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FIT to be Untied

How a new provincial government can unravel Feed-In Tariff electricity contracts

Bruce Pardy

An Ontario election is fast approaching. Renewable energy contracts made under the Liberal government's nine-year-old Feed-In Tariff program have been expensive[1] and contentious from the outset. Three distinct questions arise. Could a new government legally change or cancel existing contracts? Could it do so without paying compensation? If so, should it? This Commentary addresses the first two questions. If done with express legislation, a new provincial government would have the legal ability to cancel, amend or impose royalties on FIT contracts[2] without compensating generators, at least in the case of domestic parties to those contracts. The Canadian constitutional system provides every government with the ability to pursue its own legislative agenda, even where it may conflict with contractual obligations made under a previous regime.

"A newly elected Ontario legislature could terminate or amend FIT contracts as it chose."

WHAT CAN BE DONE?

Any provincial legislature can cancel or change contracts made by a previous government. A newly elected Ontario legislature could terminate or amend FIT contracts as it chose. It could do so without triggering contractual compensation clauses and without otherwise becoming liable to pay compensation. Alternatively, or in addition, it could impose royalties or other taxes on amounts payable under those contracts.

However, the provincial government has the absolute ability to deny compensation only to domestic parties, both corporate and individual. Foreign entities that hold FIT contracts may be able to demand compensation under NAFTA[3] or other foreign investment protection regimes regardless of what any newly enacted provincial statute might say. Cancelling the right to revenue guaranteed under a government contract, even if done by statute, could amount to expropriation of an investment under those regimes, triggering a right to compensation.[4] If the cancellation amounts to

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[1] Office of the Auditor General of Ontario, *Annual Report 2015*, 214-229.

[2] Although the focus of this *Commentary* is renewable energy contracts, the analysis applies to contracts of any kind. See Bruce Pardy, "Cancelling Contracts: The Power of Government to Unilaterally Alter Agreements," October 2014, *Fraser Institute Research Bulletin*, available at <https://www.fraserinstitute.org/sites/default/files/cancelling-contracts-power-of-governments-to-unilaterally-alter-agreements.pdf>.

[3] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289 (entered into force 1 January 1994) [NAFTA]. Chapter 11 of NAFTA imposes obligations on the Canadian, US and Mexican governments, and gives private investors the ability to enforce NAFTA's investment provisions through the Chapter 11 arbitration process. Since NAFTA is currently being renegotiated, it is impossible to say whether the present version of these rules will still be in place when a future Ontario government considers its options.

[4] Nick Gallus, "The 'fair and equitable treatment' standard and the circumstances of the host state" in Chester Brown and Kate Miles, *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011), 223 at 224; Gordon E. Kaiser, "Windstream Energy: NAFTA Arbitrators Order Canada to Pay $25 Million" (2017) 5 *Energy Regulation Quarterly* 67.

a "legal nationalization," compensation would be payable only for present but not future loss.[5] The federal structure of the Canadian constitution complicates responsibility. While the provinces have constitutional jurisdiction over electricity and intra-provincial contracts,[6] the federal government is the signatory to international investment treaties and thus is technically the responsible party in case of a breach. A more fulsome analysis of the rights of foreign investors is beyond the scope of this Commentary, the balance of which will focus on the legal power of governments to cancel contracts held by domestic companies and individuals.

WHY GOVERNMENTS CAN CANCEL CONTRACTS

Provincial and federal governments have the legal ability to change and cancel contracts with domestic parties because of the principle of legislative supremacy, a feature of the Westminster parliamentary system and the Canadian Constitution. Legislative supremacy means that legislatures can enact laws of any kind that are within the subject matter of their jurisdiction, including laws that cancel contracts, confiscate property or cause hardship to innocent parties.[7]

"Ironclad contractual guarantees cannot supersede the powers of a future legislature."

