ENERGY REGULATION QUARTERLY

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MISSION STATEMENT

The mission of Energy Regulation Quarterly (ERQ) is to provide a forum for debate and discussion on issues surrounding the regulated energy industries in Canada, including decisions of regulatory tribunals, related legislative and policy actions and initiatives and actions by regulated companies and stakeholders. The role of the ERQ is to provide analysis and context that go beyond day-to-day developments. It strives to be balanced in its treatment of issues.

Authors are drawn from a roster of individuals with diverse backgrounds who are acknowledged leaders in the field of energy regulation. Other authors are invited by the managing editors to submit contributions from time to time.

EDITORIAL POLICY

The ERQ is published online by the Canadian Gas Association (CGA) to create a better understanding of energy regulatory issues and trends in Canada.

The managing editors will work with CGA in the identification of themes and topics for each issue. They will author editorial opinions, select contributors, and edit contributions to ensure consistency of style and quality. The managing editors have exclusive responsibility for selecting items for publication.

The ERQ will maintain a "roster" of contributors and supporters who have been invited by the managing editors to lend their names and their contributions to the publication. Individuals on the roster may be invited by the managing editors to author articles on particular topics or they may propose contributions at their own initiative. Other individuals may also be invited by the managing editors to author articles on particular topics.

The substantive content of individual articles is the sole responsibility of the respective contributors. Where contributors have represented or otherwise been associated with parties to a case that is the subject of their contribution to ERQ, notification to that effect will be included in a footnote.

In addition to the regular quarterly publication of Issues of ERQ, comments or links to current developments may be posted to the website from time to time, particularly where timeliness is a consideration.

The ERQ invites readers to offer commentary on published articles and invites contributors to offer rebuttals where appropriate. Commentaries and rebuttals will be posted on the ERQ website (www.energyregulationquarterly.ca).

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Managing Editors

Rowland J. Harrison QC and Gordon E. Kaiser

Natural gas plays a central role in various initiatives aimed at moving towards reducing carbon emissions. That role, however, sometimes appears inconsistent, indeed self-contradictory. On the one hand, as the cleanest-burning, lowest carbon-emitting of the hydrocarbon fuels, wider use of natural gas is often promoted as a "bridging fuel," particularly to replace the burning of coal. On the other hand, some plans aimed at reducing carbon emissions include the direct reduction in natural gas usage itself. For example, as Christopher Bystrom and Madison Grist report in the lead article in this Issue of *Energy Regulation Quarterly* on "The Future of Gas Utilities in a Low Carbon World: Canada's First Public Utility-Administered Green Innovation Fund," British Columbia's CleanBC Plan legislates a 40 per cent reduction in natural gas usage over the next decade, and encourages electrification. Such plans will no doubt present many issues for energy regulators, as illustrated by the authors' discussion of the recent approval by the British Columbia Utilities Commission of FortisBC Energy Inc.'s Clean Growth Innovation Fund to be funded by customers and administered by the utility from 2020 to 2024.

The direct and immediate impact of the 2016 Fort McMurray was devastating. It remains the costliest natural disaster in Canadian history — and the fallout continues in the energy regulatory arena. Ian Mondrow explains in "The Fort McMurray Wildfire Cases: Life After *Stores Block*," which analyzes the different outcomes in two decisions by the Alberta Utilities Commission addressing requests by ATCO Electric Ltd. (AEL) for recovery of the undepreciated costs of assets damaged or destroyed in the Fort McMurray fire and the contemporaneous Wood Buffalo National Park fire.

Entry into force on July 1, 2020 of the "new NAFTA" was an important milestone in Canada–U.S. trade relations. The implications for the energy industry were analyzed in the last issue of *ERQ* in "Update: NAFTA 2.0: Drilling Down – The Impact of CUSMA/USMCA on Canadian Stakeholders."[1] In this issue of *ERQ*, Gordon Kaiser (co-Managing Editor of *ERQ*) discusses the significance for energy investors of the abolition by Chapter 11 of the new Agreement and concludes that it may not turn out to be that significant.

In the latest of his periodic contributions, bringing to *ERQ* commentaries on U.S. developments of interest to the Canadian energy regulatory community, Scott Hempling discusses the question "US Energy Mergers: Is "No Harm" the Right Test?"

The "honour of the Crown" and the duty to consult continue to play critical roles in the regulatory review of resource development projects, particularly energy developments. In "Resource Projects and the Honour of the Crown," Martin Ignasiak, Sander Duncanson and Jesse Baker examine two recent decisions. The first, by the Alberta Court of Appeal, found that the Alberta Energy Regulator (AER) improperly failed to consider the honour of the Crown separate from the duty to consult on a proposed oil sands project. The second, by the Nova Scotia Supreme Court found that provincial Minister of Environment improperly failed to consult on asserted Aboriginal rights and title beyond the scope of the physical impacts of a proposed gas project.

