

COURT OF APPEAL OF YUKON

Citation: *Yukon Energy Corporation v. Yukon (Utilities Board)*,  
2017 YKCA 15

Date: 20170912

Docket: 15-YU764

Between:

**Yukon Energy Corporation**

Appellant

And

**Yukon Utilities Board**

Respondent

Before: The Honourable Mr. Justice Harris  
The Honourable Madam Justice Fenlon  
The Honourable Madam Justice Dickson

On appeal from: An order of the Yukon Utilities Board, dated August 18, 2015, in the matter of the Yukon Energy Corporation, Order No. 2015-06.

Counsel for the Appellant: P.J. Landry  
E. Snow

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G. Bentivegna

Place and Date of Hearing: Vancouver, British Columbia  
December 7, 2016

Place and Date of Judgment: Vancouver, British Columbia  
September 12, 2017

**Written Reasons by:**

The Honourable Madam Justice Dickson

**Concurred in by:**

The Honourable Mr. Justice Harris

The Honourable Madam Justice Fenlon

### **Summary:**

*Yukon Energy Corporation appeals from an order of the Yukon Utilities Board setting a rate for its wholesale energy sales on the basis that the Board's interpretation of its diesel generation costs was unreasonable. Yukon Energy says the order contravenes an order in council which requires the Board to set a rate that ensures Yukon Energy "recovers its costs" but the rate it set did not have that effect. Held: appeal allowed. The Board's decision was unreasonable. By interpreting "actual diesel generation costs" for two rate stabilization mechanisms differently, in an internally inconsistent manner, the Board set a rate that prevents Yukon Energy from recovering diesel related costs it actually incurred for generating the electricity sold to its wholesale customer. In doing so, the Board failed to adhere to a mandatory regulation constraining its authority. Its reasons for decision were not responsive to the issue.*

### **Reasons for Judgment of the Honourable Madam Justice Dickson:**

## **Introduction**

[1] Yukon Energy Corporation appeals, with leave, from the August 18, 2015 order of the Yukon Utilities Board setting a rate for its wholesale electricity sales to Yukon Electrical Company Ltd. (the "Order"). Yukon Energy contends that the rate set by the Board does not enable it to recover all of its costs of generating the electricity, thus contravening Order in Council 1995/90, which requires the Board to set rates sufficient to recover all such costs (the "OIC"). In consequence, Yukon Energy submits, the Board erred in law and its decision is unreasonable. It asks this Court to set aside the Order and remit the matter to the Board with directions to set a wholesale rate that complies with the OIC.

[2] In making the Order, the Board denied Yukon Energy's request to recover from Yukon Electrical a payment it made into a Board-approved rate stabilization fund. Known as the diesel contingency fund, or DCF, this mechanism protects ratepayers from fluctuations in electricity prices due to varying water levels for hydro generation and an associated need for expensive diesel generation. The appeal centers on the Board's interpretation of Yukon Energy's diesel-related "costs" in circumstances where a DCF payment was triggered by better-than-forecast hydro generation in a year in which Yukon Electrical's wholesale purchases of electricity were also higher than forecast. Under another Board-approved mechanism, known as the energy reconciliation adjustment, or ERA, Yukon Energy's additional costs of diesel generation attributable to above-forecast wholesale purchases are to be passed through to Yukon Electrical.

[3] The Board interpreted Yukon Energy's costs of diesel generation for ERA purposes narrowly, confining them to its actual diesel generation costs without regard to the DCF payment attributable to the above-forecast wholesale purchases. In doing so, it acknowledged that its definition of "actual costs" for the ERA was different from that it used for the DCF. According to Yukon Energy, in 2012 this internally inconsistent approach to defining its diesel generation

costs meant \$439,000 that it paid under DCF rules was not recovered from Yukon Electrical, which contravened the OIC and thus was unreasonable. The Board responds that its narrow interpretation of Yukon Energy's costs for the ERA was reasonable and OIC-compliant given that the DCF payment in question was based on a simulated forecasting model and not on its actual diesel generation costs.

[4] For the reasons that follow, I would allow the appeal, set aside the Order and remit the matter to the Board with directions to set a wholesale rate that enables Yukon Energy to recover all of its diesel generation costs, which include any net DCF payment made by Yukon Energy attributable to Yukon Electrical's above-forecast wholesale purchases of electricity.

## Background

### The Regulatory Compact

[5] The generation, transmission and distribution of electrical energy are highly regulated by government in the public interest. The goal of regulation is to provide the public with an essential service that is reliable and fairly priced, while ensuring that utilities earn a reasonable profit and recover their costs. Acting through regulators, governments, not market forces, control the industry based on the "regulatory compact". Under the compact, a utility is granted the right to provide a service to all customers in a particular area, consistently, without discrimination and at a fair cost, in exchange for the opportunity to earn a reasonable return on its investment and to recover its expenses, if reasonably incurred: *FortisAlberta Inc. v. Alberta (Utilities Commission)*, 2015 ABCA 295 at paras. 9-10.

[6] As discussed in *FortisAlberta Inc.*, public utilities are typically monopolies and, under the regulatory compact, the regulator acts as a market proxy. The role of the regulator is to maintain a proper balance in rate-setting between the profit requirements of utilities and the service requirements of ratepayers, and to protect the integrity and dependability of the system of supply. Under most regulatory statutory schemes, discretion is central to the rate-setting process and the method by which it is accomplished is usually left with the regulators, who are experts. Nevertheless, regulators are constrained by the terms of their legislative authority, the jurisprudence and their prior decisions, all of which may evolve as circumstances change: *FortisAlberta Inc.* at paras. 9-14; *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44 at paras. 7, 77-78, 81; *ATCO Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2015 SCC 45 at paras. 2, 32, 46-47 [*ATCO Gas (2015)*].

