Toronto Hydro-Electric System Ltd. v. Ontario Energy Board [Indexed as: Toronto Hydro-Electric System Ltd. v. Ontario (Energy Board)]

93 O.R. (3d) 380

Ontario Superior Court of Justice,
Divisional Court,

Lederman, Kiteley and Swinton JJ.

September 9, 2008

Public utilities -- Electricity -- Ontario Energy Board -- Jurisdiction -- Ontario Energy Board not having express or implied jurisdiction to impose conditions on authority of directors of regulated business as to declaration of dividends -- Board exceeding its jurisdiction by requiring, as condition of setting electricity distribution rates, that any dividend paid by Toronto Hydro-Electric System Ltd. be approved by majority of its independent directors -- Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B, ss. 23(1), 78(3). [page381]

THC is incorporated under the Ontario Business Corporations Act, R.S.O. 1990, c. B.16 and is the sole shareholder of THESL, an electricity distributor licensed by the Ontario Energy Board ("OEB"). All of the shares of THC are owned by the City of Toronto. THESL applied to the OEB for approval of proposed electricity distribution rates. As a condition of setting rates, the OEB required that any dividend paid by THESL to the City of Toronto be approved by a majority of THESL's independent directors. THESL appealed.

Held, the appeal should be allowed.

Per Kiteey J. (Swinton J. concurring): The standard of review of the impugned decision was correctness. The Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B (the "Act") does not give the OEB any express power to dictate, as a condition of a rate hearing, how dividends are to be declared by directors of the regulated corporation. Even assuming that the Act conferred broad powers on the OEB in meeting its responsibility of protecting the public interest, the grammatical and ordinary sense of s. 23(1) and s. 78(3) of the Act does not lead to an interpretation that those broad conditions can be construed to include the authority to impose restrictions on the process for declaring dividends. Nor does the OEB have such authority by necessary implication. The jurisdiction to impose restrictions on the process for the declaration of dividends by directors is not necessary or essential to the core function of the OEB, namely, rate-setting. The goals of sustainability, equity and efficiency are not promoted by such a power. Finally, the impugned decision effectively delegates

the power to declare **dividends** to the majority of the independent directors contrary to the OBCA and to long-standing corporate law principles.

Per Lederman J. (dissenting): The standard of review of the impugned decision was reasonableness. The OEB has express authority under ss. 23 and 78(3) of the Act to attach the condition in question to its order fixing rates. Alternatively, the OEB has the power to regulate dividends impliedly under the common-law doctrine of jurisdiction by necessary implication.

Cases referred to

ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board), [2006] 1 S.C.R. 140, [2006] S.C.J. No. 4, 2006 SCC 4, 263 D.L.R. (4th) 193, 344 N.R. 293, [2006] 5 W.W.R. 1, J.E. 2006-358, 54 Alta. L.R. (4th) 1, 380 A.R. 1, 39 Admin. L.R. (4th) 159, 145 A.C.W.S. (3d) 725, EYB 2006-100901, consd

Other cases referred to

Dunsmuir v. New Brunswick, [2008] S.C.J. No. 9, 2008 SCC 9, 329 N.B.R. (2d) 1, 64 C.C.E.L. (3d) 1, 164 A.C.W.S. (3d) 727, EYB 2008-130674, J.E. 2008-547, [2008] CLLC Â220-020, 170 L.A.C. (4th) 1, 372 N.R. 1, 69 Imm. L.R. (3d) 1, 291 D.L.R. (4th) 577, 69 Admin. L.R. (4th) 1, 95 L.C.R. 65; Flatley v. Algy Corp. (c.o.b. Mezzrow's), [2000] O.J. No. 3787, 9 B.L.R. (3d) 255, 100 A.C.W.S. (3d) 411 (S.C.J.); Kerr v. Danier Leather Inc., [2007] S.C.J. No. 44, 2007 SCC 44, 286 D.L.R. (4th) 601, 368 N.R. 204, 231 O.A.C. 348, 36 B.L.R. (4th) 95, 48 C.P.C. (6th) 205, 160 A.C.W.S. (3d) 910, J.E. 2007-1969, EYB 2007-124711; Kingston (City) v. Ontario (Energy Board), [2001] O.J. No. 3485, 150 O.A.C. 347, 21 M.P.L.R. (3d) 20, 108 A.C.W.S. (3d) 181 (Div. Ct.); Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, 2004 SCC 68, 244 D.L.R. (4th) 564, 326 N.R. 267, J.E. 2004-2016, 49 B.L.R. (3d) 165, 4 C.B.R. (5th) 215, 134 A.C.W.S. (3d) 548, REJB 2004-72160; R. v. Doyle, [1977] 1 S.C.R. 597, [1976] S.C.J. No. 38, 68 D.L.R. (3d) 270, 9 N.R. 285, 10 Nfld. & P.E.I.R. 45, 29 C.C.C. (2d) 177, 35 C.R.N.S. 1; Sparling v. Javelin International Ltd., [1987] Q.J. No. 1070, [1987] R.J.Q. 1554, 37 B.L.R. 265 (S.C.); Wonsch (Litigation Guardian of) v. Wonsch (2005), 76 O.R. (3d) 198, [2005] O.J. No. 3187, [2005] O.T.C. 723, 12 B.L.R. (4th) 313, 141 A.C.W.S. (3d) 54 (S.C.J.) [page382]

Statutes referred to

Alberta Energy and Utilities Board Act, R.S.A. 2000, c. A-17, s. 15(3)(d)

Business Corporations Act, R.S.O. 1990, c. B.16, ss. 38(3), 127(3)(d) [as am.], 130 [as am.], 134 [as am.]