Not all issues relating to relations with Indigenous peoples and relevant to energy regulators arise from the duty to consult however. In commenting on a recent decision

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[1] John M. Weeks et al. "Update: NAFTA 2.0: Drilling Down – The Impact of CUSMA/USMCA on Canadian Stakeholders" (2020) 8:2 Energy Regulation Q 20.

of the Manitoba Court of Appeal overturning a decision of the Manitoba Public Utilities Board, Patrick Duffy comments that the decision "raises the fascinating question of how long-standing principles of utility regulation should be interpreted and applied in light of the recognized need to advance reconciliation between Indigenous and non-Indigenous peoples."

The final case comment in this issue of *ERQ*, by Marie Buchinski and Stephanie Ridge, reviews a recent decision of the Canada Energy Regulator (CER) denying an application by NOVA Gas Transmission Ltd. (NGTL) for leave to abandon facilities that are part of NGTL's extensive system of pipelines and facilities in Alberta. While the decision was specific to the NGTL application, the authors note that it provides guidance to all proponents who may be considering applications for leave to abandon CER-regulated facilities. Furthermore, the decision is of interest as observers monitor the evolution of the CER as successor to the National Energy Board. ■

THE FUTURE OF GAS UTILITIES IN A LOW CARBON WORLD: CANADA'S FIRST PUBLIC UTILITY-ADMINISTERED GREEN INNOVATION FUND

*Christopher Bystrom and Madison Grist**

INTRODUCTION

Natural gas distributors in Canada are under increasing pressure to reduce greenhouse gas (GHG) emissions. Policies at all levels of government impose ambitious GHG emission reduction targets that directly call for reduced use of natural gas. For example, the CleanBC Plan legislates a 40 per cent reduction over the next decade, and encourages electrification.[1] Municipalities have equally imposed stringent decarbonization goals.[2] While these policies pose an existential threat to natural gas distributors, they also present an opportunity for utilities to invest, innovate, and be a part of the solution. The ability to turn this threat into an opportunity, however, depends on the success of new innovative technologies and approaches that will allow a gas distribution utility to adapt to operate in a low carbon world.

Recognizing the need for innovation to respond to decarbonization policies, in March 2019 FortisBC Energy Inc. (FEI) applied to the British Columbia Utilities Commission (BCUC) for approval of $24.5 million Clean Growth Innovation Fund (or "Innovation Fund") to be funded by customers and administered by FEI from 2020 to 2024. In June 2020, the BCUC approved the Innovation Fund for FEI.[3] The BCUC Decision represents a key milestone for innovation funding by utilities. While utilities, including FEI, have contributed to innovation funding in the past, this involved relatively small amounts and was narrow in focus, largely due to legislative and regulatory constraints. The BCUC Decision represents a breakthrough

* Christopher Bystrom is a partner at Fasken Martineau DuMoulin LLP and appeared as counsel for FortisBC in this application.

Madison Grist is an associate at Fasken Martineau DuMoulin LLP and appeared as counsel for FortisBC in this application.

[1] See e.g. CleanBC, "CleanBC Plan" (2019) at 43, 52, online (pdf): <blog.gov.bc.ca/app/uploads/sites/436/2019/02/CleanBC_Full_Report_Updated_Mar2019.pdf> (the CleanBC plan calls for the expansion of electrification of buildings by fuel switching from natural gas appliances to electric heat pumps).

[2] For example, the City of Vancouver and other municipalities have declared climate emergencies and adopted decarbonization goals (See e.g. City of Vancouver, "Climate Emergency Response" (16 April 2019), online (pdf): <council.vancouver.ca/20190424/documents/cfsc1.pdf>).

[3] *Re FortisBC Energy Inc. and FortisBC Inc. Application for Approval of a Multi-Year Rate Plan for the years 2020 through 2024* (22 June 2020), G-165-20 & G-166-20, online (pdf): *BCUC* <www.bcuc.com/Documents/Decisions/2020/DOC_58466_2020-06-22-FortisBC-MRP-2020-2024-Decision.pdf> [BCUC Decision].

in public utility funded innovation activity, as the regulator acknowledged the need for increased innovation funding (by a gas utility) and approved a fund administered by the utility and funded by customers. The BCUC concluded: "Overall, the Panel finds that FortisBC has demonstrated it needs to accelerate its innovation activities for FEI in light of increasing governmental climate policies aimed at decarbonization and electrification."[4]

This article will describe FortisBC's proposal for the Innovation Fund, the issues raised in the BCUC proceeding, and the BCUC's decision to approve the Innovation Fund. We also conclude with a consideration of the potential implications of the Innovation Fund for other utilities in Canada.

