THE ROLE OF GOVERNMENT – BACKGROUND PAPER

Robert B. Warren

WeirFoulds LLP

I Introduction

In order to provide some context for the discussion in this session, this paper examines one example of government intervention in the energy sector. Between 1998 and the present, the Ontario government intervened frequently, using a variety of instruments, in the energy sector. It did so using three principal mechanisms: legislation, directives and policies. So frequent and so detailed was the government's intervention in the sector that Ontario has become a kind of laboratory within which to assess the proper role of government.

Because a major focus of the government's involvement was its renewable energy initiative, that will necessarily be a major focus in this paper. However, the paper is not an attempt to revisit the merits or otherwise of that, or of any other, government initiative. Rather, it is an attempt to provide a context for the discussion by examining how, and for what purpose, and to what effect, the Ontario government has intervened in the energy sector.

The paper is in four parts:

1. In the first, I review the actions the Ontario government has taken in the electricity sector from 1998 to the present;

2. In the second, I examine the effects of those actions;

3. In the third, I outline some possible arguments for and against government intervention;

4. In the fourth, I list some questions which the history of the Ontario government's activities in the sector gives rise to.

II Ontario Government Intervention in the Energy Sector, 1998 to Present

As noted above, government intervention in the electricity sector employed three principal mechanisms. In the next section, I examine the legislation. In the following section, I examine policies and directives.

(a) Legislation

The provincial Auditor General's 2011 Report provides a useful summary of major government legislation in the electricity sector from 1998 to 2011. Reproduced below is the summary from that Report.

Figure 2: Government Legislation and Policy Changes in the Electricity Sector, 1998–2011
Prepared by the Office of the Auditor General of Ontario

Legislation/Policy and Year	Impact
Energy Competition Act, 1998	• Breaks up Ontario Hydro into several companies • Ontario Energy Board (Board) assumes responsibility for regulating three Ontario Hydro successor companies and local distribution companies
Electricity Pricing, Conservation and Supply Act, 2002	• Caps electricity price at 4.3¢/kWh, for two years, effective May 1, 2002 • Freezes transmission and distribution rates until at least May 1, 2006
Ontario Energy Board Consumer Protection and Governance Act, 2003	• Creates a management committee to oversee Board activities • Strengthens Board powers to protect and educate consumers
Ontario Energy Board Amendment Act (Electricity Pricing), 2003	• Replaces 4.3¢/kWh price cap as of April 1, 2004, with 4.7¢/kWh for the first 750 kWh/month, and 5.5¢/kWh beyond 750 kWh/month • Allows local distribution companies to recoup costs by lifting freeze imposed by ***Electricity Pricing, Conservation and Supply Act, 2002***
Electricity Restructuring Act, 2004	• Amends ***Ontario Energy Board Act, 1998*** and ***Electricity Act, 1998*** • Board assumes responsibility for Market Surveillance Panel • Establishes Ontario Power Authority (OPA) to ensure adequate, reliable, and secure electricity supply in Ontario
Minister's Directive to Board (2004)	• Develops smart-meter implementation plan
Minister's Directive to OPA (2006)	• Develops plan to replace coal-fired generation with cleaner sources as soon as possible
Green Energy and Green Economy Act, 2009	• Establishes responsibility for Board and other entities to achieve objectives of conservation, promotion of renewable energy, and technological innovation
Harmonized Sales Tax (2010)	• Adds 8% to total electricity bill effective July 1, 2010
Energy Consumer Protection Act, 2010	• Requires that Ontarians be provided with the information they need about electricity contracts and prices and that consumers be protected by fair business practices effective January 1, 2011
Ontario Clean Energy Benefit (2011)	• 10% discount on electricity bill for five years from January 1, 2011

Rather than review each of the items on the Auditor General's summary, I will examine the legislation which, in my view, had the most significant impact on the energy sector.

1. *Energy Competition Act, 1998*

This legislation was the outgrowth of the MacDonald Commission's examination of the electricity sector. Its stated objective was to facilitate competition in the generation and sale of electricity and to facilitate a smooth transition to competition. It effected a wholesale

[1] 2011 Annual Report of the Office of the Auditor General of Ontario, p. 71

restructuring of that sector. It created the Independent Market Operator, the predecessor to the Independent Electricity System Operator ("IESO"), and directed the creation of rules for the operation of the new market. It mandated the breakup of Ontario Hydro into generation, distribution, and transmission arms. It required local electricity distributors ("LDCs") to become OBCA corporations, entitled to earn a rate of return, but whose rates would be subject to Ontario Energy Board ("OEB") approval.