Electricity Act, 1998, S.O. 1998, c. 15, Sch. A, s. 142

Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B., s. 1(1) [as am.], 23 [as am.], (1) [as am.], 33 [as am.], (5) [as am.], 70.1(1), 78 [as am.], (2) [as am.], (3) [as am.], 128(1)

Rules and regulations referred to

Ontario Energy Board, Affiliate Relationships Code for Electricity Distributors and Transmitters

Authorities referred to

Brown, David M., Energy Regulation in Ontario (Aurora, Ont.: Canada Law Book, 2001-)

Driedger, E.A., Construction of Statues, 2nd ed. (Toronto: Butterworths, 1983)

APPEAL from a decision of the Ontario Energy Board.

James D.G. Douglas and James C. Sidlofsky, for appellant.

Glenn Zacher and Patrick G. Duffy, for respondent.

KITELEY J. (SWINTON J. concurring):--

Introduction

[1] Toronto Hydro-Electric System Ltd. ("THESL") appeals from part of decision EB-2005-0421 of the Ontario Energy Board ("OEB") made pursuant to s. 78 of the Ontario Energy Board Act, 1998[1] by which the OEB required that, as a condition of setting rates for the distribution of electricity, any dividend paid by THESL to the City of Toronto be approved by a majority of THESL's independent directors.

[2] Counsel for the appellant argues that the OEB had no jurisdiction to impose such a condition, it created an unwarranted restriction on the authority of the board of directors of THESL and it should be struck out. Counsel for the OEB argues that it acted within its authority in its decision regarding payment of "excessive dividends" and that the appeal should be dismissed.

[3] The issue in this appeal is whether the OEB exceeded its jurisdiction and/or erred in law by imposing conditions on the authority of the directors of a regulated business as to the declaration of dividends. For the reasons that follow, the appeal is allowed and the condition is deleted. [page383]

Background

[4] Toronto Hydro Corporation ("THC") was incorporated under the Ontario Business Corporations Act[2] in 1999. All of the shares of THC are owned by the City of Toronto.

[5] THC is the sole shareholder of three corporations: Toronto Hydro Energy Services Inc. ("THESI"), which manages electricity contracts and engages in the development and sale of energy efficiency products and services; Toronto Hydro Telecom Inc. ("THTI"), which provides fibre optic cable capacity and manages data communications services; and THESL. THESI and THTI are not subject to the OEBA.

[6] The third corporation, THESL, is an electricity distributor licensed by the OEB. Pursuant to s. 142 of the Electricity Act, 1998,[3] no municipal corporation is permitted to distribute electricity after November 7, 2000 except through a corporation incorporated under the OBCA. THESL represents the amalgamation of the six municipal electric utilities that served the six cities that preceded amalgamation into the City of Toronto in 1998. THESL is one of the largest municipal electricity distribution utilities in Canada; it is responsible for the sale and delivery of electrical power to approximately 673,000 residential, commercial and industrial customers. It owns 90 per cent of the assets and accounts for 92 per cent of the consolidated gross revenue of the THC family of companies.

[7] The electricity distribution rates that THESI may charge customers are regulated by the OEB, pursuant to the OEBA. The OEB is the regulator of the Ontario electricity sector. One of its principal statutory objectives requires it to "protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service" (s. 1(1) OEBA). The OEB has broad statutory authority to make orders approving or fixing "just and reasonable rates" for the distribution of electricity (s. 78(3)) and to attach to a rate order "any conditions as it considers appropriate" (s. 23).

[8] On August 2, 2005, THESL applied to the OEB for approval of its proposed distribution rates effective May 1, 2006 on a forward test year basis (as opposed to an historic test year basis). A number of intervenors opposed certain aspects of the application. Board staff also made submissions. [page384]

[9] The OEB issued guidelines and rate-making principles in its 2000 and 2006 Electricity Distribution Rate Handbook. Pursuant to those handbooks, the distributor calculates its rate base and adds its market based rate of return ("MBRR"). Each of the Handbooks contained a maximum permitted MBRR: in 2000 it was 9.88 per cent and in 2006 it was 9 per cent. Relying on the handbook, THESL selected the maximum MBRR in its rate application.

[10] In a preliminary ruling, the OEB held that once a utility filed on a forward test year basis, it was open to any party to question any element of the filing, including the rate of return. As a result of that ruling, most of the parties and intervenors made submissions on the rate of return.

[11] Some of the intervenors questioned the adequacy of the evidence filed by THESL. The OEB noted that the evidence might have been "light" but there were mitigating circumstances: this was the first time THESL appeared before the OEB on a full oral hearing; this was the first time THESL had applied on a forward test year basis; THESL had reasonably assumed that the handbook (including the rate of return on equity) would apply; and THESL had been confronted with many challenges in amalgamating six utilities. The OEB issued several directions requiring that more comprehensive evidence be prepared in anticipation of the next rate application.

[12] One of the intervenors filed the THC Annual Report for the period ending December 31, 2004, which indicated that THC had paid to the City $67 million in interest and would pay in March 2005, dividends of $49 million for total payments to the City in 2005 of over $116 million.[4]

[13] The evidence showed that prior to 2003, THESL did not pay any dividends. In 2003, THESL paid a dividend to the THC of $5 million; in 2004, THESL paid a dividend of $34.1 million; and in 2005, it paid $31.5 million. A significant part of the dividends paid by THC to the City was derived from the regulated business of THESL as opposed to the unregulated businesses of THESI and THTI.