OVERVIEW OF FORTISBC'S INNOVATION FUND

FEI and its sister company FortisBC Inc. (FBC) (together "FortisBC") jointly applied to the BCUC in March of 2019 for approval of the Innovation Fund for each of the utilities.[5] FEI is a natural gas distribution utility serving most of BC, and FBC is an electric utility that serves communities in the interior of BC. The application was made as part of FortisBC's 2020–2024 multi-year rate plans (the "MRPs"), which combined elements of performance based and cost of service ratemaking that together provide a framework to set FortisBC's rates for five years. The Innovation Funds were proposed as part of this five-year framework.

The goals of the Innovation Funds, as stated by FortisBC, were to "accelerate the pace of clean energy innovation, to achieve performance breakthroughs and cost reductions, and to provide cost effective, safe and reliable solutions for our customers."[6] FortisBC proposed to accomplish this by using the Innovation Funds to invest in innovation activities at the pre-commercial and commercial level across the utility "value chain" including supply, transmission and distribution, and end-uses. FortisBC's guiding principles for the fund included using a portfolio approach to diversify risk and leveraging partnerships with other organizations.

FortisBC identified investment areas that included blending hydrogen, renewable natural gas, fugitive emissions reductions and carbon capture (for the gas utility) and electric vehicles and charging stations (for the electric utility).[7] The Innovation Fund was proposed to support initiatives that were ready for feasibility research, rather than basic technology research. The aim was to focus on activities that had relatively shorter and more certain potential benefit timelines, increasing the likelihood of customer benefits.

The size of the Innovation Fund was proposed to be $24.5 million for FEI and $2.5 million for FBC over a five-year period. This was based on annual funding of $4.9 million for FEI and $0.5 million for FBC.[8] FortisBC requested this amount based on a "bottom-up" assessment on the innovation activities available for each utility to fund.

FortisBC proposed collecting the funds from customers though a fixed charge rate rider that would apply equally to all customers ($0.40/month for FEI gas customers and $0.30/month for FBC electric customers). FortisBC also proposed to record the amounts collected as credits in an Innovation Fund deferral account, with utility expenditures recorded as debits in the same account. At the end of the five-year term, any unused balance in the account would be returned to customers.[9]

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[4] *Ibid* at 154.

[5] FortisBC Energy Inc. & FortisBC Inc., "Application for Approval of a Multi-Year Rate Plan for 2020 through 2024" (11 March 2019), online (pdf): *BCUC* <www.bcuc.com/Documents/Proceedings/2019/DOC_53564_B-1-FortisBC-2020-2024-Multi-YearRatePlan-Application.pdf> [FortisBC Application] (All documents filed in the proceeding are available on the BCUC's website at: www.bcuc.com/ApplicationView.aspx?ApplicationId=667).

[6] *Ibid* at C-142.

[7] FortisBC Energy Inc. & FortisBC Inc., "Application for Approval of a Multi-Year Rate Plan for 2020 through 2024 – Appendices" (11 March 2019), Appendix C6-4, online (pdf): *BCUC* <www.bcuc.com/Documents/Proceedings/2019/DOC_53565_B-1-1-FortisBC-2020-2024-Multi-YearRatePlan-Appendices.pdf> [FortisBC Appendices] (FortisBC provided details of the main innovation activities anticipated to be funded).

[8] FortisBC Application, *supra* note 5 at C-120.

[9] *Ibid* at C-120–C-121.

In support of the Fund, FortisBC outlined its proposed governance model, which sought to ensure that funds were prudently distributed to pursue innovations with strong customer benefit.[10]

FortisBC proposed a stage-gate process for evaluating innovation project proposals and determining project funding. The selection criteria included the amount of co-funding secured, estimated emissions reduction, and energy cost reductions.

As an accountability framework, FortisBC proposed annual reporting to the BCUC as a part of its annual ratemaking process. FortisBC promised to establish progress milestones for each initiative and report information that would allow the BCUC and customers to evaluate the success of an initiative.

REGULATORY PROCESS AND INTERVENER POSITIONS

FortisBC's proposed MRPs, including the Innovation Funds, were reviewed by the BCUC through an extensive written process. Six interveners actively participated in the proceeding, representing a range of customer and stakeholder groups: the Movement of United Professionals (MoveUP), the BC Sustainable Energy Association and Sierra Club BC (BCSEA), the British Columbia Municipal Electric Utilities (BCMEU), the Industrial Customers Group (ICG), the Commercial Energy Consumers Association of British Columbia (CEC), and the British Columbia Old Age Pensioners' Organization et al. (BCOAPO).[11]

Interveners were divided on the proposal. In their written submissions, MoveUP (representing unionized workers at FortisBC) and the BCSEA (an environmental advocacy group) expressed support for approval of the Fund. The CEC (representing commercial customers) also supported approval of the Fund, albeit subject to conditions, particularly around the cost-benefit analysis of innovation initiatives. The ICG (representing industrial customers of FBC) and BCOAPO (representing low or fixed income customers) disputed the need for the Innovation Fund, the BCUC's jurisdiction to approve it and other aspects of FortisBC's proposal. The BCMEU took no position.

