Ontario Green Energy and Green Economy Act, 2009: Implications for Regulatory Independence.

Conclusion.

It is of critical import to stability and confidence in the energy sector that the respective roles of the government and the regulator remain clear and distinct. A particularly striking feature of the *GEA* is the degree to which it contemplates direct and detailed government intervention into both the practice and the substance of provincial energy policy, which implementation has historically been the purview of the OEB. Such direct and detailed government intervention would undermine regulatory independence, at the expense of ratepayer acceptance of, and investor confidence in, regulatory outcomes. The government would be well advised to exercise its new authorities in such a way that reflects a clear separation between the legislature and the regulator, by setting clear and broad policy and then allowing the OEB to independently undertake its detailed implementation.

Introduction

The Ontario *Green Energy and Green Economy Act, 2009* (*GEA*) formally redefines ratepayer interests to include significant environmental priorities. The *GEA* conscripts Ontario's energy policy, and its energy regulator, into the service of the government's broader environmental and socioeconomic policy. In doing so the *GEA*redefines the nature and scope of utility ratepayer interests for the purposes of the "regulatory calculus" used by the Ontario Energy Board (OEB or the Board) to strike a balance between low prices for utility services and the quality and sustainability of utility infrastructure and services.

While the efficacy of such redefinition is legitimately the subject of political debate, it does not itself threaten the regulatory independence of Ontario's energy regulator; the Ontario Energy Board (OEB or the "Board"). The threat to the regulatory independence of the OEB comes not from the substance of the *GEA*, but from its potential intrusiveness on due regulatory process.

The essence of economic regulation.

Energy regulation has traditionally focussed on economic allocations between utility ratepayers and utility shareholders. The regulator's task has been to protect the interests of consumers in reasonable prices for essential services while ensuring that utility shareholders obtain sufficient return on their investment to continue to invest in their networks and maintain adequate, reliable and universal service. In most sectors of the economy competition and customer choice strikes the economically optimal balance. Because network utilities, such as natural gas and electricity distribution businesses, have practical service monopolies, economic regulators are mandated to step in to protect the consumer interest where competition does not apply.

These economic regulators, like the OEB, are expert tribunals. They are created and tasked to apply a deep and detailed understanding of the sector that they regulate. These tribunals have the legal authority to affect the economic and personal rights of those that they regulate (utilities) and of those on behalf of whom they regulate (ratepayers). They are thus legally required to provide due process and procedural fairness in exercising their authorities and making their determinations. Providing that they do so, Courts traditionally afford these expert and uniquely experienced regulators a significant degree of independence to determine how best to implement their legislative mandates and authorities. Governments, too, have traditionally created and mandated such regulators, and then let them alone to protect and balance ratepayer and utility shareholder economic interests. Thus arises the concept of "regulatory independence".

Regulatory independence, particularly where combined with due process and transparency of action, is important because it engenders confidence. Confidence on the part of ratepayers results in acceptability of outcomes. Confidence on the part of investors supports the long term investments that characterize network infrastructure development and redevelopment. Like the common law model through which case by case judicial determinations incrementally develops the law, the model for energy regulation in Ontario allows the specialized regulatory tribunal to carefully and incrementally build on policies created and decisions taken over time, and thus provide continuity, predictability and stability.

It is a basic principle of regulatory law that an economic regulator, as a creature of statute, has authority and legal jurisdiction only to the extent granted to it by its governing legislation. At a basic level, the OEB is, and has always been, subject to government direction, should the government choose to provide it.

Courts and regulators, including the OEB, have, over time, taken this basic principle an important step further. Not only is the Board bounded and directed by its governing legislation, it has also been found to be obliged to implement, within its sphere of activity and authority, government policy.

To consider the implications of the *GEA* on the role of the OEB, it is thus important to consider the role of government policy in the work of an economic energy regulator.

The Chair of the OEB considered the nature of government policy in his May, 2007 address to the Ontario Energy Network. He described government policy as: *"... the means by which the government translates its political vision into broad structures, directions and mandates intended to deliver particular outcomes. Government policy is broadly set out in legislation and further developed in regulations and directives issued under the legislation."* There are also less formal ways that government makes and communicates policy, such as through public statements and government programs.

Political redefinition of Ontario ratepayer interests.

As concern for the environmental impacts of energy consumption has grown over time, environmental considerations have been added to the traditional calculus of economic energy regulators. In Ontario, as elsewhere, this has been an evolutionary process.