[14] The Board heard that the City had anticipated a significant shortfall in its 2006 operating budget; the City regarded [page385] THC as "a revenue source in the operating budget"; and the City demanded substantial increases in dividends from THC. Given the anticipated shortfall in the 2006 operating budget, the City's demand for a substantially increased dividend provoked THC to demand substantially increased dividends from the regulated business of THESL.

[15] As indicated, THC had paid $67 million in interest to the City during 2005 on a $980 million promissory note at an above-market interest rate of 6.8 per cent. This obligation was backed by an inter-company note issued by THESL to THC in the same amount and at the same rate. The note

originated as partial consideration for the assets transferred by the former Toronto Hydro-Electric Commission and the City in 1999.

[16] The evidence revealed that there was a Shareholder Direction from the City to THC dated in 1999. THC directors were required to pay a dividend equivalent to 40 per cent of THC's net income from regulated sources. In 2004, the policy was amended to require a dividend equivalent to 50 per cent of THC's consolidated net income. The Shareholder Direction also recognized the discretion not to declare a dividend; provided that the dividend policy was subject to restrictions imposed by legislation; and acknowledged that the operation of THC would be governed by the principle that it is in the best interests of THC and the community of stakeholders that THC conduct its affairs on a commercially prudent basis and in accordance with certain financial performance objectives. Furthermore, notwithstanding the terms of the Shareholder Direction, THC's board of directors retained the discretion not to declare a dividend if doing so would run contrary to their statutory or fiduciary duties to act in the best interests of the corporation.

[17] THESL conceded there would be a potential reduction in distribution rates charged to consumers if the debt was replaced with lower cost financing. However, THC and THESL could not do so because the City had the sole right to replace the debt and the City had different financial needs.

[18] THESL admitted that it could have invested the dividends paid to its shareholder to fix THESL's aging infrastructure; however, it did not conduct a full, in-depth analysis of that option or complete a plan for capital investment.

[19] At the time of the application, the board of directors of THESL was comprised of 11 directors. No members of THESL management served as directors of THESL. Of the 11 directors, three were members of Toronto City Council and the remainder were individuals who were either senior executives of other unrelated corporations or were experienced corporate directors. [page386]

[20] The OEB had established the Affiliate Relationships Code for Electricity Distributors and Transmitters (the "ARC"), which directed that at least one-third of the Board of a licensed electricity distributor must be independent of any affiliate. This provision became applicable to municipally owned electricity distribution utilities, including THESL, on July 1, 2006. Independent directors are considered by the OEB to be individuals who are not directors of the affiliates of the licensed distributor or members of the city council.

[21] At the time the OEB rendered its decision dated April 12, 2006, the ARC had not come into effect. The membership of the board of directors of THESL was identical to that of THC.

[22] The OEB panel expressed concern that THESL was paying increased dividends and an above market rate of interest while it was "under-investing by about $60 million" in capital expenditures.

[23] On the final day of the eight-day hearing, the presiding OEB member asked the chief administrative officer of THESL whether, "from a regulatory perspective, as opposed to a shareholder perspective", he thought that there was merit in the Board setting a limit on the percentage of net income that a regulated utility could pay out in dividends in any year. For a number of reasons, the CAO resisted the prospect that the regulator would manage the earnings.

Decision of the Board

[24] Based on a 9 per cent rate of return, THESL applied for a revenue requirement from rates of $456.8 million. That would have resulted in a reduction of distribution rates for the typical residen-

tial customer of approximately 6 per cent. The Board allowed the 9 per cent rate of return, but as a result of other adjustments, the Board granted a revenue requirement from rates of $436.5 million, resulting in a decrease of approximately 10 per cent.

[25] In establishing the rates that THESL could charge effective May 1, 2006, the OEB disallowed as a regulatory expense any interest charges above market rate, which it found to be 5 per cent. That decision was not the subject of this appeal.

[26] The OEB also imposed a condition requiring that a majority of THESL's independent directors approve any future dividends payable to an affiliate. The reasoning of the OEB consists of the following:

> 6.4.1 Considerable discussion in the Toronto Hydro Application concerned the relationship between utility [sic] and its parent, the City of Toronto. As [page387] indicated previously in this Decision, this concerned payments for shared services and the above market rate of interest the utility was paying the City of Toronto. It also concerned the extremely high dividend payout made to the City.[5] Much of the information has been filed in confidence. It is sufficient to say that there was a very dramatic increase in the dividend payouts in 2004 and 2005. The level of dividends appears to be greater than the net income of the utility over at least a two year period.
>
> 6.4.2 At one time, there was a shareholder direction that limited the dividend payout to 40% of the utility's income but that was changed to 50% of consolidated income. Moreover, it appears that there were special dividends over and above that amount.
>
> 6.4.3 In addition, the utility purchased the street lighting business from the City of Toronto. A number of intervenors questioned the prudence of that investment, which totaled $50 million. The information filed with the Board indicated that the business would not be yielding a positive income for sometime. The utility's explanation was that they had front loaded certain costs.
>
> 6.4.4 The question arises as to whether the Board should restrict the dividend payout by the utility. To the extent a utility pays all of its retained earnings to the shareholder, it will become more dependent on borrowing and this may have an adverse effect on its credit rating.
>
> 6.4.5 A related question is the independence of the directors. The evidence in the hearing is that the directors of the utility and the parent, Toronto Hydro Corporation are currently identical. And none of the members of management are to be on the Board. This is an unusual situation.
>
> 6.4.6 There is a requirement that at least one third of the directors of the distributor [footnote omitted] must be independent but that rule will not apply to this utility until July 1, 2006. In the course [of] these hearings the utility has con-