While not active interveners, various organizations, including the Pembina Institute, the University of Victoria, Fort Capital Partners and Foresight, filed letters of support for FortisBC's Innovation Fund.

ISSUES AND BCUC DETERMINATIONS

The Information Requests (IRs) and submissions in the proceeding canvassed a range of issues related to the Innovation Fund, including the need, the benefit to customers, the jurisdiction of the BCUC, the appropriateness of a fixed charge, and whether funding of an activity should be subject to BCUC approval. These issues and the BCUC's determinations are discussed below.

Need for the Innovation Fund

A fundamental issue in the proceeding was the need for the Innovation Fund. FortisBC's position was that the Innovation Fund was needed "to pursue innovation and the adoption of new technologies to help mitigate policy-driven demand risks and proactively manage rate impacts, while supporting GHG emissions reductions and helping customers meet their energy and emissions goals."[12]

[10] BCUC Decision, *supra* note 3 at 146–47 (Section 5.2 summarizes the key elements of the governance structure, which includes an Executive Steering Committee and Innovation Working Group (comprised of utility staff) along with an External Advisory Council (comprised of external stakeholders drawn from interveners))

[11] *Ibid* at 4.

[12] FortisBC Energy Inc. & FortisBC Inc., "Final Submission" (10 January 2020) at para 507, online (pdf): *BCUC* <www.bcuc.com/Documents/Arguments/2020/DOC_56783_2020-01-10-FortisBC-Final-Argument.pdf> [FortisBC Final Submission].

Key evidence for FortisBC was the policy direction from all levels of government moving towards decarbonization and the expectations of customers, including:

a. Canada's commitment to reducing GHG emissions by 30 per cent from 2005 levels by 2030, and by 80 per cent by 2050.[13]

b. BC's renewal of its GHG emission reduction targets in 2018 by legislating a 40 per cent reduction by 2030, 60 per cent reduction by 2040 and 80 per cent reduction by 2050.

c. Municipal governments and regions throughout Canada and British Columbia declaring climate emergencies, including the City of Vancouver, and adopting decarbonization policies and goals.[14]

FortisBC emphasized to the BCUC that both the federal and provincial governments were relying on innovation to meet their climate objectives. FortisBC claimed that, at the federal level, over a quarter of the GHG reductions (79 Mt) required to achieve Canada's 2030 targets must be achieved with some combination of innovation and additional provincial policies. At the provincial level, the CleanBC Plan's target of 15 per cent renewable gas was forecast to achieve 75 per cent of the total emission reductions sought in the buildings sector. FortisBC observed that this target makes FortisBC's renewable gas supply and the associated generation and delivery infrastructure central components of the provincial strategy to reduce GHG emissions. FortisBC's evidence was that achieving the Province's target requires FortisBC to quickly advance innovation and develop new sources of renewable gas under supportive regulatory and policy constructs developed by the BCUC and the Province.[15]

FortisBC's evidence on government policy was not contradicted and proved persuasive. The BCUC concluded:

> Overall, the Panel finds that FortisBC has demonstrated it needs to accelerate its innovation activities for FEI in light of increasing governmental climate policies aimed at decarbonization and electrification.
>
> …FEI needs to step up its innovation efforts in order to meet the ambitious targets pertaining to renewable gas outlined in the CleanBC Plan. As already noted, the focus on decarbonization and electrification increases FEI's risk profile as a gas utility. Greater innovation efforts are needed within FEI if natural gas is to remain a viable fuel in the long term in light of those climate objectives. FEI has explained that existing gaps in its innovation funding remain unfilled, which its Innovation Fund is designed to address.[16]

The BCUC also agreed with FortisBC that the existing alternatives for innovation (including the Natural Gas Innovation Fund (NGIF)[17] and FortisBC's demand-side management program) left significant gaps:

> The Panel notes that FortisBC has been engaging in innovation initiatives since 2007 and intends to continue to pursue innovation to address climate initiatives even in the absence of an approved Innovation Fund. However, the limited scope of FEI's current innovation activities means FEI is unable to keep pace with the ambitious renewable gas targets set out in the CleanBC Plan. Given these circumstances, the Panel

[13] We note that after this evidence was filed, the federal government further updated its commitment to provide for net-zero emissions by 2050.

[14] FortisBC Final Submission, *supra* note 12 at para 508.

