to get oversedated. She said that can happen quite quickly and suddenly. Not one witness testified that there would have been indications, by 11:45, that the plaintiff was about to encounter medical difficulties of any kind, let alone the specific ones that did occur.

[59] Although vital signs should have been monitored at 10:45 and 11:45 p.m., there is simply no indication in the evidence that such monitoring would have revealed any signs of problems developing. The plaintiff complained of no nausea. He made no complaints of excess pain. He was dozing on and off, but that is normal for a patient in his circumstances. He was asleep when Ms. Wood left, and if he had not been fine she would have called for assistance. The informal

observations made by the nurses at 10, 11:15 and approximately midnight did not demonstrate any cause for concern.

[60] This is not a case in which it would be appropriate to infer causation, as a result of the defendant nurses failing to monitor and record vital signs at the required intervals, as there is evidence before me which is contrary to the inference the plaintiff asks me to draw, as in the case of in ***Smith et al. v. Grace et al.***, 2004 BCSC 395 and in ***Kooner (Guardian ad litem of) v. Matsqui-Sumas-Abbotsford General Hospital***, 2001 BCSC 1266.

[61] With respect to the failure to chart, I similarly am unable to conclude that this breach can give rise to an inference of causation, and the plaintiff has, quite simply, failed to establish causation.

CONCLUSION

[62] In short, although I conclude that the plaintiff has proved some breaches by the defendant nurses, I am unable to conclude that the plaintiff has established that their breaches caused his loss. As Satanove J. said in ***Smith,*** *supra*, at para. 71, "It is only when the [medical] complications are caused by the fault of the attending medical professionals that the courts can intervene to provide compensation".

[63] Consequently, the plaintiff's claim is dismissed.

"A.J. Beames, J."
The Honourable Madam Justice A.J. Beames

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