> firmed that it will comply with the requirement and at that time, the independent directors will be appointed.
>
> 6.4.7 Given the unusual high level of dividend payout and the concern expressed by a number of Parties, the Board believes that it is appropriate that any dividend paid by the utility to the City of Toronto should be approved by a majority of the independent directors.
>
> 6.4.8 Much of the controversy in this case has been dominated by discussion about non arms length transaction [sic] between the utility and the City of Toronto, whether it relates to dividend payouts, payment of interest on loans or the purchase of goods and services. The introduction of independent directors will be a step in the right direction. The requirement that independent directors approve dividend payouts to affiliates will give the public greater assurance that the interests of ratepayers are not subservient to those of the shareholders. The Board believes this is in keeping with the policy intent of Section 2 of the ARC. [page388]
>
> 6.4.9 This provision will be reviewed by the Board in the next rate case. At a minimum it will signal the Board's serious concern with the state of inter-affiliate relations.

[27] As a result of the ARC, during the period covered by the rate application, at least one-third of the directors of THESL would be independent. The effect of the condition imposed by the OEB was that any dividend had to be approved by a majority of that one-third, regardless of the vote of two-thirds of the directors.

Position of the Parties

[28] Counsel for the appellant takes the position that there is no express jurisdiction in s. 23(1) and s. 78(3) of the OEBA to impose a condition on the declaration of dividends. Nor is there implied jurisdiction to impose a condition with respect to the payment of dividends by a regulated distributor to its affiliate. Furthermore, the order was contrary to the OBCA and the common law as to the discretion of the board of directors to declare a dividend in that it purported to require THESL's non-independent directors to delegate their power to declare dividends to the independent directors, contrary to long-settled principles of corporate law. The OEB, having acted outside its jurisdiction, the condition imposed should be deleted.

[29] Counsel for the respondent takes the position that s. 23(1) and s. 78(3) give the OEB express jurisdiction to impose such conditions. Alternatively, the jurisdiction could be found by necessary implication. In reaching its decision, the OEB observed that if a utility was to pay all of its retained earnings to its shareholder, this could adversely effect its credit rating, which in turn could cause higher costs and a degradation in services for electricity consumers. The OEB's statutory mandate requires it to protect the interests of consumers with respect to price and the adequacy, reliability and quality of electricity service. The OEB exercises this mandate through its core function, which is to set just and reasonable electricity rates. In performing this core function, the OEB's discretion is extremely broad and it is permitted to make any order or attach any condition which in its opinion is necessary to protect consumer interests. The power to regulate the payment of excessive divi-

dends by a licensed electricity distributor falls squarely within the OEB's broad mandate to protect consumer interests through the setting of just and reasonable rates.

Jurisdiction to Hear the Appeal

[30] Pursuant to s. 33 of the OEBA, this appeal is limited to a question of law or jurisdiction. [page389]

Standard of Review

[31] Counsel for the respondent argued that the essence of the appeal was the imposition of conditions by the OEB. This should be characterized as a matter of discretion, which attracts the standard of reasonableness. As a question of fact, discretion or policy where the expert tribunal was interpreting its own statute as to what conditions should apply to a rate decision, deference is required.

[32] I do not agree with that characterization of the issue. The issue is whether, in setting rates that a distributor may charge, the OEB has the jurisdiction to impose conditions on the authority of the directors of a regulated business as to the declaration of dividends. The issue will be resolved by reference to the OEBA and to principles of corporate law. Both are questions of law.

[33] In ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board),[6] the Supreme Court of Canada held, at para. 26, that the expertise of the Board is not engaged when deciding the scope of its powers. Furthermore, at para. 32, the Supreme Court held that the determination of the Board's power to allocate proceeds from a sale of utility assets suggests a standard of review of correctness because it "goes to jurisdiction". As counsel for the respondent noted, ATCO was not a rates case but it dealt with a jurisdictional issue. I see no reason to depart from the standard of correctness. Nor does the decision in Dunsmuir v. New Brunswick[7] lead to a different conclusion.

Statutory Framework

[34] The relevant sections of the OEBA are as follows:

> 1(1) The Board, in carrying out its responsibilities under this or any other Act in relation to electricity, shall be guided by the following objectives:
>
> 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.
>
> . . . . .
>
> 23(1) The Board in making an order may impose such conditions as it considers proper, and an order may be general or particular in its application.
>
> . . . . . [page390]

> 70.1(1) The Board may issue codes that, with such modifications or exemptions as may be specified by the Board under section 70, may be incorporated by reference as conditions of a licence under that section.
>
> . . . . .
>
> 78(2) No distributor shall charge for the distribution of electricity . . . except in accordance with an order of the Board . . .
>
> 78(3) The Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity and for the retailing of electricity in order to meet a distributor's obligations under section 29 of the Electricity Act.

(citation omitted)

[35] The ARC established pursuant to s. 70.1 contains the following:

> The purpose of the Affiliate Relationships Code is to set out the standards and conditions for the interaction between electricity distributors and or transmitters and their respective affiliated companies. The principal objectives of the Code are to enhance the development of a competitive market while saving ratepayers harmless from the actions of electricity transmitters and distributors with respect to dealings with their affiliates.
>
> 2.1.3 A utility shall ensure that at least one-third of its Board of Directors is independent from any affiliate.
>
> 2.1.4 Section 2.1.3 does not apply to a municipal utility until July 1, 2006.