[15] *Ibid* at para 509–10.

[16] BCUC Decision, *supra* note 3 at 154–55.

[17] The NGIF as created by the Canadian Gas Association.

> believes incremental funding for FEI to pursue such initiatives is warranted and required.[18]

However, the BCUC found that the case for innovation funding was not persuasive in the context of an electric utility and disapproved the Innovation Fund for FBC:

> FBC has not made a case for additional ratepayer funding for innovation. The Panel agrees with ICG that while the case may be compelling for FEI, the same is not true for FBC. Decarbonization as a climate objective affects primarily, if not exclusively, the business of the gas utility (FEI) as it strives to reduce if not eliminate reliance on GHG emitting fuel sources such as natural gas. Decarbonization is an objective that may drive down consumer demand for natural gas, hence increasing risk for the gas utility and its long-term financial viability. In contrast, electrification potentially benefits the electric utility (FBC) by driving up customer demand for energy fueled by clean hydroelectricity. Thus, electrification and decarbonization policies may serve to actually reduce FBC's risk profile. In contrast, greater innovation efforts are needed within FEI if natural gas is to remain a viable fuel in the near and long term in light of current climate objectives…[19]

These determinations make it clear that the BCUC found the direction of policy (posing a direct existential risk to the natural gas utility) persuasive. As government policy did not pose such a risk to the electric utility, the BCUC was unable to approve the fund for FBC.

Benefits of the Innovation Fund and Who Should Bear the Cost

A second key issue was whether FortisBC has made the case that customers would benefit from the Innovation Fund such that it would be reasonable for customers to bear the costs.

FortisBC's position was that the Innovation Fund would provide "a direct benefit to customers by improving how they use and benefit from FortisBC's energy products and accelerating the pace of clean energy innovation."[20] FortisBC argued that prioritizing the role of innovation was part of FortisBC's core business and that investments would be aimed at "increasing the overall cost effectiveness, safety and reliability of the solutions FortisBC offers its customers."[21]

However, demonstrating the benefits of investment in innovation is inherently difficult, as the technologies are by definition novel and always attract some risk.

To overcome this challenge FortisBC demonstrated that other jurisdictions (with similarly structured programs) had experienced measurable benefits.[22] For example, an independent evaluation of a Low Carbon Networks Fund by Ofgem found that the fund "encouraged [utilities] to include innovation as core business" with "current benefits estimated to be approximately one third of the total funding cost" and "the future net benefit…is significant

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[18] BCUC Decision, *supra* note 3 at 155.

[19] *Ibid* at 154.

[20] FortisBC Final Submission, *supra* note 12 at para 548.

[21] *Ibid*.

[22] This evidence included:

1. A report prepared by Ron Edelstein titled "History of U.S. Natural Gas RD&D", which concluded that, over the 40 year period of the Gas Research Institute's operation in the U.S., gas consumer benefits were more than four times RD&D costs;
2. A review of customer-funded innovation in other jurisdictions conducted by Concentric Energy Advisors, titled "Regulator Rationale for Ratepayer Funded Electricity and Natural Gas Innovation"; and
3. Case studies of the United Kingdom's RIIO Framework, New York State's Millennium Fund and Ontario's Low Carbon Initiative Fund.

(See FortisBC Appendices, *supra* note 7, Appendices C6-1 & C6-2).

and is estimated to range from 4.5 to 6.5 times the cost of funding the scheme."[23] FortisBC argued that the Innovation Fund was structured similarly to other innovation funds and should therefore be expected to achieve similar benefits.

FortisBC also appealed to the big picture, stating in argument:

> It is in the best interest of customers, the Utilities and society for the Utilities to pursue projects which address strategic and emerging issues, serve customer needs, and maintain the long term health of the Utilities. In this regard, FortisBC's interests are aligned with its customers. Customers, who consume the Companies' energy products and services on a daily basis, receive the direct benefits of innovation. Shareholders will benefit indirectly, over the long term, as the Utilities remain viable and continue to thrive, allowing shareholders the opportunity to earn a fair return on their investment.[24]

Ultimately, the BCUC determined that it was reasonable for customers to bear the cost of the Innovation Fund because the benefits will accrue to customers "by ensuring cost-effective, safe and reliable gas solutions both in the short term and long term." The BCUC identified the following benefits:

- Improving gas pipeline inspections and reducing inspection costs;
- Providing cleaner and more affordable energy sources;
- Mitigating the risk of future rate increases; and
- Ensuring the long-term viability of the gas utility by reducing the risk of stranded assets through the development of new technologies.[25]

The BCUC concluded: "Ratepayers should reasonably be expected to fund innovation activities that are designed to provide ratepayer benefits."[26]