The ability of legislatures to pass any law as they please is restrained only by constitutional limitations. Under the Canadian Constitution, provinces have jurisdiction over electricity production as well as property and civil rights.[8] Unlike in the United States,[9] the *Canadian Charter of Rights and Freedoms*[10] does not protect property or contract rights. The Supreme Court of Canada has acknowledged that unwritten constitutional principles, including the rule of law, are "capable of limiting government actions,"[11] but it has rejected the argument that breaching rule of law principles invalidates a statute.[12] In particular, the Court has rejected the notion that statutes must be prospective in application.[13]

When legislation explicitly cancels or amends contracts, the terms of those contracts do not matter. Governments can provide ironclad guarantees that contracts will be honoured, but such guarantees cannot supersede the power of a future legislature to do otherwise. Where there is conflict between legislation and the provisions of a contract, the legislation prevails.

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[5] "In assessing present loss, there is a need to take into account a whole range of factors such as the nature of the past relationship between the parties, the extent of the profits made by the foreign investor, the duration of the investment, the legitimate expectations of the foreign investor and other like factors." M. Sornarajah, *The International Law on Foreign Investment* 4th ed. (Cambridge University Press, 2017) at 530.

[6] *Constitution Act*, 1867 (UK), 30 & 31 Vict, c3, reprinted in RSC 1985, App II, No 5, ss 91, 92, 92A.

[7] "...the Legislature within its jurisdiction can do everything that is not naturally impossible, and is restrained by no rule human or divine. If it be that the plaintiffs acquired any rights, which I am far from finding, the Legislature had the power to take them away. The prohibition, 'Thou shalt not steal,' has no legal force upon the sovereign body." Mr. Justice Riddell in *Florence Mining Co v Cobalt Lake Mining Co* [1908] OJ No 265 at para 18, 12 OWR 297 (HC); affirmed [1909] OJ No 196 at para 56, 18 OLR 275 (CA); affirmed (1910), 43 OLR 474 (UKPC).

[8] *Constitution Act*, 1867 (UK), 30 & 31 Vict, c3, reprinted in RSC 1985, App II, No 5, ss 91, 92, 92A.

[9] US Const amend V: ". . . nor shall private property be taken for public use, without just compensation." Also note US Const art I, § 10: "No state shall . . . pass any law impairing the obligation of contracts." This clause does not apply to the federal congress. The extinguishment of a contractual right against the government amounts to a taking of property.

[10] Part I of the *Constitution Act*, 1982, being Schedule B to the *Canada Act* 1982 (UK), 1982, c 11.

[11] *Babcock v Canada (Attorney General)*, [2002] 3 SCR 3 at para 54, McLachlin CJC.

[12] *British Columbia v Imperial Tobacco Canada Ltd*, [2005] 2 SCR 473 [*Imperial Tobacco*]. Also, see *Authorson v Canada (Attorney General)*, [2003] 2 SCR 40.

[13] *British Columbia v Imperial Tobacco Canada Ltd*, [2005] 2 SCR 473 at para 69: "Except for criminal law, the retrospectivity and retroactivity of which is limited by s. 11(g) of the *Charter*, there is no requirement of legislative prospectivity embodied in the rule of law or in any provision of our Constitution."

HOW GOVERNMENTS MUST CANCEL CONTRACTS TO AVOID PAYING COMPENSATION

A government may cancel or change contracts without triggering a right to compensation only by express legislation. Any attempt to do so by administrative order would fail to avoid the contract's robust compensation clauses. Only legislation that explicitly denies and eliminates the right to compensation would be effective. Any ambiguity in the statute would defeat this purpose. Courts interpret expropriating statutes to implicitly require the payment of compensation unless the statute is explicit that no compensation shall be paid.[14]

In the case of FIT contracts, a new Ontario government would have to make a host of choices in designing such legislation. Cancel the contracts or alter their terms? If the latter, then in what respect and by how much? For example, the price paid for electricity in the contract could be changed or a different pricing mechanism could be established. The price could be tied to the "wholesale market price" for power, or an entirely different formula could be applied. All of these choices, and more besides, could be accommodated in legislation.

