OUTLINE OF PRESENTATION TO THE CONFERENCE ON "GOVERNANCE AND REGULATION IN THE ELECTRICITY SECTOR: *BALANCING INDEPENDENCE WITH ACCOUNTABILITY"*

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The background paper for the conference discusses, among other topics, regulatory governance. It defines regulatory governance as consisting of "the role and powers of regulatory agencies, and their relationships with ministries, parliaments and courts who oversee them – i.e. *how* regulatory policies are made, and by *whom*".

My contribution to the discussion of regulatory governance will take the form of a discussion of the role of the Ontario Energy Board ("OEB"), in the regulation of the electricity sector. In particular, I will use the OEB's role in implementing the provincial government's green energy policy as a test case of what the proper role of a regulatory agency should be.

It will be the burden of my comments that the OEB should play a very limited role in determining energy policy. It will also be the burden of these comments that, to the extent that the government compels the OEB to carry out the government's policies, it derogates from the ability of the OEB to properly carry out its core functions and derogates from the ability of the OEB to protect the public interest.

What these comments are ultimately intended to address is the question of the relationship between regulatory governance and the protection of the public interest.

The transmission and distribution of electricity is a monopoly function. Electricity is an essential commodity. The availability, and cost, of electricity play critical roles in the wellbeing of individuals and businesses.

Consumers, both individuals and businesses, need to be protected from the abuses which naturally flow from monopolies. It is the role of the energy regulator, the OEB, to provide that protection. But it is also the role of the energy regulator to ensure that electricity distributors and transmitters remain economically viable.

The balance between the respective interests of consumers and utilities has been described as the "regulatory compact". The role of the energy regulator, with respect to this regulatory compact, was described in the Supreme Court of Canada, in a foundational decision, in the following way:

> The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an

> attractiveness, stability and certainty equal to that of the company's enterprise. [1]

The obligation of utilities to protect the interests of their ratepayers, and of the energy regulator to ensure that the utilities do so, has long been recognized by the courts. That obligation was most recently expressed, by the Ontario Court of Appeal, in the following terms:

> The principles that govern a regulated utility that operates as a monopoly differ from those that apply to private sector companies, which operate in a competitive market. The directors and officers of unregulated companies have a fiduciary obligation to act in the best interests of the company (which is often interpreted to mean in the best interests of the shareholders) while a regulated utility must operate in a manner that balances the interests of the utility's shareholders against those of its ratepayers. If a utility fails to operate in this way, it is incumbent on the OEB to intervene in order to strike this balance and protect the interests of the ratepayers. [2]

The OEB's power to approve electricity rates is set out in section 78 of the *Ontario Energy Board Act* (the "OEB Act")[3]. The relevant portions of section 78 are the following:

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[1] *Northwestern Utilities Ltd. et al. v. City of Edmonton,* [1929] S.C.R. 186 at 193

[2] *Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284 at p. 21 (the "THESL Decision")

[3] *Ontario Energy Board Act,* 1998 S.O. 1998, C. 15 Schedule B, s. 78

> 78.(2) No distributor shall charge for the distribution of electricity or for meeting its obligations under section 29 of the *Electricity Act, 1998* except in accordance with an order of the Board, which is not bound by the terms of any contract.
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> 78.(3) The Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity or such other activity as may be prescribed and for the retailing of electricity in order to meet a distributor's obligations under section 29 of the *Electricity Act, 1998*.

The OEB's power to determine what constitutes just and reasonable rates is not constrained by the wording of the OEB Act. The legislature granted the OEB this broad discretion, for many reasons. Among other things, a broad discretion is necessary to ensure that the OEB has the flexibility to balance competing interests, and to do so independently of the political exigencies of the day. Simply put, the ability to act independently was seen by the legislature as an essential means to protect the public interest.

The courts have repeatedly, and over many years, confirmed that the OEB has a broad discretion to determine what is just and reasonable when setting rates. For example, the Ontario Court of Appeal, in the THESL Decision referred to above,

stated: "The case law suggests that the OEB's power in respect to setting rates is to be interpreted broadly and extends well beyond a strict construction of the task"[4].