[7] Rate-setting is an inherently forward-looking exercise. On a general rate application, a utility presents its forecast revenue requirement for a specified period to the regulator for approval, together with supporting materials and an explanation of its proposals. The revenue requirement is the total revenue needed by the utility to pay all of its allowable expenses and recover all costs associated with its invested capital: *Ontario (Energy Board)* at para. 24. Following due consultation and inquiry, the regulator sets rates designed to be fair to both customers and the utility based on forecast demand and the reasonable cost of supplying the service. As Rothstein J. explained in *ATCO Gas (2015)* at para. 7:

... 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 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.

## Regulatory Framework in Yukon

[8] In Yukon, the electrical energy industry is governed by the *Public Utilities Act*, R.S.Y. 2002, c. 186 [Act]. Pursuant to its terms, the Board is responsible for administration of the Act. The Board is composed of not fewer than three, nor more than five, persons appointed for three-year terms by the Minister: ss. 2, 3. The skills required of the Board include an understanding of economics, financial markets and the technology of regulated utilities: *Utilities Consumers’ Group v. Yukon (Utilities Board)*, 2001 YKCA 5 at para. 3 (Chambers).

[9] Amongst its powers and duties under the Act, the Board is authorized to make orders setting the rates of a public utility: s. 27. When a rate has been set, the utility may not charge any other rate unless a further Board order is made permitting it to do so: s. 28. In setting rates, the Board may consider a utility’s revenues and costs for the time period in question: s. 29. In most cases, rates are approved for test periods of one to three years.

[10] Section 1 of the Act defines the word “costs” as including “fees, counsel fees, and expenses”, but does not otherwise limit or clarify its meaning. Nor are the parameters of the Board’s rate-setting power limited or clarified by s. 27:

27 The board may make orders

- (a) setting rates of a public utility;
- (b) prohibiting or limiting any proposed rate change;

...

(d) setting just and reasonable standards, classifications, regulations, practices, measurements, or services to be observed, provided, or followed by a public utility ...

[11] However, s. 17(1) of the Act provides that the Board’s powers and functions are subject to any direction of the Commissioner in Executive Council, which direction is a regulation within the meaning of the *Regulations Act*, R.S.Y. 2002, c. 195: s. 17(2). The Board’s s. 27 powers are thus constrained by the Act and it must adhere to this constraint when it sets rates: *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4 at para. 35. In addition, when it conducts a hearing or inquiry, the Board’s power to determine questions of fact, law or mixed fact and law is subject to the provisions of the Act and the regulations, as well as the need to abide by the fundamental principles of justice: s. 52.

[12] Section 69 of the *Act* permits an appeal from a Board decision to this Court, with leave, on a question of law or excess of jurisdiction. Pursuant to s. 72(1), this Court has the same jurisdiction and powers on appeal as it has for appeals from orders of the Supreme Court.

## **Regulated Utilities in Yukon**

[13] There are two regulated electrical energy utilities in Yukon: Yukon Energy and Yukon Electrical.

[14] Yukon Energy is a publicly owned utility that operates under the Board's jurisdiction. It generates and transmits most of Yukon's electrical energy, accounting for over 90 per cent of power generation for the Yukon integrated grid system. Yukon Energy directly serves some retail customers, but most of its sales are made up of firm wholesale sales to Yukon Electrical. The vast majority of its electricity is generated by hydro.

[15] Yukon Electrical (now ATCO Electric Yukon) is the other major electrical utility in Yukon. It is the primary distributor of power for the integrated system. Yukon Electrical purchases electricity on a wholesale basis from Yukon Energy for distribution to its residential and industrial customers. It also generates power for some of them.

[16] In the past, Yukon Energy and Yukon Electrical were managed together, but since 1998 they have been managed separately. As a result, their general rate applications are not filed concurrently, they do not own assets jointly and their load and generation forecasts sometimes differ.

## **The OIC**

[17] In 1995, the Commissioner issued the OIC, which is entitled "Rate Policy Directive, 1995". Pursuant to its terms, the Board must fix rates that allow Yukon Energy to recover a fair return on its equity and accord with established Canadian rate-setting principles for utilities: ss. 2, 3. Section 7 deals specifically with the Board's obligations when fixing wholesale rates for the electricity sold to Yukon Electrical:

7. The Board must fix rates of Yukon Energy Corporation for the wholesale power customer in accordance with the following rate policy for Yukon:
  - a) Yukon Energy Corporation shall sell electricity to The Yukon Electrical Company Limited at the same demand rate and the same energy rate throughout the Yukon and those rates must be sufficient to enable Yukon Energy Corporation to recover its costs that are not recovered from its other customers;
  - b) the wholesale rate to The Yukon Electrical Company Limited shall include appropriate provisions to ensure that Yukon Energy Corporation will recover its costs for retail and major industrial power service with

adoption of the rates for retail power customers and major industrial power customers as specified herein.

[18] Canadian rate-setting principles generally require that rates, and thus approved costs upon which they are based, be just and reasonable to both the utility and consumers: *Ontario (Energy Board)* at paras. 7, 14-20. Subject to its overarching duty to ensure that its orders are just and reasonable, nothing in the OIC or the *Act* constrains the Board's discretion to determine the methodology it uses to assess Yukon Energy's costs in its rate-setting decisions.