Analysis

A. Express or implied authority

[36] Counsel agree that the powers of the OEB must be found in its enabling legislation. Statutory bodies may perform only those tasks assigned to them and in performing those tasks they have only those powers granted to them expressly or impliedly.[8]

[37] Both counsel referred extensively to ATCO, supra, in which a regulated utility sought approval from the Alberta Energy and Utilities Board ("AEUB") for the sale of buildings and land. ATCO also asked that the AEUB approve the proposed disposition of the sale proceeds including a recognition that the profits would be paid to shareholders.[9] The AEUB approved the sale but allocated a portion of the net gain on the sale to the rate-paying customers. The Alberta Court of Appeal set aside that [page391] decision and referred the matter back to the AEUB to allocate the entire net gain to ATCO. The Supreme Court dismissed the appeal. This was not a rate-setting case, but the issue of the jurisdiction of the AEUB to impose conditions provides a useful context.

[38] For the majority, Bastarache J. began his analysis with this observation:

> The respondent in this case is a public utility in Alberta which delivers natural gas. This public utility is nothing more than a private corporation subject to certain regulatory constraints.[10]

(Emphasis added)

(a) Principles of statutory interpretation

[39] Bastarache J. reviewed the statutory framework, which is not materially different from the OEBA.[11] He referred to the modern approach to statutory interpretation as follows:

> Today there is only one principle or approach, namely, the words of an Act are to be read 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.[12]

[40] He noted that tribunals obtain their jurisdiction by express grant or by application of the doctrine of jurisdiction by necessary implication.[13]

(b) Express grant of jurisdiction

[41] Counsel for the OEB argues that the authority to restrict the declaration of dividends is found in the combination of s. 23(1) and s. 78(3) which allows the OEB to impose such conditions as it considers proper when fixing just and reasonable rates. There is no qualification on the breadth of the power to impose conditions.

[42] I disagree. The OEB did not identify that it had jurisdiction to impose such a condition either pursuant to s. 23(1) or s. 78(3). It apparently assumed that it had the jurisdiction. There is no express power to dictate, as a condition of a rate hearing, how dividends are to be declared by directors of the regulated corporation. The respondent did not refer to any authority to [page392] support such an express power. Even assuming that the OEBA conferred broad powers on the OEB in meeting its responsibility of protecting the public interest,[14] the "grammatical and ordinary sense" of s. 23(1) and s. 78(3) does not lead to an interpretation that those broad conditions can be construed to include the authority to impose restrictions on the process for declaring dividends.

[43] To paraphrase Bastarache J. at para. 46 of ATCO, supra, it would be absurd to allow the OEB an unfettered discretion to attach any condition it wishes. The Board cannot be given total discretion without limitations.

(c) Jurisdiction by necessary implication

[44] I turn then to the question as to whether the OEB has such authority by necessary implication.

[45] In ATCO, supra, Bastarache J. pointed out that the mandate of the court is to determine and apply the intention of the legislature without crossing the line between judicial interpretation and legislative drafting.[15] He noted that the doctrine of jurisdiction by necessary implication required the court to identify "all powers which are practically necessary for the accomplishment of the object intended to be secured by the statutory regime created by the legislature".[16]

[46] Bastarache J. held that the principal function of the AEUB was to determine rates and that the power to supervise the finances of those companies and their operations, although wide, is in practice incidental to fixing rates.[17] He also opined that rate regulation serves several aims: sustainability, equity and efficiency.[18] He noted that those goals have resulted in an economic and social arrangement dubbed the "regulatory compact" which ensures that all customers have access to the

utility at a fair price. Regulated utilities are given exclusive rights to sell their services within a specific area at rates that "will provide companies the opportunity to earn a fair return for their investors".[19] That led him to the finding that the fact that the utility is given [page393] the opportunity to make a profit on its services and a fair return on its investment in its assets should not and cannot stop the utility from benefiting from the profits which follow the sale of assets.[20]

[47] At para. 78, Bastarache J. made a finding on which the appellant relies:

> In my view, allowing the Board to confiscate the net gain of the sale under the pretence of protecting rate-paying customers and acting in the "public interest" would be a serious misconception of the powers of the Board to approve a sale; to do so would completely disregard the economic rationale of rate setting, as I explained earlier in these reasons. Such an attempt by the Board to appropriate a utility's excess net revenues for ratepayers would be highly sophisticated opportunism and would, in the end, simply increase the utility's capital costs . . . At the risk of repeating myself, a public utility is first and foremost a private business venture which has as its goal the making of profits. This is not contrary to the legislative scheme, even though the regulatory compact modifies the normal principles of economics with various restrictions explicitly provided for in the various enabling statutes. None of the three statutes applicable here provides the Board with the power to allocate the proceeds of a sale and therefore affect the property interests of the public utility.[21]

(Emphasis added)

[48] At para. 79, Bastarache J. concluded as follows:

> It is well established that potentially confiscatory legislative provision ought to be construed cautiously so as not to strip interested parties of their rights without the clear intention of the legislation . . . Not only is the authority to attach a condition to allocate the proceeds of a sale to a particular party unnecessary for the Board to accomplish its role, but deciding otherwise would lead to the conclusion that a broadly drawn power can be interpreted so as to encroach on the economic freedom of the utility, depriving it of its rights. This would go against the above principles of interpretation.