The legislation was an attempt to create a competitive market. The hope was that competition would drive efficiencies in the generation, transmission and distribution of electricity, and reduce rates. Included in the policy objectives was the aim to have ratepayers pay the true cost of power.

2. ***Electricity Pricing, Conservation and Supply Act, 2002***

This legislation capped electricity prices for two years. It also froze transmission and distribution rates until 2006.

The effect of the legislation was, in substantial measure, to undo what the 1998 legislation tried to accomplish. By fixing prices for electricity, it undermined the experiment in an electricity market. It also effectively precluded LDCs, and HONI, from making necessary investments in infrastructure.

3. ***Ontario Energy Board Amendment Act (Electricity Pricing), 2003***

This legislation undid, in part, what the 2002 legislation did by increasing the price for electricity and allowing LDCs to begin recapturing some of the revenue they had lost as a result of the freeze in prices. One of the stated objectives of the legislation was to better reflect the true cost of electricity and thereby encourage conservation.

4. ***Electricity Restructuring Act, 2004***

This legislation effected, for the second time in six years, a significant restructuring of the electricity sector. Responsibility for the acquisition of electricity supply, and for long-term planning, was devolved onto the newly-created Ontario Power Authority ("OPA"). At the same time, however, the legislation granted the government the power to issue directives to the OPA, thereby creating a mechanism through which the provincial government could directly intervene in the planning process. Included in the power to issue directives was the power to set the goals for, among other things, the power to be obtained through conservation measures and from renewable energy sources. The manner in which, and the extent to which, the government has used this directive power is examined further below.

As a result of this legislation, the OPA began its electricity supply planning process. That process, both expensive and time-consuming, was brought to an abrupt halt with the introduction of the *Green Energy and Green Economy Act, 2009.*

It is interesting to note that, in introducing the legislation, the then-Minister of Energy, Dwight Duncan, stated that "It's crucial that private investors be allowed to enter Ontario and support the construction of the thousands of megawatts of electricity that we need to build over the next 15 years. We must send a clear and unambiguous message that Ontario's electricity sector is a great place in which to invest." One of the questions this session addresses is whether government investment in the sector has made Ontario an attractive place to invest and, more broadly, whether the public and private sectors can effectively co-exist in the energy sector.

5. ***Green Energy and Green Economy Act, 2009***

This legislation represented the government's wholesale embrace of renewable energy generation. It mandated the creation of the FIT tariff program, through which the government underwrote the cost of renewable energy generation activities. In doing so, the government fulfilled Mr. Duncan's promise to make Ontario an attractive place, at least for some, in which to invest in the electricity sector.

As noted below, the 2009 Act also substantially increased ministerial directive powers, thereby reducing the scope of OPA and OEB authority over major dimensions of electricity policy.

6. ***Ontario Clean Energy Benefit (2011)***

In the face of the forecast significant increases in electricity prices, the government introduced a 10% discount on ratepayers' electricity bills. The government was, in effect, attempting to offset the impact of the increasing electricity costs driven by its own green energy initiative. One of the effects of the clean energy benefit was to disguise the true cost of electricity.

Each of these Acts reflects different motives or drivers for government involvement in the electricity sector.

- The 1998, 2004 and 2009 legislation reflected the government's desire to fundamentally re-shape the electricity sector.
    - the 1998 legislation was to make the sector, for the first time, competitive, by breaking with the historic model of electricity-at-cost supplied solely by the government.
    - the 2004 legislation was to re-shape the market by, among other things, placing greater emphasis on conservation.
    - the 2009 legislation was to, again, re-shape the market by requiring the development of renewable energy sources.
- The 1998 legislation reflected a desire to get the government out of the electricity sector, to the extent possible.
- By contrast, the 2004 and 2009 legislation embodied a model of centralized planning and control:

- Government created and controlled instruments of planning
- Government provided subsidies for market

- The 2002, 2003 and 2011 legislation inserted the government into the centre of the electricity market by controlling electricity prices and setting rules for capital investments.

That the legislation reflected contradictory impulses of the government towards the electricity sector is one of the features influencing any analysis of the role of government in the energy sector. The constant in all of the legislation is that government involvement had material effects on the sector, another factor influencing the analysis of the role of government.