## **Diesel Generation and the DCF**

[19] The integrated system in Yukon is isolated from other grids outside the territory. As a result, electricity cannot be purchased and transmitted from elsewhere to meet local demand. Yukon Energy's predominant source of power generation is hydro, which depends on the variable availability of water. Therefore, when necessary, Yukon Energy relies on diesel to generate additional electricity to meet customer demand. The cost of diesel generation is significantly higher than the cost of hydro generation.

[20] As noted, rate-setting is a forward-looking exercise. When a rate application is made, the Board sets rates based on forecast demand and forecast costs of supply. The DCF was established to ensure that ratepayers cover the risk of changes in forecast diesel generation costs due to fluctuating water levels, which changes are beyond the control of the utility. Created through a negotiated settlement and first approved by the Board in 1996-97, the effect of the DCF is to smooth customer rates and shield them from short-term volatility caused by hydro generation variances. In doing so, it permits rates to be set based on long-term average hydro availability rather than short-term availability.

[21] When water levels are higher than expected based on long-term average conditions, Yukon Energy needs less diesel-generated electricity than forecast to meet the demand of its customers. In these circumstances, under DCF rules, it must pay into the fund the amount it would otherwise have paid for diesel generation. Conversely, when water levels are lower than the long-term average, as in a drought, Yukon Energy needs to generate more electricity than forecast through diesel. In these circumstances, Yukon Energy is paid the additional diesel-related cost out of the DCF. The purpose and result is that consumers pay more stable and consistent rates for electricity than would otherwise be the case.

[22] The DCF thus ensures that, regardless of actual water conditions, Yukon Energy's costs for diesel generation are based on hydro generation at long-term average water conditions. The fund is replenished in years of high water levels and drawn down in years of drought. It is operated by Yukon Energy as a trust fund for ratepayers. The amounts it pays into or receives from the DCF are charged or credited to its annual income statements as diesel expenses.

[23] To determine the long-term average water forecast, Yukon Energy uses a simulation model known as "YECSIM". Designed specifically for its use, YECSIM enables Yukon Energy to determine the expected need for diesel generation in light of expected water conditions and expected customer loads. As to the latter, Yukon Electrical provides Yukon Energy with its

wholesale purchase forecast, which Yukon Energy reviews and may adjust for its own forecasting purposes. Yukon Energy shares information on the operation and results of YECSIM with Yukon Electrical and others, but it has not made the model itself available for testing before the Board.

[24] When the DCF was established in 1996-97, diesel generation was considered to be “on the margin”. This means that Yukon Energy required diesel to meet its baseload generation or long-term energy requirements, not just its periodic peak requirements. However, between 1998 and 2008, due to reduced demand caused by mine closures, its diesel infrastructure was utilized primarily to meet peak or short-term emergencies. In consequence, except for interest income, the DCF was inactive between 1999 and 2011.

[25] Baseload demand increased materially in Yukon between 2008 and 2011, largely because of economic expansion. This led Yukon Energy to rely increasingly on diesel generation to meet baseload, which, in turn, led to a perceived need to reactivate the DCF. As a result, in its 2012 general rate application Yukon Energy sought Board approval to reactivate the DCF as part of its requested revenue requirement. In doing so, it proposed revisions to the DCF and the ERA to address changes in the Yukon system since the 1990s.

## **Diesel Generation and the ERA**

[26] The ERA is another Board-approved stabilization mechanism which addresses variances from Yukon Energy’s forecast costs of diesel generation. Whereas the DCF addresses variable water conditions, the ERA addresses variances from forecast wholesale purchases. Established in 1993, it is a retrospective payment calculation designed to ensure that Yukon Electrical receives a full pass-through of all incremental costs or savings of diesel generation attributable to higher or lower than forecast wholesale demand. Like the DCF, the ERA was long inactive due to hydro generation exceeding wholesale demand.

[27] The current formulation of the ERA is found in “Rate Schedule 42”, approved by the Board in 2011. Rate Schedule 42 sets out the wholesale rate that Yukon Energy charges to Yukon Electrical. The rate consists of two elements. The first element is an “energy charge” that sets the wholesale rate for “all energy consumed”, which rate incorporates approved forecast hydro and diesel generation costs based on long-term average water conditions and wholesale purchase forecasts. The second element is the ERA, which adjusts Yukon Electrical bills to reconcile actual and forecast wholesale purchases when diesel generation is on the margin at long-term average water conditions. Rate Schedule 42 provides:

Charges to [Yukon Electrical] will be adjusted on a monthly basis to reconcile actual wholesale purchases to test year forecast purchases during the months when diesel generation in the Hydro zone is on the margin at long term average water flows. To the extent that actual wholesale purchases fall short or exceed forecast wholesale purchases, an adjustment to the [Yukon Electrical] bills will be made at a rate equal to the Hydro zone incremental cost of diesel of 32.74 cents per kW.h [kilowatt hour] as approved by the Board in Order 2010-13. Such adjustment for shortfalls in actual wholesale purchases will be limited to minus 10% of the forecast wholesale purchases in any period.



# **Yukon Energy's General Rate Application for 2012-13 Test Years**

[28] On April 27, 2012, Yukon Energy filed a general rate application for approval of its forecast revenue requirement for the 2012 and 2013 test years. As noted, the revenue requirement included proposed revisions to the DCF and the ERA. Yukon Energy asserted that, going forward, diesel generation would be required to meet forecast baseload demand. In other words, it would predictably be permanently “on the margin”. Therefore, rate stabilization mechanisms such as the DCF and ERA were once again relevant and important, and Yukon Energy proposed their reactivation.