[49] Counsel agree that the test for the common-law doctrine of jurisdiction by necessary implication can be summarized as follows:

> The jurisdiction sought is necessary to accomplish the objects of the legislative scheme and is essential to the Board fulfilling its mandate;
>
> The enabling Act fails to explicitly grant the power to accomplish the legislative objective;
>
> The mandate of the Board is sufficiently broad to suggest a legislative intention to implicitly confer jurisdiction;

> The jurisdiction sought is not one which the Board has dealt with through use of expressly granted powers, thereby showing an absence of necessity; and [page394]
>
> The legislature did not address its mind to the issue and decide against conferring the power to the Board.[22]

(Emphasis added)

[50] The respondent argues that the power must be implied to respond to the need for utility regulators to protect ratepayers from affiliate transactions, including excessive dividends and above-market interest rates. As counsel observed, gas distributors in Ontario have for many years been subject to undertakings that mandate a minimum number of independent directors, restrict affiliate transactions and require the maintenance of an appropriate level of common equity -- which, arguably effectively prevents the payment of excessive dividends. The respondent relies on a prior decision of the OEB which held that without effective regulation, the parent company could "drain the utility of its cash resources or its equity through unreasonable actions, dividend policies, etc.".[23]

[51] The OEB did make such a statement. However, it was in the context of the proposed sale of Consumers' Gas. The passage from which that excerpt has been taken is important:

> One of the key issues of concern to the Board in a takeover case is the question of the new parent's financial integrity. The principal reason for this concern is the potential for a financially unsound owner to unduly rely on the utility for financing. Further, the new parent may drain the utility of its cash resources or its equity through unreasonable actions, dividend policies, etc.

(Emphasis added)

[52] The OEB is the gatekeeper for such acquisitions. In the event of such a concern, it has the jurisdiction to refuse to approve the sale. That decision does not stand for the proposition that, by implication, the OEB has the power to impose conditions in a rate-setting application as to the process for the declaration of dividends.

[53] Indeed, to the extent that the OEB has reflected on the point, counsel for the appellant pointed the court to another decision in a rate-setting application. Referring to a previous rate decision in which the OEB had authorized a rate of return on equity and set a gas distribution rate for ICG, the OEB stated as follows: [page395]

> The dividend policy of ICG is set by its Board of Directors and is not directly subject to review by the Ontario Energy Board. Therefore, the shareholder's actual return on common equity invested in the utility is determined by the actual operating results of the utility operations and the dividend policy established by ICG's Board of Directors.[24]

[54] Counsel for the appellant also referred to a decision of the OEB in another context. In a decision in 2005,[25] the OEB considered issues that arose in three separate applications under s. 86 relating to change in ownership or control. At p. 9, the OEB held as follows:

> With respect to the claim that ratepayers have a right to "an open and transparent process" for the sale of the shares or the assets of an electricity distributor, the Board has two observations. First, . . . Further, the legislature has determined that distributors should be governed by the Ontario Business Corporations Act ("OBCA"). The OBCA contains provisions governing procedures and rights associated with, among other things, amalgamations and other significant corporate activities. Viewed from this perspective, the Board does not believe it is appropriate to open up corporate process issues to review. The Board does not believe it is appropriate to add an additional layer of corporate review by vesting process rights (again, in the sense of rights associated with the process leading up to the conclusion of a transaction) within customers of distribution companies. The content of such rights and the process by which they may be exercised is beyond the Board's objectives or role within the energy sector.

[55] While that was not a rate-setting case, there is no reason to distinguish between the corporate processes involved in amalgamations and in the declaration of dividends. Neither is relevant to the Board's objectives or role within the energy sector.

[56] The respondent also argues that the power must be implied because other jurisdictions have responded to the need by granting regulators, either explicitly or implicitly, the power to restrict dividends. The authorities to which the respondent refers are from United States tribunals and courts and authors. The regulatory environment is sufficiently different that I do not consider them applicable.

[57] Moreover, I agree with the appellant that it is not necessary to imply such powers because of the safeguards in the OBCA, including the duty of a director to act honestly and in good faith (s. 134), the requirement that the solvency test is met before declaring a dividend (s. 38(3)), the liability on the director [page396] to restore amounts paid (s. 130) and the well-established fiduciary duty of directors to act in the best interests of the corporation at all times.[26]

[58] I am not persuaded that the jurisdiction to impose restrictions on the process for the declaration of dividends by directors is necessary or essential to the core function of the OEB, namely, rate-setting. To paraphrase Bastarache J., the power to restrict the process for the declaration of dividends is not "practically necessary for the accomplishment" of the rate-setting function. The goals of sustainability, equity and efficiency are not promoted by such a power.

[59] Furthermore, the interests of the ratepayers are not subservient to the interests of the shareholders if the OEB does not have such jurisdiction. The handbooks have provided for a market based rate of return. As indicated above, the OEB accepted THESL's rate of return. Having established expectations with respect to the MBRR, the disposition of the profit belongs in the hands of the directors. It would undermine the "regulatory compact" if the utility were deprived of the fair return for its investors. As Bastarache J. pointed out, a public utility is nothing more than a private corporation subject to certain regulatory constraints. Those constraints do not include restrictions on the process for the declaration of dividends.

[60] I agree with the appellant that by s. 6.4.7, the OEB exceeded its jurisdiction.

B. Corporate law principles

[61] Counsel for the appellant argues that the decision is contrary to long-standing corporate law principles. Section 127(3)(d) of the OBCA prohibits directors from delegating the authority to declare dividends. In Wonsch (Litigation Guardian of) v. Wonsch,[27] the court held as follows:

> It is clear that the declaration of dividends is a power vested in the board of directors of a company; it is a matter of internal management, within the discretion of the directors.

[62] In Flatley v. Algy Corp. (c.o.b. Mezzrow's),[28] the court also held: [page397]

> The decision whether to order the payment of a dividend is normally within the discretion of the board of directors, and courts are very reluctant to interfere with their exercise of discretion.