JURISDICTION TO APPROVE

FBC's industrial customer group, ICG, questioned the BCUC's jurisdiction to approve the Innovation Fund. However, the BCUC ultimately sided with FortisBC, finding that it could approve the fixed rate rider as a just and reasonable rate under the *Utilities Commission Act* (*UCA*):

> As for whether the Innovation Fund and fixed rate rider amount to just and reasonable rates within the meaning of sections 59 and 60 of the UCA, the Panel notes that section 60(1)(b.1) of the UCA gives the BCUC discretion to "use any mechanism, formula or other method of setting the rate that it considers advisable." A fixed rate rider is one such mechanism…
>
> The Panel disagrees with ICG's view that the Innovation Fund offends cost of service principles. As noted, FEI already has in place another innovation fund, the national NGIF, that addresses gas innovation activities. The Innovation Fund is just a broader iteration of that fund, albeit one funded by ratepayers under the Proposed MRPs. The Panel further agrees that there is nothing inherently wrong with forecasting the costs likely to be incurred by that fund during the Proposed MRP term, using a bottom-up approach based on current proposals as a reasonable estimate of the anticipated expenditures. The Panel also notes that any monies that remain unspent in the Innovation Fund at the end of

[23] Pöyry, "An independent evaluation of the LCNF – A report to Ofgem" (October 2016) at 2, online (pdf): *ofgem* <www.ofgem.gov.uk/system/files/docs/2016/11/evaluation_of_the_lcnf_0.pdf>.

[24] FortisBC Final Submission, *supra* note 12 at para 524.

[25] BCUC Decision, *supra* note 3 at 155 –56.

[26] *Ibid* at 156.

> the Proposed MRP term will be returned to ratepayers. In short, the costs of the Innovation Fund will be limited to the amount of actual expenditures.[27]

Governance Model and Accountability Framework

Interveners also took issue with FEI's governance model and accountability framework. BCOAPO argued that all innovation projects should be approved annually by the BCUC. CEC argued that there should be a cost-benefit analysis supporting all investments. In response FortisBC argued that an annual approval process would not be feasible and that, while it would consider the benefits of each initiative, the nature of the investments were not suitable for the kind of simple cost-benefit analysis requested by the CEC. The BCUC took no issue with FortisBC's governance model, taking comfort from evidence that FortisBC's proposal was in line with best practices in other jurisdictions:

> As for the proposed governance structure and accountability framework for the Innovation Fund, the Panel finds no issue. The governance structure appears to be consistent with that used for similar funds in other jurisdictions and to reflect accepted best practices. Similarly, the Panel does not consider it necessary for FEI to seek annual approval of specific projects before they are initiated. The Panel agrees that such an approval process would cause uncertainty, delay in project implementation and missed opportunities that would defeat the fund's purpose. We are satisfied that the Annual Review process provides sufficient opportunity for the BCUC and interveners to receive and review progress reports on individual projects and monitor the operation of the fund.[28]

Fixed Versus Variable Charge

The BCUC also agreed with FortisBC's fixed charge approach, rejecting the BCOAPO argument that urged for a volumetric approach, presumably to impose more costs on to higher volume customers. FortisBC preferred a fixed per-customer rate on the basis that the costs for Innovation Fund activities were largely fixed and would not vary by volume, and that the reduction of GHG emissions resulting from successful research and development would benefit all customers. The BCUC agreed.[29]

IMPLICATIONS AND CONCLUSION

The BCUC's approval of the Innovation Fund may signal a growing willingness on the part of regulators to recognize the significant challenges faced by natural gas utilities in Canada and the urgent need for innovation to meet climate policies. This may provide impetus for other utilities to apply for similar funds.

Given the rising tide of energy policies aimed at decarbonization, other utilities can be expected to follow FortisBC's approach in developing their own innovation funds that address the particular challenges and policy goals in their jurisdiction. FortisBC's Innovation Fund provides a blueprint on which to model such funds, and the BCUC Decision provides a precedent to support these funds. As FortisBC gains experience with its Innovation Fund projects, the benefits of innovation investments will likely be proven out, providing further support for increased funding.

Before the Innovation Fund was approved, gas utility investment in innovation has been primarily focused in the Natural Gas Innovation Fund (created by the Canadian Gas Association). In recent years, FEI has contributed approximately $400,000 per year to the NGIF. With approval of the Innovation Fund, FEI's funding for innovation has increased over ten fold, to approximately $5 million per year. If funding changes of this magnitude are replicated in other utilities across Canada, the pace of change in clean growth innovation could be transformed dramatically. This innovation is key to meeting government's

[27] *Ibid.*

[28] *Ibid.*

[29] *Ibid.*

emission reduction goals by bringing innovative new, low carbon energy services to customers through existing gas assets in Canada.