Alternatively, a royalty or other tax[15] could be imposed[16] to claw back guaranteed FIT contract payments. Sections 53 and 90 of the *Constitution Act 1867* require taxes to originate with the provincial legislature[17] rather than arise as a policy decision without statutory authority[18] unless they can be characterized as "regulatory charges."[19] A new tax could require a referendum or legislated exemption under the *Taxpayer Protection Act 1999*.[20] Furthermore, compensation clauses in the contracts would still apply unless legislation expressly nullified those terms.

"Compensation clauses will apply unless legislation expressly says otherwise."

In summary, the legal principle is simple but unforgiving. While governments can cancel or change contracts that lie within their constitutional jurisdiction,[21] they must do so with precisely worded legislation. If the statute is silent or ambiguous, courts will determine that compensation is payable in

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[14] *Manitoba Fisheries Ltd. v. The Queen*, [1979] 1 SCR 101; *Wells v Newfoundland*, [1999] 3 SCR 1999. [2003] 2 SCR 40.

[15] The province would clearly have the jurisdiction to impose such taxes: *Constitution Act 1867*, section 92A(1) and (4).

[16] In *Charanne v Kingdom of Spain*, Case No 062/2012, Energy Charter Treaty, 21 January 2016, an arbitration panel dismissed the claim for compensation made by foreign companies against the government of Spain for imposing limits and charges on solar power contracts. "As in Ontario, the Spanish program consisted of feed-in tariffs for a 25-year period. Aside from the attractive rate for the power, the program allowed the claimants to distribute all of the energy produced to the grid. Subsequently the Spanish government amended the program to limit the amount of electricity that could be supplied and added a new charge for grid access." Gordon E. Kaiser, "Windstream Energy: NAFTA Arbitrators Order Canada to Pay $25 Million" (2017) 5 *Energy Regulation Quarterly* 67 at 68.

[17] Section 53 of the *Constitution Act*, *1867* prohibits taxation without representation: only the House of Commons can decide to tax. Pursuant to section 90 of the *Constitution Act*, *1867*, section 53 applies to the provinces. Therefore, provincial taxes must originate in the legislature: *620 Connaught v Canada (Attorney General)*, [2008] 1 SCR 131 at paras 4-5 and 46; *Re Eurig Estate*, [1998] 2 SCR 565 at paras 28-32; *Westbank First Nation v. British Columbia Hydro and Power Authority,* [1999] 3 SCR. 134 at para 19.

[18] The rule that taxes must originate in the legislature does not mean that the power to tax cannot be delegated. Instead, it means that a tax cannot arise as an initiative of the executive branch without authorization of the legislature, or arise incidentally in delegated legislation. A delegation of taxing power is valid if express and unambiguous language is used: *Ontario English Catholic Teachers' Assn. v. Ontario (Attorney General)*, [2001] 1 SCR 470 at para 74 per Iacobucci J., "The animating principle is that only the legislature can impose a new tax *ab initio*. But if the legislature expressly and clearly authorizes the imposition of a tax by a delegated body or individual, then the requirements of the principle of 'no taxation without representation' will be met."

[19] *Westbank First Nation v. British Columbia Hydro and Power Authority*, [1999] 3 SCR 134 at para 44.

[20] S.O. 1999, c. 7, Sched. A.

[21] Courts have on occasion declared legislation that cancelled contracts to be unconstitutional on the grounds that the legislature in question lacked jurisdiction over the subject matter rather than because the legislation cancelled contracts per se. In *Reference Re Upper Churchill Water Rights Reversion Act 1980*, [1984] 1 SCR 297, the Supreme Court considered legislation enacted by the Newfoundland legislature cancelling a contract for the supply of power to Hydro-Quebec. The Court held that the province did not have the territorial jurisdiction to legislate on inter-provincial contractual rights. The Court did not question a provincial legislature's power to expropriate contractual rights within the province.

accordance with existing terms. Delegating authority to the executive branch to develop regulations that contain the substance of the policy will not suffice.