The *GEA*, however, represents a fundamental redefinition of the economic regulatory calculus. The best interests of ratepayers have been redefined. While the OEB's objective of protecting the interests of consumers in reasonable energy prices and quality of service remains, new objectives have been added which shift the economic calculus from least cost reliable energy services to least cost achievement of a "green" energy sector.

In some ways, the *GEA* has made the OEB's job easier. Going beyond the less formal statements of the role of energy policy in achievement of environmental and socioeconomic objectives that preceded it, the *GEA* clearly directs that the "cost effectiveness" of green energy is assumed. The government has decided, on behalf of those who elected it, that green is good in its own right, and worth the cost. This decision, and the express directions contained in the legislation for implementation of this decision, do not, in and of themselves, undermine the OEB's traditional regulatory authority or independence. The *GEA* provides clarity on the social and economic objectives to be achieved through Ontario's energy sector. In fulfillment of its role to protect the interests of energy consumers in prices and quality energy services, the OEB will be expected to exert economic discipline on green energy investments. The OEB's task is now to ensure that the green energy investment directed by the government is achieved in as cost effective and as economically sustainable a manner possible.

Thus while electricity and gas distributors can now develop small renewable generation within the utility company, the OEB has determined that these are competitive business initiatives the costs of which should not be included in regulated utility rates. While electricity distributors are now directed to transform their systems from electricity distribution systems to energy collection and management systems, they are still obligated to justify to the regulator the economic prudence of their plans to do so. While the grid investments required to connect many small and distributed solar and wind generation facilities, and to move the electricity that they generate to where the load is, are now determined appropriate and are legislatively directed, presumably the OEB will still actively assess the prudence of the choice and implementation of the grid expansion projects required to obtain this result.

The OEB was not responsible for establishing the original calculus between low energy delivery rates and sufficient return to attract appropriate energy infrastructure investment. That calculus was defined for the regulator by the law, and more particularly by the OEB's legislated objectives. The establishment through the *GEA* of a new objectives, and thus a new regulatory calculus, one founded on an assumption of the economic and social necessity of green energy investment, does not, in and of itself, compromise the OEB's traditional regulatory independence.

The threat to regulatory independence.

There are, however, troubling aspects of the *GEA* from the perspective of regulatory independence. There are also some signs that concerns about the erosion of regulatory independence are valid.

A striking structural feature of the *GEA* is the number of powers of direction reserved by the government. These powers of direction pertain not only to what the Board should consider, but also how the Board should consider it, using what procedure, and under what time limits. It is one thing for the government to provide guiding policy objectives or to make policy decisions. This is what the

government's electoral mandate entitles, indeed obliges, it to do. It is quite another thing for the government to reserve to itself the right to direct the regulator to make a decision without a hearing, to limit what the regulator can consider in making such a decision, or to constrain the time frame within which such a decision must be made.

A knowledge of, and deference to, the fundamental legalities of due process, is central to the specialized expertise and the legal obligations of a regulatory tribunal such as the OEB. The OEB is empowered, and directed, in law to provide for its own process, in accord with legal principles of fundamental justice. If and when the government exercises its reserved authority to dictate the procedure that the regulator should follow in determining the matters within its jurisdiction the independence of the regulator will have been undeniably compromised. In this writer's personal opinion, the government would be wise to refrain from the use of such authority, and well advised to jettison it altogether.

Another liberty that the numerous directive powers embedded in the *GEA* affords the government is the ability to "micromanage" the OEB's activities. This, too, compromises the independence of the regulator. Through the use of carefully and inclusively developed regulatory policy and jurisprudence the OEB has provided stability, predictability and transparency to Ontario's energy sector, to the benefit of both ratepayers and investors. This carefully crafted confidence could be undermined in one fell swoop by government intervention to reverse or dictate in detail what the Board should or should not do.

The model for energy regulation in Ontario allows the regulatory rules to be built carefully and incrementally on policies and decisions taken over time, creating continuity, stability and predictability. In contrast to this careful approach to regulatory evolution, the threat of political reversal has historically been the greatest impediment to confidence and necessary investment in Ontario's energy sector. To re-establish the confidence necessary to sustain significant sector investment at a reasonable economic cost, the government would be well advised to exercise its authorities in such a way that reflects a clear separation between the legislature and the regulator. The government should set clear policy, and then step back and allow the OEB to undertake its implementation.