While numerous utilities provide funding to NGIF, before the BCUC Decision utilities were hard pressed to find a regulator's decision determining that such funding is needed and will benefit ratepayers, let alone should be increased. The BCUC Decision provides a clear example of an economic regulator explicitly and openly endorsing the need for innovation investment funded by ratepayers. This could potentially open the door for similar decisions by other regulators to increase investment in this needed area.

Further, if innovation funding becomes more prevalent, utilities may adopt their own emission reduction goals. A recent example is FortisBC's 30BY30 target to reduce its customer's emissions by 30 per cent by 2030. If the prospects for innovation becomes more promising, utilities may be bolder in targeting more aggressive reductions that are premised on innovation, such as new sources of supply, new methods of reducing fugitive emissions, or feasible carbon capture solutions.

As the BCUC recognized, a key benefit of investment in innovation is a means to ensure the long-term viability of a gas utility by reducing the risk of stranded assets through the development of new technologies. For example, through innovation, more sources of renewable natural gas may become possible and the blending of hydrogen into the supply mix in Canada may become accepted as a safe, reliable and economic option. This type of innovation could significantly "green" the content of supply for customers, reducing emissions and enabling the long-term viability of natural gas utilities in a low carbon world. ■

THE FORT McMURRAY WILDFIRE CASES: LIFE AFTER *STORES BLOCK*

*Ian Mondrow**

WHO BEARS THE RISK?

In October, 2019 the Alberta Utilities Commission (AUC or Commission) issued two decisions addressing requests by ATCO Electric Ltd. (AEL) for recovery of the undepreciated costs of assets damaged or destroyed in the 2016 wildfires in Alberta. One decision was in AEL's 2018–19 Transmission General Tariff Application (GTA),[1] in which AEL sought recovery of the residual costs of assets destroyed in the May 2016 Fort McMurray Wildfire. The other was in AEL's application for a Z Factor Adjustment related to the contemporaneous and adjacent Wood Buffalo wildfire.[2] Both decisions were issued on October 2, 2019. The two Hearing Panels had one member in common, and 3 members on each panel.

Fort McMurray Wildfire GTA Decision

In its GTA application AEL summarized the events of spring 2016 as follows:

> In May of 2016, sustained strong winds fueled a series of wildfires in the vicinity of the community of Fort McMurray. Over the course of several days, fueled by strong winds, the fire grew to approximately 590,000 hectares. The fire spread through the city of Fort McMurray, impacted operations in the Athabasca Oil Sands, and threatened several transmission substations and powerline facilities in the area. During this period of time it destroyed thousands of homes within the city and is estimated to have cost $3.58 billion in insurable damages. Roughly 88,000 people were evacuated in the municipality of Wood Buffalo.[3]

AEL's evidence referred to the Fort McMurray wildfire as "*the worst natural disaster in Canadian history*."[4]

An earlier, 2011 Alberta wildfire at Slave Lake destroyed 0.8 per cent of the area devastated by the 2016 fires, and destroyed AEL assets 1/8th the value of those destroyed by the 2016 fires. In its Decision 2014-297 issued January 8, 2015, the AUC determined that the Slave Lake fire driven AEL asset retirements

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[1] *Re ATCO Electric Ltd 2018–2019 Transmission General Tariff Application* (2 October 2019), 22742-D02-2019, online (pdf): *AUC* <www.auc.ab.ca/regulatory_documents/ProceedingDocuments/2020/22742-D02-2019_varied.pdf#search=22742%2DD02%2D2019> [Fort McMurray Wildfire Decision].

[2] *Re ATCO Electric Ltd Z Factor Adjustment for the 2016 Regional Municipality of Wood Buffalo Wildfire* (2 October 2019), 21609-D01-2019, online (pdf): *AUC* <www.auc.ab.ca/regulatory_documents/ProceedingDocuments/2019/21609-D01-2019.pdf#search=21609%2DD01%2D2019> [Wood Buffalo Wildfire Decision].

[3] Fort McMurray Wildfire Decision, *supra* note 1 at para 6.

[4] *Ibid* at para 13.

were extraordinary, having resulted from a fire event not comparable to any weather driven events which had come before.[5]

Notwithstanding AEL's characterization of the Fort McMurray wildfire as "*the worst natural disaster in Canadian history,*" in its GTA AEL advocated the position that the asset impairment resulting from "*the worst natural disaster in Canadian history*" resulted in an ordinary course asset retirement for AEL. Curious position to take at first blush. When one considers the result, however, AEL's position is less curious.

In Alberta, if a utility asset is retired in the ordinary course its residual costs are recoverable from customers. If, on the other hand, an asset retirement is a special one, outside of the ordinary course, any residual costs of the asset are for the account of the shareholder. As the utility bears the risk for extra-ordinary retirements, but not ordinary retirements, the utility would naturally be inclined to a position that an asset retirement is in the ordinary course, even when that retirement results from "*the worst natural disaster in Canadian history*."