[29] In response, the Board commenced what became a lengthy regulatory process. It issued interim and procedural orders, granted intervenor status to Yukon Electrical and others, and held a public hearing. It also received and assessed a large body of evidence and argument on various issues, including Yukon Energy's proposals for the reactivated DCF and ERA.

[30] On March 25, 2013, the Board issued Board Order 2013-01. Pursuant to its terms, the Board directed Yukon Energy to provide a compliance filing in accordance with its Reasons for Decision and approved its 2012 and 2013 revenue requirement with changes as directed.

## **Board Order 2013-01, Reasons for Decision**

[31] The Board began its Reasons with an overview of Yukon energy system sales and generation, historical and current. It then addressed the contentious issues, setting out the parties' positions and explaining its views. One contentious issue was the reliability of Yukon Energy's forecast wholesale sales volumes, which differed from those forecast by Yukon Electrical. With one exception, the Board concluded that Yukon Energy's forecast was reasonable.

[32] As to power generation, the Board directed Yukon Energy to base its hydro and diesel energy requirements on 100 per cent of long-term average hydro generation for the forecast load in its compliance filing. In doing so, it accepted that long-term average hydro generation forecasts would be used as the basis for diesel generation costs incorporated in approved rates.

[33] The Board went on to express concerns regarding Yukon Energy's proposed DCF revisions. The concerns included the fact that the DCF had been inactive for several years and was never fully tested by the Board. Given its concerns, the Board declined to approve the revised DCF proposed by Yukon Energy and directed it to provide a new proposal which addressed various factors. It also directed Yukon Energy to “work with [Yukon Electrical], and the two utilities will provide a joint recommendation on how the DCF will affect the [ERA] in Rate Schedule 42 and any proposed wording changes to that rate schedule”.

## **After Board Order 2013-01**

[34] Yukon Energy provided a revised proposal in its May 1, 2013 compliance filing. The proposal responded to the directions in Board Order 2013-01 except that it did not include a joint recommendation for the ERA because the two companies could not agree. As a result, the Board did not approve Yukon Energy's revised proposal. Instead, it permitted Yukon Energy and Yukon Electrical to file separate proposals, together with explanations of their differing points of view.

[35] On January 31, 2014, Yukon Energy and Yukon Electrical each filed an application for approval of proposed revisions to or replacement of the DCF and ERA.

[36] In its application, Yukon Energy emphasized that, for rate-setting purposes, its diesel costs are determined based on long-term average water conditions to stabilize rates and smooth cost fluctuations due to variable water availability, regardless of actual diesel generation in a given year. It also noted the effects of two significant events which coincided in 2012.

[37] First, water levels were higher than predicted. This meant Yukon Energy produced 12,939 MW.h (megawatt hours) less electricity than forecast through diesel generation, which saved \$3.715 million. Under DCF rules, it paid this amount into the DCF. Second, Yukon Electrical's wholesale demand was 14,264 MW.h higher than forecast. Under the approved diesel generation forecast based on long-term average water conditions, Yukon Energy would have expected to meet about half the excess wholesale load through diesel generation. However, due to the favourable water conditions, it was able to generate almost all Yukon Electrical's excess wholesale load through hydro. Nevertheless, under DCF rules, it was obliged to pay into the DCF the *expected* increase of \$1.773 million in diesel generation costs attributable to the excess wholesale demand. Additional revenues from the above-forecast purchases were \$1.334 million, leaving a shortfall of \$439,000.

[38] According to Yukon Energy, its additional net DCF payment attributable to above-forecast wholesale demand should be recovered from Yukon Electrical through the ERA as a diesel-related cost. In support of its position, it noted that the DCF payment was an obligatory cost Yukon Energy incurred to meet Yukon Electrical's wholesale demand which, under DCF rules, was based on long-term average water conditions and *not* on actual conditions.

[39] Yukon Electrical opposed Yukon Energy's revised DCF and ERA proposals. It did so largely because they relied upon the "overly complex, opaque, untestable" YECSIM model to forecast diesel volumes for rate-setting and to calculate the "expected actual" diesel volume to which the forecast was trued up for purposes of determining the DCF payment. Although it supported the need for a fund to ensure that neither ratepayers nor the utilities experience windfalls or losses due to fluctuations in diesel costs that could not be forecast, Yukon Electrical opposed approval of a revised DCF. Instead, it recommended replacing the DCF with a straightforward deferral account, reconciled with actual diesel volumes, to address forecast variances.

## **Board Order 2015-01, Reasons for Decision**

[40] The Board dealt with the DCF and ERA separately in its Reasons for Decision.

[41] In explaining its views on the DCF, the Board noted that all parties agreed a mechanism to protect ratepayers from diesel generation cost impacts caused by hydro generation fluctuations due to water conditions was necessary. It framed the issue as how best to accomplish this objective. Quoting from Yukon Energy's evidence on its diesel generation costs for the DCF, the Board summarized its interpretation of that evidence:

The Board notes the following from [Yukon Energy]'s evidence:

Diesel generation fuel costs at 100% [long-term average] related to any incremental growth above [general rate application] approved forecasts in any year are also charged to [Yukon Energy] under the DCF as proposed in [Yukon Energy]'s January 31, 2014 filing, regardless as to actual diesel generation that occurs in any year. This reflects long-standing principles under the DCF and [Yukon Energy]'s prior Low Water Reserve Fund, i.e., when the DCF is activated, [Yukon Energy]'s actual costs for diesel in any year reflect [general rate application] approved diesel generation forecasts based on specified water forecast assumptions and not actual [Yukon Energy] generation. [Emphasis added.]