[63] And in Sparling v. Javelin International Ltd.[29] (relied on in both Wonsch and Flatley), the court observed as follows:

> It is a well-established principle of company law that the authority to declare dividends is a power vested in the board of directors . . . The directors may not delegate this authority.

[64] Counsel for the appellant also relied on the "business judgment rule", which provides that courts will generally not interfere with directors' business decisions in the absence of evidence which calls in question the bona fides and reasonableness of those decisions.[30] The Rate Decision constitutes second-guessing by the OEB of corporate decision making.

[65] Counsel for the respondent argues that the Rate Decision does not mean that THESL's directors have delegated a non-delegable duty in contravention of the OBCA. Rather, the respondent argues that the OEB made an order changing THESL's procedures for declaring dividends. The authority to approve dividends has not been taken away. The independent directors will act as an additional check on the authority of the full board. I disagree. I accept the submission of the appellant that s. 6.4.7 of the Rate Decision effectively delegates the power to declare dividends to the majority of the independent directors contrary to the OBCA and to the long-standing corporate law principles referred to above.

[66] Section 128(1) of the OEBA provides that, in the event of a conflict between the OEBA and "any other general or special act", the OEBA will prevail. Counsel for the respondent relies on s. 128(1) for the proposition that the OEBA prevails over the OBCA. I disagree. There is no conflict when the OEBA is silent on the point of the procedure for the declaration of dividends.

[67] Counsel for the respondent argues that the condition does not override statutory requirements.[31] By analogy, under the OEBA, it is the function of the OEB, not the management of THESL, to set the regulatory requirements necessary to protect the interests of ratepayers. I disagree. As indicated above, while the OEB protects the interests of ratepayers, it must do so in ways in which it is authorized by statute. [page398]

[68] I agree with the appellant that by including s. 6.4.7 in the Rate Decision, the OEB erred in law.

Costs

[69] Pursuant to s. 33(5), the OEB is not liable for costs in connection with any appeal to this court.

Confidentiality Issues

[70] The OEB has the power to direct that some or all of the material filed in a rate-setting application shall be confidential. After the appeal was launched, an order was made in the Divisional Court to seal documents that had been treated as "Confidential Documents" before the OEB. That order had included the facta.

[71] During submissions, counsel agreed that the contents of the three facta were not confidential. Accordingly, the order made on February 20, 2007 does not apply to them.

Order to Go as Follows

[72] The appeal is allowed. Section 6.4.7 of the Rate Decision dated April 12, 2006 is set aside to the extent that it requires any dividend paid by THESL to an affiliate be approved by a majority of the independent directors of THESL's board. No costs are awarded.

[73] LEDERMAN J. (dissenting):-- My main point of departure from my colleagues is the effect of the Supreme Court of Canada decision in ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board), [2006] 1 S.C.R. 140, [2006] S.C.J. No. 4. Unlike this case, which is a rate setting case, the ATCO decision dealt with a regulator's approval of the sale of assets of a gas utility and its order confiscating the net gain of the sale.

[74] The statutory mandate of the Ontario Energy Board (the "OEB") requires it to protect the interests of consumers with respect to price and the adequacy, reliability and quality of electricity service. The OEB exercises this mandate through its core function which is to set just and reasonable electricity rates. In performing this core function, the OEB's discretion is extremely broad and is permitted to make any order or attach any condition which in its opinion is necessary to protect consumer interests (ss. 23 and 78(3) of the Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sch. B (the "OEBA")).

[75] At para. 28, the Supreme Court of Canada in ATCO put it this way: [page399]

> The legislative framework at hand has as its main purpose the proper regulation of a gas utility in the public interest, more specifically the regulation of a monopoly in the public interest with its primary tool being rate setting . . .

[76] The Supreme Court of Canada, at para. 30, made it clear that there is a significant distinction between a regulator engaged, as it was in that case into whether a proper construction of the enabling statutes gave it jurisdiction to allocate the profits realized from the sale of assets, and its generally accepted protective role in ensuring that utility rates are always just and reasonable.

[77] At para. 84, the Supreme Court stated that the Board has considerable discretion in the setting of future rates in order to protect the public interest.

[78] At the heart of a regulator's rate-making authority lies the "regulatory compact" which involves balancing the interests of investors and consumers. In this regard, there is an important distinction between private corporations and publicly regulated corporations. With respect to the latter, in order to achieve the "regulatory compact", it is not unusual to have constraints imposed on utili-

ties that may place some restrictions on the board of directors. That is so because the directors of utility companies have an obligation not only to the company, but to the public at large.

[79] The OEB's public interest mandate is exercised through its rate-making power. Rate-making is not just setting the costs of distribution, but involves assurance that utilities are properly capitalized, are reinvesting in aging infrastructure and are capable of providing adequate and reliable electricity service.

[80] The setting of rates will accomplish little in terms of public protection if the revenue can be stripped out of the company without any controls.

[81] The Direction of the OEB in this case that any dividend payout by the utility to an affiliate be approved by a majority of the independent directors arises out of the OEB's concern about THESL's excessive dividends. It is a moderate restriction on corporate governance. By leaving the discretion to declare a dividend in the hands of THESL's directors, albeit with an additional check by THESL's independent directors, the OEB has crafted a reasonable and less intrusive remedy that balances the interests of THESL's shareholder and its ratepayers and is consistent with the "regulatory compact".