In like fashion, the courts have, repeatedly and over many years, referred to the OEB's status as an expert tribunal in making decisions within the scope of its jurisdiction, and in particular in setting just and reasonable rates. The Divisional Court stated that "…the OEB is a highly specialized expert tribunal with broad authority to regulate the energy sector in Ontario and to balance competing interests".[5] That statement was quoted with approval by the Court of Appeal in the THESL Decision.[6]

To this broad discretion has been added the OEB's obligation to determine just and reasonable rates in a hearing. This obligation allows those affected by the OEB's decisions to see the evidence on which the decision is to be based and to make representations as to what the rates ought to be. This has created a substantial level of transparency, something which is highly valued by stakeholders.

The OEB, like any regulator, must be sensitive to, and indeed in some measure responsive to, government policy. To what extent regulatory agencies must reflect government policy in their decision-making has been the subject of considerable

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4 THESL Decision, *supra,* p. 12

5 *Toronto Hydro-Electric System Limited v. Ontario Energy Board et al.* (2009) 252 O.A.C., p 17

6 THESL Decision, *supra, p. 12*

judicial and academic consideration. There is a spectrum of opinion on that question that ranges from the view that a regulatory agency is little more than an instrument of policy implementation to the view that regulatory agencies have independent status guaranteed by the Constitution.

Government policy has been communicated to the OEB in a number of ways, formal and informal. The least intrusive of the formal mechanisms is listing, in the OEB Act, of objectives that the OEB must be guided by in carrying out its responsibilities.[7] While the OEB must take the objectives into consideration in its decision-making, it nonetheless is free to apply the objectives, as it feels appropriate, to the facts before it. The use of the word "guided", in the section of the OEB Act setting out the objectives, serves the purpose of reserving for the OEB a broad discretion as to the extent to which, and the manner in which, they apply the objectives. Among the other considerations, this flexibility is critical in light of the fact that many of the objectives are, on their face, contradictory.

A more intrusive way for communicating policy is through the use of directives. The 1998 amendments to the OEB Act contain a provision, in section 27, allowing the Minister to issue policy directives concerning "general policy and the

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[7] *Ontario Energy Board Act*, 1998 S.O. 1998, C. 15 Schedule B, Section 1

objectives to be pursued by the Board". The section requires the OEB to implement such policy directives.[8]

It is in the implementation of its "green energy" policy that the government has most fully employed the use of directives and, in the process, stripped the OEB of much of its discretion and, therefore, its independence to carry out its core functions.

The government did this in a number of ways. It amended the *Electricity Act, 1998* to require the Ontario Power Authority to enter into contracts for the supply of renewable energy.[9] It further amended that Act to require that distribution companies provide connections to those renewable energy sources.[10] It also amended the OEB Act to include, as a condition of licences held by distributors, the requirement that distributors connect to renewable energy sources and prepare plans for the expansion of their systems to connect to renewable energy generation facilities. [11]

The practical effect of these legislative provisions is this: the OEB must approve an application for approval of rates which reflect the cost of a LDC connecting to a

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8 *Ontario Energy Board Act*, 1998 S.O. 1998, C. 15 Schedule B, s. 27
9 *Electricity Act, 1998* S.O. 1998, C. 15, Schedule A, s. 25.35
10 *Electricity Act, 1998* S.O. 1998, C. 15, Schedule A, s. 25.36
11 *Ontario Energy Board Act*, 1998 S.O. 1998, C. 15 Schedule B, s. 72(2.1)

renewable energy generation facility. The OEB must do so regardless of whether, absent the legislation, it would have found those rates just and reasonable.

To put the matter succinctly, the use of directives derogates from the ability of the OEB to carry out its core public policy obligations of setting just and reasonable rates that protect the interests of ratepayers and utilities. The OEB is, as far as the government's green energy policy is concerned, now little more than a policy implementation body.