The Board interprets that the above sets out how the fund operates. That is, [Yukon Energy] records the expected diesel costs based on long-term average (LTA) hydro availability. Any deviation between the expected diesel costs at LTA availability and actual diesel costs are then attributed to the DCF.

[Emphasis of the Board. Footnotes omitted.]

[42] The Board went on to discuss Yukon Electrical's arguments opposing Yukon Energy's proposal, including its reliance on the YECSIM model. However, it ultimately approved Yukon Energy's revised DCF proposal, subject to reporting requirements, capped at plus or minus \$8 million:

When the Board considers the two proposed models (DCF and [Yukon Electrical's Diesel Deferral Account]), both have a forecast element in terms of diesel costs and both review those forecasts versus either actual results or adjusted actual results. The Board has previously accepted [long-term average] hydro generation as the basis for [Yukon Energy] [general rate application] forecasts. The 2012-13 [long term-average] forecast was provided by means of [Yukon Energy]'s YECSIM model and was not contested at that time. Moreover, no evidence has been presented in this proceeding that the YECSIM model does not operate as it is intended, or that there would be any harm to customers if the model is used in a consistent fashion for DCF purposes. The evidence of [Yukon Energy] is that the fund is held in "trust" for customers.

However, if [Yukon Energy] is to continue to use the YECSIM model for forecasting, it has to make the model and its results available for testing because as a public utility its forecasts and rate proposals that are based on its forecasts are subject to testing by intervenors and the Board. Providing forecasts which can be tested is essential in setting rates.

Therefore, although the Board has noted the other parties['] concerns regarding the YECSIM model, and is aware that the YECSIM model has not been tested before the Board, the Board accepts the DCF as proposed by [Yukon Energy] because it is a fund for customers to smooth rate impacts for those occasions when hydro generation is less than [long-term average] or to build up the fund when hydro generation is greater than [long-term average]. ...

[43] The Board turned next to the ERA, reviewing the parties' positions and arguments. In doing so, it quoted from Yukon Energy's ERA proposal:

Therefore, [Yukon Energy] proposed "... that charges to Yukon Electrical be adjusted when changes in actual Yukon Electrical wholesale purchases (relative to Yukon Energy's most recent test year forecast for such purchases) result in changes to Yukon Energy costs incurred for diesel generation, whether such costs are incurred through adjustments in actual diesel generation or through adjustments in DCF payments or recoveries". [Footnotes omitted.]

[44] After discussing the proposal, the Board turned to Yukon Electrical's position. It began by noting Yukon Electrical's statement that the ERA was designed when the two companies were jointly managed and thus it was appropriate for them to share forecast risk. However, according to Yukon Electrical, as they were no longer jointly managed it should not be subject to forecast risk based on Yukon Energy's forecasts. The Board also noted that, in opposing the proposed ERA, Yukon Electrical repeated and emphasized its previously expressed concerns regarding the YECSIM model.

[45] The Board declined to approve Yukon Energy's ERA proposal. Although it retained an ERA mechanism as part of the wholesale rate, it did not accept that the DCF payment attributable to changes in Yukon Electrical's forecast wholesale purchases should be recovered under the ERA. After reproducing s. 7 of the OIC, the Board stated:

For the ERA, the Board interprets costs narrowly; to be clear, the costs are for actual diesel generation costs, not forecast or derived costs from the YECSIM model.

Based on the above interpretation of Section 7 of OIC 1995/90, the Board has the following concerns regarding the YECSIM model:

- 1) The Board is of the view that the results of the YECSIM model cannot be verified;
- 2) The YECSIM model is a planning tool and not a billing engine; and
- 3) Operational decisions of [Yukon Energy] can affect variables such as losses and in turn affect diesel generation requirements.

For the above reasons, the Board does not accept the ERA as proposed by [Yukon Energy].

The Board is also of the view that the ERA does not need to be linked to the DCF to comply with O.I.C. 1995/90. The ERA, as determined by the Board, is a comparison of forecast and actual

values and therefore the DCF calculation does not need to be completed before ERA amounts are determined.

In its compliance filing to this decision, [Yukon Energy] is to provide a revised ERA that is based on actual diesel costs. That is, if the actual diesel costs are higher than the levels of diesel contained in [Yukon Energy]'s latest approved forecast, then those costs which are attributable to [Yukon Electrical]'s wholesale purchases that are in excess of those in the last approved forecast will become billable to [Yukon Electrical]. The converse is also true: a credit applies when diesel costs are lower and that reduction in cost relates to [Yukon Electrical] wholesale loads being less than forecast. ...

## **After Board Order 2015-01**

[46] On April 7, 2015, Yukon Energy made a compliance filing in response to Board Order 2015-01. However, the filing did not put forward a revised ERA calculation based on diesel generation costs which did not include the contentious net DCF payment. Instead, Yukon Energy noted that, in its Reasons, the Board made two different references to its “actual diesel costs”:

...

- The first reference (Reference A) occurs during the DCF part of the Order (section 2.1) and assumes [Yukon Energy]'s costs after DCF determinations; and
- The second reference (Reference B) occurs during the ERA part of the Order (section 2.2) and assumes [Yukon Energy]'s costs before DCF determinations.

...