SHOULD A NEW GOVERNMENT CANCEL FIT CONTRACTS AND LIMIT COMPENSATION?

While it is clear that legislatures have the power to cancel contracts, whether they should do so is contentious. Examples of such statutes can be found, [22] but it is not a step that Canadian legislatures often take.[23] Whether such legislation would have detrimental effects upon overall business confidence or economic conditions is not a legal question. Friedrich Hayek wrote that consistency and predictability are features of the rule of law, which calls for rules that are "fixed and announced beforehand,"[24] allowing people to govern their affairs with the expectation that those rules will be followed. However, fixed rules are not always consonant with democratic principles and the constitution does not impose a fixed-rules requirement on Canadian legislatures. Each new government has the ability to pursue its own policies without restriction from the previous regime. If it were not so, any government could govern beyond its democratic mandate by making contracts far into the future to establish policies that its political rivals might oppose. As Mr. Justice Sopinka of the Supreme Court of Canada stated in *Re Canada Assistance Plan*:

> "[I]t is fundamental to our system of government that a government is not bound by the undertakings of its predecessor. .... I adopt the words of King C.J. of the Supreme Court of South Australia, in banco, in West Lakes Ltd. v. South Australia (1980), 25 S.A.S.R. 389, at p. 390, a case strikingly similar to this one: 'Ministers of State cannot, however, by means of contractual obligations entered into on behalf of the State fetter their own freedom, or the freedom of their successors or the freedom of other members of parliament, to propose, consider and, if they think fit, vote for laws, even laws which are inconsistent with the contractual obligations.' " [25]

"Each new government has the ability to pursue its own policies without restriction from the previous regime."

When governments cancel or change contracts legislatively, they imperil the fortunes of the contracting party. That is an inherent risk of entering into contracts with a public entity. It cannot be eliminated by negotiating better terms. Those who do not wish to subject themselves to that risk should pursue business outside the public sector.

SUMMARY

Governments may make laws as they see fit, subject to constitutional limitations. No such limitations exist on cancelling renewable energy contracts. A new Ontario government may cancel or amend FIT contracts as it wishes without triggering a right to compensation (except for foreign investors) if it does so with legislation that is express and unambiguous. Measures that appear to leave existing contracts unchanged but impose royalties or other taxes must be accompanied by express statutory provisions rather than by delegating such authority to government officials. While unilateral government changes to long-term contracts may be criticized by some as unfair, the Canadian Constitution and principles of representative democracy demand that each new government be free to pursue its own policies without restrictions created by long-term contracts made by the previous regime. Cancelling long-term electricity contracts or imposing a royalty or other tax is a legitimate legal step that a newly elected government could take.

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[22] See e.g. *Re Canada Assistance Plan*, [1991] 2 SCR 525 (upholding a federal statute reducing transfer payments promised by Canada to the provinces under federal-provincial agreements); *Authorson v Canada (Attorney General)*, [2003] 2 SCR 40 (upholding a federal statute extinguishing veterans' rights to interest on funds held by the federal Crown on their behalf); *Clitheroe v Hydro One* (2009), 96 OR (3d) 203 (Sup Ct J), aff'd 2010 ONCA 458 (CA), application for leave to appeal dismissed [2010] SCCA No 316 (upholding a provincial statue extinguishing a contractual pension right); *Bacon v Saskatchewan Crop Insurance Corp*, [1999] 11 WWWR 51 (Sask CA) (upholding a statute denying compensation for statutory changes to crop insurance contracts).

[23] It is difficult to determine how many statutes have been passed in Canada to terminate or alter contracts. Courts consider the validity of such legislation only when aggrieved parties challenge its constitutionality.

[24] Friedrich A Hayek, *The Road to Serfdom* (U of Chi Press 1944) at 72.

[25] *Re Canada Assistance Plan*, [1991] 2 SCR 525 at para 64.