The cumulative effect of the legislation, and in particular of the directive powers contained in the 2004 and 2009 Acts, was to place the government in control of the electricity sector. The Auditor General's 2011 Report observed, of the 2009 legislation, that "the government created a process to expedite the development of renewable energy by providing the Minister with the authority to supersede many of the government's usual planning and regulatory oversight processes"[2]. That observation could stand as a useful summary of the effect of all of the legislation from 2004 on.

(b) Policies and Directives

As noted above, each of the 1998, 2004 and 2009 Acts gave the power to the Minister to issue directives to the OPA and/or the OEB. With each succeeding Act, the scope of the power became more extensive.

The 2004 legislation gave the Minister the power to issue directives to the OPA and to set the goals to be achieved by electricity from renewable energy sources and by the development and implementation of conservation measures.

The 2009 legislation gave the Minister the power to issue directives to the OPA to enter into contracts, whether on a competitive basis or otherwise, to procure supply from renewable energy sources at pricing or other economic factors determined by the Minister.

The government has used these directive powers extensively. From March 2005 to date, the government has issued some 65 directives to the OPA. Among other things, those directives have determined the content of the OPA's FIT tariff program and set conservation targets for the OPA to achieve. In the same period, the government has issued some 13 directives to the OEB, requiring the OEB to, among other things, establish conservation targets for LDCs and implement the government's smart meter program.

The sheer number and frequency of directives to the OPA reflects the extent of the government's intervention in the electricity sector. In addition, the directives have reflected changes in

[2] 2011 Annual Report of the Office of the Auditor General of Ontario, p. 89

government policy. For example, between November of 2006 and 2011, there were some six (6) changes to the FIT program from its first iteration to, effectively, its cancellation.

The table below, taken from Guy Holburn's paper "Assessing and Managing Regulatory Uncertainty in Renewable Energy: Contrasts between Canada and the United States" [3], illustrates both the frequency of the government's intervention in the renewable energy program and the inconsistency of that intervention.

Year	Energy Minister	Feed-in Tariffs for Renewable Energy	Renewable Capacity Targets	Renewable Capacity Procurement
2004	Dwight Duncan		• Government announces targets for 1350 MW of renewable energy capacity by 2007 and 2700 MW by 2010	• Ministry initiates procurement of 300 MW
2005	Dwight Duncan	• Minister directs Ontario Power Authority to develop feed-in tariff program	• Minister requests Ontario Power Authority to recommend targets for new renewable energy capacity by 2015, 2020 and 2025	• Minister announces 200 MW RfP for projects less than 20 MW • Minister directs Ontario Power Authority to procure 1000 MW for projects greater than 20 MW
2006	Donna Cansfield	• Ontario Power Authority implements feed-in tariff program		• Ontario Power Authority postpones 200 MW RfP announced in 2005
	Dwight Duncan		• Minister directs the Ontario Power Authority to create a long term energy plan that includes renewable capacity targets of 2700 MW by 2010 and 15700 MW by 2025	
2007	Dwight Duncan	• Minister directs Ontario Power		• Minister directs Ontario Power

[3] Guy LF Holburn, "Assessing and Managing Regulatory Risk in Renewable Energy: Contrasts Between Canada and the United States" (2012) 45 Energy Policy 654, at 661.

		Authority to modify feed-in tariff program to include small hydro projects in northern Ontario		Authority to procure 2000 MW of projects greater than 10MW to become operational by 2015, and to initiate the first tranche of RfPs by year's end for 500 MW
2008	Gerry Phillips	• Feed-in tariff program suspended		
	George Smitherman		• Minister suspends long term energy plan; directs the Ontario Power Authority to increase renewable energy capacity targets	•
2009	George Smitherman	• Minister directs Ontario Power Authority to re-instate feed-in tariffs for biogas projects only • Minister directs Ontario Power Authority to create new feed-in tariff program		• Minister directs OPA to include specified domestic content requirements, varying by renewable source in feed-in tariff contracts
2010	Brad DuGuid	• Ontario Power Authority announces new feed-in tariff program and rates • Feed-in tariff rates reduced for ground-mounted solar power • Feed-in tariff program abandoned for off-shore wind	• Minister announces a new long term energy plan that includes new renewable energy capacity target of 10,700 MW for 2018. Previous 2025 target dropped	

Since 1999, the Minister has issued some twenty (20) directives to the OEB. Four, in particular, are worth noting. One required the Board to establish electricity conservation and demand management ("CDM") targets to be met by licenced electricity distributors and to issue a code pertaining to CDM. A second required the Board to develop and provide to the Minister of Energy an implementation plan for the achievement of the government's smart meter targets.