In summary, adoption of Reference B for [Yukon Energy]'s actual diesel costs (i.e., before any DCF determinations) when implementing the ERA yields impacts which [Yukon Energy] believes would be patently unacceptable to all stakeholders including the Board. For example, when actual loads exceed [general rate application] forecasts:

- Under drought conditions (where water availability is significantly less than [long-term average]), double counting of DCF related diesel costs would occur, i.e., [Yukon Energy] would receive payments from both the DCF and from [Yukon Electrical] for the same added costs for actual diesel generation being higher than long-term average. And if [Yukon Electrical] seeks to recover its ERA costs from ratepayers in this situation, ratepayers would be charged a second time for the amounts that [Yukon Energy] recovered from the DCF.
- Under high water conditions (where water availability exceeds [long-term average]), [Yukon Energy] would be unable to recover its added actual diesel costs, after DCF determinations (as defined in Reference B), when [Yukon

Electrical] wholesales exceed the [general rate application] forecast. One of the prime purposes of the ERA is to enable [Yukon Energy] to recover such costs when they occur.

In contrast, adoption of Reference A for [Yukon Energy]'s actual diesel costs (i.e., after the DCF determinations) when implementing the ERA avoids the above unintended impacts on parties.

[Emphasis of Yukon Energy.]

[47] Yukon Energy based the revised ERA on the Reference A definition of its actual diesel costs. Noting that Reference A actual diesel costs are the costs used for its income statement, revenue requirement and rates charged to customers, it sought again to recover its net DCF payment attributable to Yukon Electrical's above-forecast wholesale purchases through the ERA. In response, Yukon Electrical emphasized that Yukon Energy had not complied with the Board's specific directions in Board Order 2015-01. It also asserted that the revised ERA must be "based on actual diesel costs, with actual being defined as real, verified diesel costs instead of derived costs from the YECSIM model".

## The Order (Board Order 2015-06, Reasons for Decision)

[48] On August 18, 2015, the Board issued the Order from which this appeal is taken. It declined the ERA portion of Yukon Energy's compliance filing and directed it to update Rate Schedule 42 based on its Reasons for Decision. In those Reasons, the Board quoted extensively from its previous decisions and, under the heading "Views of the Board", stated:

Contrary to the submissions of [Yukon Energy], the Board was cognizant that the definition of "actual costs" for ERA purposes was different from that used for the DCF. On page 23 of Appendix A to Board Order 2015-01, the Board stated:

For the ERA, the Board interprets costs narrowly; to be clear, the costs are for actual diesel generation costs, not forecast or derived costs from the YECSIM model. [underlining added]

And

In its compliance filing to this decision, [Yukon Energy] is to provide a revised ERA that is based on actual diesel costs. That is, if actual diesel costs are higher than the levels of diesel contained in [Yukon Energy]'s latest approved forecast, then those costs which are attributable to [Yukon Electrical]'s wholesale purchases that are in excess of those in the last approved forecast will become billable to [Yukon Electrical]. [underlining added]

The Board observes that in its June 3, 2015 submission (page 4) [Yukon Energy] stated:

Yukon Energy submits that its responses to the Board's clarifying questions in effect also address other concerns noted by [Yukon Electrical] and the Board regarding the YECSIM model verifiability or use as a "billing engine". The actual diesel costs incurred by [Yukon Energy] on its income statement for [long-term average] diesel as determined by YECSIM-derived tables approved by the Board are fully verifiable, and provide a clear basis for determination of ERA billing charges. [footnote omitted]

The Board considers that the above statement of [Yukon Energy] does not address the Board's concerns regarding the verifiability of YECSIM. [Yukon Electrical] has previously noted that "... due to its proprietary nature, YECSIM cannot be independently tested or retrospectively verified ...". In addition, the concerns expressed that YECSIM has not been fully tested before the Board still stand. The Board finds that: (a) [Yukon Energy] has not shown that the YECSIM is verifiable for purposes of the ERA; and (b) the YECSIM has not been tested in this compliance proceeding.

Therefore, the Board is not persuaded that the definition of "actual costs" for ERA purposes as provided in Appendix A to Board Order 2015-01 should be changed. Further, as long as actual diesel generation costs are recovered, the criteria in section 7 of OIC 1995/90, are met. By utilizing the Board's definition of actual costs, the Board is of the view that the "perverse outcome" as described by [Yukon Energy] in Appendix B to its application, during high-water years, will not occur because [Yukon Energy] will recover its actual diesel generation costs. To address any "perverse outcome" which can occur during drought periods, that is, where rate payers could be charged twice (once through the DCF and a second time through the ERA), the Board directs [Yukon Energy] to amend Rate Schedule 42 to reflect that during drought periods, when diesel generation costs are recovered through the DCF, [Yukon Energy] cannot invoke the ERA.

[Emphasis of the Board. Footnote omitted by the Board.]

[49] Yukon Energy requested a review and variance of Order 2015-06, but the Board dismissed the application. On March 9, 2016, Madam Justice Stromberg-Stein granted Yukon Energy leave to appeal the Order.

## Positions on Appeal

[50] Yukon Energy submits that the Order fixes a wholesale rate which does not enable it to recover all of its costs of generating the electricity it sells to Yukon Electrical. This, it says, defeats the Board's legislative mandate, contravenes the OIC's requirements and is plainly unreasonable. While the Board has discretion to choose the methodology by which it enables Yukon Energy to recover its costs, it has no jurisdiction to set a wholesale rate that denies it full cost recovery. However, it did so, without meaningful explanation and in an internally inconsistent manner, by imposing an ERA mechanism that excludes its net DCF payment attributable to Yukon Electrical's above-forecast purchases. According to Yukon Energy, this was a decision which exceeded the Board's jurisdiction and must be corrected on appeal.