Prognosis.

In the year since the *GEA* was enacted, some deference has been shown by the government to the role of the OEB in balancing ratepayer and shareholder interests. While Ontario's two main natural gas utilities have had their regulatory framework adjusted to allow for investment by the utility company in green energy initiatives, the Ministerial directive that effected this adjustment included an express disclaimer of any intention to dictate how the OEB sets regulated gas distribution rates.

The OEB itself has also been holding its own on the issue of regulatory independence. In a recent decision the Board found that while government policy clearly favours investment by Ontario natural gas distributors in small green generation and related district heating initiatives, the costs of such competitive activities are not appropriate for inclusion in regulated delivery rates and should be to the sole account of the shareholder. The OEB has reached the same conclusion regarding small scale renewable energy investments which the *GEA* expressly allows electricity distributors to undertake.

The OEB has twice issued guidelines confirming that while such investments are permitted to the utility, the associated costs will not be allowed into regulated electricity distribution rates.

More troubling from the perspective of regulatory independence is the government's recent interventions into the OEB's activities on low income energy conservation and assistance programs.

In July, 2008 the OEB initiated a consultation process to examine issues associated with low income energy consumers. This consultation was prompted, in part, by a decision of the Ontario Divisional Court released in May, 2008 in which the Court indicated that the Board has the jurisdiction to consider ability to pay when setting utility rates, should the Board consider this to be appropriate.

In February, 2009 the OEB issued its *Report of the Board: Low Income Energy Assistance Program*. The OEB's report provided a framework for continuation and expansion of existing utility funded financial assistance programs for low-income energy consumers, and for conservation programs and customer service requirements aimed specifically at low-income energy consumers. The OEB also directed the formation of a number of industry working groups to develop recommendations for implementation of the Report's conclusions. Ontario Ministry of Energy and Infrastructure staff participated in these working groups. The OEB also initiated a public process to incorporate low-income specific amendments to the customer service requirements of the OEB's electricity *Distribution System Code*.

All of this work and progress by the OEB on low-income energy consumer issues was abruptly arrested by a September 8, 2009 letter from the Ontario Minister of Energy and Infrastructure. The letter requested that the Board cease work on its various initiatives in this area pending implementation by the government of a province wide integrated program for low-income energy consumers, as the Government moved forward with the *GEA*.

The Board suspended its work in this area. Considerable uncertainty ensued as gas distributors were directed by the Board to remove from their ongoing conservation plans low-income programs, and electricity distribution code amendments to address low-income energy consumer service were removed from a broader package of code amendments in progress. The Board subsequently directed the gas distributors to reinsert low-income components in their conservation programs. The working groups struck by the OEB wound their work down and delivered reports on their conclusions to date.

Then, by letter dated July 5, 2010, the (new) Minister of Energy and Infrastructure essentially reversed course again. The Minister has asked the Board to resume its work to address the needs of low-income energy consumers.

This most recent direction, however, goes much further. It lays out specific *"policy objectives"* that *"could further guide the OEB's work in developing such a program"*. These *"policy objectives"* include specific conservation program measures, and direct financial criteria and parameters for such measures. The Minister also *"urges"* the OEB to *"consider expanding both low-income and general natural gas [conservation] efforts"* beyond the levels previously concluded by the OEB to be appropriate, and to*"consider increasing the funds allocated to [an emergency financial assistance program for low-income consumers] beyond the level established by the OEB in its earlier consultation process"*. In short, the Minister's letter sets out detailed parameters for a low-income energy assistance program, which expressly differ from those parameters previously deemed by the

Board to be appropriate following a full consultation by the OEB which engaged interested and knowledgeable stakeholders.

Advisability aside, it is within the government's purview to make and implement detailed energy policy implementation decisions within the ambit of those outlined in the Minister's recent letter of direction to the OEB. However, to do so while at the same time purporting to defer to the OEB's own determinations of appropriateness, as the Minister's letter does, blurs the line between government policy and regulatory decision making. Perhaps actually, and certainly perceptively, such blurring compromises the OEB's regulatory independence. Such compromise can only harm the stability, transparency and predictability in the energy sector that the OEB has worked so hard to foster, potentially hindering the significant investment necessary to achieve the government's broader energy, environmental and socio-economic objectives.