[82] In my view, the OEB had express authority under ss. 23 and 78(3) of the OEBA to attach this condition to its order fixing rates. It should be noted that in the ATCO decision, Bastarache J. stated that even when a regulator considers the approval of a sale of a utility, it can attach conditions to such approval, such as [page400] the utility giving undertakings regarding the replacement of the assets and their profitability or a condition that the utility reinvest part of the sale proceeds back into the company in order to maintain a modern operating system that achieves the optimal growth of the system (para. 77).

[83] Alternatively, the OEB had the power to regulate dividends impliedly under the common-law doctrine of jurisdiction by necessary implication. Such powers are practically necessary to ensure that the OEB has the jurisdiction to accomplish its statutory mandate. The need for regulators to protect ratepayers from affiliate transactions, including excessive dividends and above market interest rates requires such powers incidental to the rate-making exercise. They are all concerned with ensuring that the utility has sufficient financial strength capable of providing the public service for which it was given a monopoly. Otherwise, if unable to restrict a utility from issuing excessive dividends, the regulator is left with the unpalatable choice of either approving a higher rate to cover the cost of excessive dividends or holding rates steady and allowing the quality of service to deteriorate.

[84] I take issue with my colleagues, as well, with respect to the standard of review applicable on this appeal. In my view, the applicable standard of review is reasonableness. That is so primarily because this decision of the OEB, as a specialized and expert tribunal, dealt with setting just and reasonable distribution rates, which is its primary function. In so doing, the OEB was interpreting provisions that lie at the heart of its mandate. This is an exercise that the OEB does on a regular basis and engages its unique expertise in determining the appropriate conditions to attach to rates. Its decision should attract deference and a standard of reasonableness from this court.

[85] The OEB had evidence before it that THESL was paying increased dividends and an above market rate of interest while it was under-investing by about $60 million in its capital expenditures. The OEB noted that if a utility like THESL was to pay all its retained earnings to its shareholder, this could adversely impact its credit rating, which in turn, could cause higher costs and degradation

in service to electricity consumers. Given these concerns, it was reasonable for the OEB to conclude that it was appropriate that any dividend paid by the utility to the City of Toronto should be approved by a majority of the independent directors.

[86] Accordingly, the appeal should be dismissed.

Appeal allowed.

Notes

1 S.O. 1998, c. 15, Sch. B (the "OEBA").

2 R.S.O. 1990, c. B.16 (the "OBCA").

3 S.O. 1998, c. 15, Sch. A (the "Electricity Act").

4 Annual Report, p. 34: "On March 31, 2005, the board of directors of the Corporation declared dividends in the amount of $49.0 million. The dividends are comprised of a $23.7 million payment for 2004 net income, a $6.0 million payment in connection with the first quarter of 2005 and a $19.3 million one-time extraordinary payment. The dividends are payable on March 31, 2005."

5 Counsel for the appellant pointed out that THESL does not pay dividends to the City; rather, it pays to its shareholder THC, which in turns paid dividends to the City. Since they are affiliated, we do not consider this error to be relevant.

6 [2006] 1 S.C.R. 140, [2006] S.C.J. No. 4 ("ATCO").

7 [2008] S.C.J. No. 9, 2008 SCC 9, at para. 50.

8 R. v. Doyle, [1977] 1 S.C.R. 597, [1976] S.C.J. No. 38, at p. 602 S.C.R.; ATCO, at para. 38.

9 At para. 40, Bastarache J. held that the request by ATCO for approval of the disposition of the proceeds of sale was not a recognition that the Board had authority to do so.

10 ATCO, supra, at para. 3.

11 Secton 15(3)(d). The AEUB may "make any further order and impose any additional conditions that the Board considers necessary in the public interest".

12 ATCO, supra, at para. 37, quoting from E.A. Driedger, Construction of Statutes, 2nd ed. (Toronto: Butterworths, 1983), at p. 87.

13 ATCO, supra, at para. 38.

14 Kingston (City) v. Ontario (Energy Board), [2001] O.J. No. 3485, 150 O.A.C. 347 (Div. Ct.), at para. 5.

15 ATCO, supra, at para. 51.

16 ATCO, supra, at para. 51.

17 ATCO, supra, at para. 60.

18 ATCO, supra, at para. 62.

19 ATCO, supra, at para. 63.

20 ATCO, supra, at para. 67.

21 ATCO, supra, at para. 78.

22 David M. Brown, Energy Regulation in Ontario (Aurora, Ont.: Canada Law Book, 2001) at pp. 2-16.4, 2-16.5 and referencing Ontario Energy Board decision in E.B.R.O. 410-11/411-11/412/11 (March 23, 1987), at para. 4.73.

23 Ontario Energy Board, The Proposed Sale of Consumers' Gas Company, E.B.O. 179 (May 27, 1994), at s. 5.3.1.

24 Ontario Energy Board, Report of the Board, ICG Utilities (Ontario) Ltd., Cogeneration Boise Cascade Canada ltd. Fort Frances E.B.R.L.G. 33 at ss. 3.6.6. and 3.6.7 (December 21, 1989).

25 OEB decision dated August 31, 2005, OEB file Nos. RP 2005-0018; EB-2005-0234, EB-2005-0254, EB-2005-0257.

26 Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, at p. 477 S.C.R.

27 (2005), 76 O.R. (3d) 198, [2005] O.J. No. 3187 (S.C.J.), at para. 69.

28 [2000] O.J. No. 3787, 9 B.L.R. (3d) 255 (S.C.J.), at para. 39.

29 [1987] Q.J. No. 1070, 37 B.L.R. 265 (S.C.), at para. 8.

30 Peoples Department Stores, supra, at p. 477 S.C.R.

31 Kerr v. Danier Leather Inc., [2007] S.C.J. No. 44, 2007 SCC 44, at para. 55.