[51] The Board responds by emphasizing that it is a specialized tribunal. In setting rates, it directly engages its expertise and applies its home statute to its highly technical, polycentric task. Although the Board concedes that its interpretation of the statute must be reasonable, it submits it has a broad discretion to resolve uncertainty in statutory language and to choose the methodology it employs in exercising its legislative mandate. In these circumstances, it says, its rate-setting decisions are entitled to a high degree of deference.

[52] The Board goes on to submit that the statutory language in question is uncertain. The OIC does not define “costs” and the proper interpretation of the term in the context of wholesale rate-setting is not resolved by the open-ended definition in the *Act*. According to the Board, given the different purposes of the DCF and the ERA, the simulated nature of the YECSIM model and the unverified quality of its derived costs calculation, it was reasonable to define Yukon Energy’s costs for the ERA as its actual diesel generation costs rather than its costs as derived from YECSIM. In other words, it says, Yukon Energy failed to establish that its proposed definition of its diesel generation costs should be adopted for the ERA. The Board says further that, while succinct, its Reasons are adequate because they permit this Court to understand why it made its decision and to determine whether its conclusion is within the range of acceptable outcomes.

## **Issue for Determination**

[53] Was it reasonable for the Board to exclude Yukon Energy’s net DCF payment attributable to above-forecast wholesale purchases from the definition of its diesel generation costs for the ERA?

## **Discussion**

### **Standard of Review**

[54] The parties agree that the standard of review is reasonableness. In my view, they are correct.

[55] Rate-setting is at the heart of the Board’s expertise and its decisions on rates are entitled to a high degree of deference. Accordingly, the Board’s expert actions in determining Yukon Energy’s costs when setting its wholesale rates are reviewable based on a standard of reasonableness: *ATCO Gas (2015)* at paras. 26-28. If its decision falls within a range of possible acceptable outcomes, defensible in respect of the facts and the law and reasoned in a justifiable, transparent and intelligible manner, the decision will pass muster on a reasonableness review: *Dunsmuir v. New Brunswick*, 2008 SCC 9 at para. 47.

### **Was it reasonable for the Board to exclude Yukon Energy’s net DCF payment attributable to above-forecast wholesale**



## **purchases from the definition of its diesel generation costs for the ERA?**

[56] The language of s. 7 of the OIC is mandatory and unambiguous. It is a specific statutory direction on how wholesale rates for Yukon Energy are to be fixed by the Board, with which direction it must comply: *British Columbia Electric Railway Co. v. Public Utilities Commission*, [1960] S.C.R. 837 at 856; *Hemlock Valley Electrical Services Ltd. v. British Columbia (Utilities Commission)* (1992), 66 B.C.L.R. (2d) 1 (C.A.) at paras. 53-57; *Act*, s. 17. Pursuant to s. 7 of the OIC, the Board must, when setting rates, enable Yukon Energy to “recover its costs” of generating the electricity it sells to Yukon Electrical if those costs are not recovered from its other customers. As discussed above, the definition of Yukon Energy’s diesel costs in the ERA is one element of the wholesale rate set out in Rate Schedule 42.

[57] As also discussed, the Board’s discretion to choose the methodology by which it achieves this result is unconstrained by the OIC or the statutory scheme that governs it. This means the Board may consider a variety of analytical tools and evidence in determining Yukon Energy’s reasonable costs: *ATCO Gas (2015)* at para. 47. However, the Board has no jurisdiction to set a wholesale rate which does not enable Yukon Energy to recover its otherwise unmet reasonable costs of generating the electricity, including its costs of diesel generation: *Ontario (Energy Board)* at para. 18. A decision that has this effect does not fall within a range of possible, acceptable outcomes which are defensible on the facts and the law.

### **What does “recover its costs” mean?**

[58] The meaning of “recover its costs” is determined by considering the words of the OIC in their grammatical and ordinary sense, in context, and in harmony with the *Act* and its purpose: *ATCO Gas (2015)* at paras. 33-35. The *Act* is the enabling legislation and, therefore, its purpose transcends and governs the OIC: *Wood v. Schaeffer*, 2013 SCC 71 at para. 33, citing *Bristol-Myers Squibb Co. v. Canada (Attorney General)*, 2005 SCC at para. 38. As noted, the definition of “costs” in the *Act* is open-ended and expressly includes “expenses”. The grammatical and ordinary sense of the words “recover” and “costs” are illuminated by examining their dictionary definitions.

[59] The definition of “recover” in *Black’s Law Dictionary*, 10th ed., includes “to get back or regain in full or in equivalence”. In *Webster’s Third New International Dictionary*, it includes “to get or win back” and, in the *Shorter Oxford English Dictionary*, 6th ed., “recovery of something lost, a debt or amount due, etc.”. The definition of “cost” in *Black’s* includes “the amount paid or charged for something; price or expenditure”. In *Webster’s*, it includes “an outlay incurred in the operation of a business enterprise” and, in the *Shorter Oxford*, “what must be given in order to acquire, produce, or effect something; the price (to be) paid for a thing”.

[60] Case authorities add little more to the analysis. However, some helpful guidance is found in *Kettle River Sawmills Ltd. v. Canada* (1993), [1994] 1 C.T.C. 182 (F.C.A.). In *Kettle River Sawmills* at 189, Hugessen J.A. considered the general meaning of the word “costs” by contrasting it with the word “value”:

In the first place, both tax law and the common use of language draw a clear distinction between cost and value. Cost means the money or money's worth which is given up by somebody to get something. It is generally viewed as an objectively determinable historical fact, the answer to the question "how much was paid?" ... To put the matter at its simplest, cost is what you have paid for something, value is what another will give you for it ...