Neither directive allowed the OEB to assess whether the CDM targets or the smart meter targets were in the public interest. Implementing both had impacts on electricity rates. The OEB was thus put in the position of having to design and implement plans, the reasonableness of the cost consequences of which it was, as the independent regulator, then supposed to assess.

As noted above, the green energy legislation resulted in what amounts to a complete take-over of the planning and implementation mechanisms in one area of the energy sector. Included in that legislation was a provision requiring the OEB to calculate and collect the so-called "special purpose charge", a fund to cover the cost of certain government conservation measures. The government had, in this instance, reduced its independent regulator to a collection agency.

III The Effects of the Government's Actions

Each of the Acts discussed above had direct and indirect cost consequences. The 1998 legislation resulted in significant restructuring costs. The 2002 legislation, by freezing rates and precluding LDCs from recovering the costs of infrastructure spending, had long-term effects in delaying capital spending, effects being felt to this day as LDCs try to catch up on foregone investments in infrastructure. The directives issued under the green energy legislation resulted in the larger subsidies paid under the FIT tariff program.

The overall effect of the government's intervention in the electricity sector has been a material increase in electricity prices. The Ministry of Energy forecast, in November of 2010, that a typical residential electricity bill would rise about 7.9% annually over the succeeding 5 years, with 56% of that increase due to investments in renewable energy. That was on top of an increase of about 26% between 2008 and 2010.

Rising costs are the most visible effect of government intervention. Less visible is the effect on business and investor confidence. Survey research by the Ivey Business School has found that policy stability is an important attribute of the policy environment in private sector investment decisions, and that Ontario is rated as having the most unstable policy environment for renewable energy out of all provinces.

Still less viable is the effect of directives on the independence, and the perceived independence, of government agencies. For example, the legislature created the OEB to act as an independent authority to protect the public interest. Requiring the OEB to carry out government directives which have consequences for utility rates is arguably inconsistent with that independence.

It would be unfair, however, to describe the effects of government intervention as wholly malign. Rising electricity prices may well be a necessary effect of achieving an important public policy objective, for example, moving electricity generation away from reliance on fossil fuels and towards renewable resources. Indeed, one of the stated objectives of several government

initiatives was to have ratepayers pay the true cost of power as an incentive to reduce electricity consumption.

Governments are elected to pursue what they see as important public policy objectives. The government introduced legislation, and issued directives, that fostered the development of renewable energy sources and mandated conservation targets. The government believed that these were laudable objectives, and that achieving them was beneficial.

IV The Role of Government

At one level, the government plays an essential role in the energy sector. It designs the regulatory structure for the sector, creating institutions, such as the OEB and the IESO, that are essential to its operation. It also enacts rules to protect consumers from potential abuses by monopoly transmitters and distributors.

It is also the case that governments play an essential role in designing and implementing certain projects that are essential to the sector. Nuclear reactors could not be built without government involvement. The Lower Churchill Falls could not be developed without government involvement. And, as another session will explore, federal government involvement will be an essential pre-condition to the development of a national power grid.

There is also an argument that, to fulfill its obligation to protect vulnerable consumers, governments must from time to time intervene to limit price increases. And, since electricity plays such a critical role in industrial and commercial activity, there is an argument that government has to intervene to manipulate prices in order to protect and enhance that activity.

Questions about the proper role of government should not be distorted by considerations of whether a particular intervention was executed well. There is a growing body of research which demonstrates that the Ontario government's renewable energy initiative, however well intentioned, was poorly planned and badly executed. That should perhaps not be an argument against the government undertaking the initiative at all.

Balanced against these considerations is the evidence that frequent government intervention, based on contradictory impulses, erodes investor confidence and makes long-term planning and investment difficult and very costly. Simply put, the argument is that government involvement has increased, unnecessarily, the cost of electricity and the uncertainty that plagues the sector.

V Questions

Against this background the session will address the following questions:

(a) How should, or even should, the elected government play a role in the energy sector?

(b) What are the limits of that role? For example, should the government be limited to setting broad policy objectives in legislation that agencies (such as the OEB and OPA) then implement through rules and orders? Should ministers have directive authority?

(c) Should the government play any role in determining electricity prices? Or should independent agencies have sole jurisdiction?

(d) What are the consequences for the economic and physical performance of the energy sector of significant government intervention – through frequent legislation and ministerial directives? What would be the consequences of strengthening the jurisdiction, and independence of, agencies and boards?

28/03/13

5310724.3