The OEB itself has no statutory mandate to make policy. It differs, in that respect, from, for example, the CRTC. Courts have recognized that, to properly and efficiently carry out their operations, regulatory agencies can set guidelines for how they will carry out their operation and, indeed, guidelines as to how they will apply tests like "just and reasonable" in the cases that come before it. The courts have also said, however, that regulatory agencies cannot be bound by these guidelines, and must consider each case on the evidence before it, and on the merits of the case. The use of guidelines is not, in this view, inconsistent with the independence of the regulatory agency.[12]

What is problematic is the OEB's use of guidelines to disguise what amounts to the making of a policy, or the implementation of a government policy. The structure

[12] See, for example, *Attorney General of Canada v. Inuit Tapirisat of Canada*, [1980] 2 S.C.R. 735

of section 72 of the OEB Act bears careful analysis in this context. The section requires LDCs to provide priority access to their distribution systems for renewable energy generation facilities, in the manner mandated by the Board. The section also requires LDCs to prepare plans, again in the manner mandated by the OEB, for the expansion of their distribution systems to accommodate the connection of renewable energy generation facilities.

In the absence of a directive, there is nothing in the OEB Act which requires the OEB to develop plans for the required connections. But the OEB has done so, to the extent of issuing detailed guidelines on what the green energy plans are to consist of.

Indeed, the OEB has gone even further. In order to facilitate the implementation of the government's green energy initiatives, the OEB has established a number of new accounting and cost recovery mechanisms.[13] While the OEB has, in most instances, said that the use of those cost recovery mechanisms will be subject to an after-the-fact review of the prudence of the LDC's use of the mechanisms, the reality is that in almost all instances the Board will approve the utility's actions in order to facilitate the implementation of the government's green energy policy.

[13] EB-2009-0152, Report of the Board on "The Regulatory Treatment of Infrastructure Investment in Connection with the Rate-Regulated Activities of Distributors and Transmitters in Ontario", January 15, 2010.

Despite appearances to the contrary, these comments are not a criticism of what the OEB has done. The OEB's actions follow the logic of the green energy legislation and are, no doubt, realistic in the face of the threat of the issuance of a directive. The OEB has invited stakeholders to participate in the development of its guidelines, and it has been careful to state that all expenditures, by LDCs, in green energy initiatives will be subject to a prudence review as part of the determination of just and reasonable rates. But, with respect, this is largely window dressing. The Board is simply implementing government policy and will do little of substance to delay or subvert that implementation.

In all of these actions, the OEB has surrendered its role as an independent regulator. That was a role that was envisaged by the legislature, when it enacted the OEB Act and it is a role which has been recognized, by the courts, as an important support for the functioning of a well-ordered and just society.

As noted above, the courts have recognized the expertise of the OEB and, as a result, are reluctant to interfere with its decisions. This is part of a larger judicial trend towards deference, encapsulated in the courts' decisions on the issue of standard of review. It is ironic that the courts would defer to the decisions of the OEB, based on their respect for the OEB's independence and expertise, when the

OEB has, at least as far as green energy initiatives are concerned, largely surrendered that independence.

How, then, does the role of the OEB fit into a model of effective governance? The existence, and the exercise, of a broad discretion to set just and reasonable rates is arguably inconsistent with effective governance, since no stakeholder can predict how the OEB will react to a particular set of circumstances coming before it. The OEB may alleviate that concern by the use of policies, and by a track record of consistent decision-making. There is, whoever, never any guarantee that the OEB will make a decision that a utility, or its investors, like. The THESL Decision of the Court of Appeal, referred to above, is a case in point.

But the question must be asked whether the diminished role of the OEB, as the facilitator of the government's green energy policy, is a better model of effective governance. In one sense it clearly is. There is a clear policy, clearly delineated, and consistently applied. Those would seem to be characteristics of good governance. The question, however, is whether that good governance is purchased at the cost of the independence necessary to protect the public interest.