[61] What emerges is that "recover its costs" means, in a grammatical and ordinary sense, to get back everything actually paid for something. This broad interpretation of these words finds support, for OIC purposes, in the legislative context in which they are found. The legislative context includes the *Act's* open-ended definition of "costs" and the other OIC provisions that require rates to be sufficient to recover costs in accordance with established Canadian rate-setting principles, which require costs to be reasonable to be recovered through rates. It is also consistent with the purpose of s. 7 of the OIC, namely to ensure that Yukon Electrical, not Yukon Energy, bears the full costs of generating the electricity that it needs.

[62] In sum, s. 7 of the OIC directs the Board to fix wholesale rates sufficient to enable Yukon Energy to get back everything it reasonably paid for generating the electricity it sells to Yukon Electrical and would not otherwise recover from other customers. In my view, this is the single available reasonable interpretation of s. 7 of the OIC. Accordingly, the Board was obliged to adopt and apply it in fixing the rate for Yukon Energy's wholesale electricity sales to Yukon Electrical: *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67 at para. 38.

### **Does the Order fix a rate for Yukon Energy's wholesale electricity sales to Yukon Electrical that enables it to get back everything it reasonably paid to generate the electricity?**

[63] The Board approved the revised DCF in Board Order 2015-01. In doing so, it accepted that Yukon Energy's annual diesel generation costs are its generation costs plus its DCF payments, not just its actual diesel costs. It also accepted that the DCF is a customer trust fund, meaning that, when a DCF payment is made, Yukon Energy retains no beneficial interest in the money paid into the fund. It further expressly accepted that the expected diesel costs included in approved rates are based on long-term average hydro generation forecasts provided by YECSIM:

... The Board has previously accepted [long-term average] hydro generation as the basis for [Yukon Energy] [general rate application] forecasts. The 2012-13 [long term-average] forecast was provided by means of [Yukon Energy]'s YECSIM model and was not contested at that time. Moreover, no evidence has been presented in this proceeding that the YECSIM model does not operate as it is intended ...

[64] Other rate stabilization mechanisms for addressing hydro generation variances may well have been available to the Board when it made Board Order 2015-01. However, the revised DCF was the approach that it approved and adopted as an integral part of setting Yukon Energy's rates.

[65] In Board Order 2015-01, the Board also chose to retain the ERA, albeit not as urged by Yukon Energy. As previously discussed, the ERA is a rate stabilization mechanism intended to ensure that Yukon Electrical receives a full pass-through of all incremental costs or savings of diesel generation attributable to higher or lower than forecast wholesale purchases.

[66] In 2012, Yukon Energy made the additional \$439,000 net DCF payment attributable to Yukon Electrical's above-forecast wholesale purchases into the DCF trust fund in which it has no beneficial interest. The payment was made because it was obligatory under Board-approved DCF rules, even though Yukon Energy was able to meet almost all the excess wholesale load through hydro generation due to the better than long-term average forecast water conditions. In other words, Yukon Energy was required by a Board-approved mechanism to pay an additional \$439,000 into the DCF for the above-forecast electricity purchased by Yukon Electrical even though it did not pay that \$439,000 in "actual" diesel generation costs.

[67] Nevertheless, the additional net DCF payment of \$439,000 in 2012 was real and it was reasonable. Unless the Board used a consistent definition of Yukon Energy's diesel generation costs for both the DCF and the ERA, it was also otherwise unrecoverable.

[68] In its Reasons, the Board did not explain clearly why, in these circumstances, it excluded Yukon Energy's net DCF payment attributable to above-forecast wholesale purchases from the definition of its diesel generation costs for ERA purposes. Although it acknowledged using two different definitions of Yukon Energy's diesel generation costs for the DCF and the ERA, it merely repeated its previous statement from the Reasons for Board Order 2015-01 and asserted that its concerns regarding YECSIM remained unaddressed.

[69] The Board's reference to concerns regarding YECSIM verifiability was unresponsive to the costs definition issue. It had already approved the revised DCF and adopted YECSIM forecasts as the basis for determining Yukon Energy's expected diesel generation costs. The cost Yukon Energy was seeking to recover was the obligatory DCF payment set by the Board based on YECSIM, which, as noted, was previously uncontested and accepted by the Board. There was nothing else to "verify". In addition, the references to compliance with the OIC in the Board's Reasons for Board Orders 2015-01 and 2015-06 were circular. They merely assumed the narrow, internally inconsistent, definition of "costs" the Board adopted when a rational justification for that definition was required.

[70] In my view, given the foregoing, the Order contravenes s. 7 of the OIC and the decision was unreasonable. It does not fix a rate for Yukon Electrical's wholesale purchases that enables Yukon Energy to get back everything it reasonably paid for the electricity. More specifically, the Order fixes a rate that does not enable Yukon Energy to recover from Yukon Electrical its reasonable net DCF payment attributable to above-forecast wholesale purchases, which payment is part of its diesel generation costs.

## **Conclusion**

[71] I would allow the appeal, set aside the Order and remit the matter to the Board with directions to set a wholesale rate that enables Yukon Energy to recover all of its diesel generation costs, which costs include any net DCF payment made by Yukon Energy attributable to Yukon Electrical's above-forecast wholesale purchases of electricity. I would also order that the parties bear their own costs of the appeal.

“The Honourable Madam Justice Dickson”

I AGREE:

“The Honourable Mr. Justice Harris”

I AGREE:

“The Honourable Madam Justice Fenlon”