As it turns out, the AUC agreed with AEL's position, notwithstanding the Board's 2015 decision which found that the much smaller and less damaging 2011 Slave Lake fires which resulted in significantly less asset value impairment resulted in extraordinary asset retirements. In the result, the Commission found that the losses incurred on the damaged and destroyed property were recoverable from Alberta electricity customers, rather than being for the account of the utility and its shareholders.[6]

Wood Buffalo Wildfire Z Factor Decision

In the contemporaneous Wood Buffalo wildfire Z factor recovery application by AEL, the AUC determined that the Wood Buffalo wildfire caused asset retirements were outside of the ordinary course and the residual costs of those assets were for the account of the utility shareholders.[7] Same series of wildfires, same underlying climactic causes, same description by AEL as "*one of the largest natural disasters Canada has ever faced*," growing to approximately 590,000 hectares and causing 88,000 people to be evacuated.

Different result. The AUC found that "*for regulatory purposes the RMWB wildfire gives rise to an extraordinary retirement of the destroyed assets*."[8]

RECONCILING THE RESULTS

Reconciliation of this seemingly odd state of affairs is traceable to the AUC's seminal Utility Asset Disposition (UAD) decision of November, 2013.[9] That extremely thoughtful and well considered policy decision in turn follows on the Supreme Court of Canada's pivotal decision in *ATCO Gas & Pipelines Ltd. v Alberta (Energy & Utilities Board)*,[10] commonly referred to as the *Stores Block* decision. To understand the seemingly opposite results in the October, 2019 Fort McMurray and Wood Buffalo wildfire asset retirement determinations, we need to go back to *Stores Block* and then consider UAD.

We will then return to the most interesting part of the AUC's recent, on one level contradictory, decisions; the flare that the decision makers have sent up regarding the potential ultimately negative impact on the public interest of the current legal framework governing Canadian regulatory commission discretion regarding allocation of costs and benefits upon utility asset disposition.

STORES BLOCK

In *Stores Block* the Supreme Court of Canada considered the implications of the sale by ATCO Gas of an office building in downtown Calgary. The story of the ensuing regulatory

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[5] *Re 2012 Distribution Deferral Accounts and Annual Filing for Adjustment Balances* (8 January 2015), 2014-297, online (pdf): *AUC* <www.auc.ab.ca/regulatory_documents/ProceedingDocuments/2014/2014-297_Errata.pdf#search=2014%2D297>.

[6] Fort McMurray Wildfire Decision, *supra* note 1 at paras 62–64.

[7] Wood Buffalo Wildfire Decision, *supra* note 2 at para 128.

[8] *Ibid*.

[9] *Re Utility Asset Disposition* (13 November 2013), 2013-417, online (pdf): *AUC* <www.auc.ab.ca/regulatory_documents/ProceedingDocuments/2013/2013-417.pdf#search=2013%2D417> [UAD Decision].

[10] 2006 SCC 4 [*Stores Block*].

and court proceedings is a long one, familiar to all Canadian utility regulatory lawyers and not one that needs to be repeated here. Suffice it for present purposes to note that two of the Court's seminal findings, which altered the course of economic regulation of utility assets, were:

1. The property employed by the regulated utility in providing utility service to customers belongs solely to the utility and its shareholders. Ratepayers pay for the use of that property, but do not thereby acquire any rights or entitlements to the property.

2. Accordingly, any gains, or losses, on the disposition of utility property are for the account of the utility and its shareholders, and utility regulatory commissions have no jurisdiction to allocate any portion of those gains (or losses) to ratepayers.[11]

It must always be noted in considering the *Stores Block* rulings that the Court was expressly not addressing the utility commissions' rate making authority in considering and ruling on the issue of utility property ownership and gains or losses from the disposition of that property. There is, according to the courts and utility regulators, a difference with a distinction.

UAD & DEPRECIATION: CUTTING THE GORDIAN KNOT?

Following the *Stores Block* decision and a number of regulatory and court decisions which attempted to apply it, in April, 2008 the AUC initiated its Utility Asset Disposition proceeding,[12] through which the Commission undertook a comprehensive review and consideration of the implications of *Stores Block* and the commission and court decisions that had attempted to apply it. In its Notice launching the UAD review the AUC stated:

> The Stores Block Decision may have various implications with respect to regulation of Alberta utilities. In particular, the guidance provided by the courts may require consideration of certain aspects of traditional regulatory approaches to the acquisition and disposition of utility assets to the setting of just and reasonable rates. Parties have argued various interpretations of the Stores Block Decision in several recent proceedings before the [Alberta Energy and Utilities Board] in various ongoing proceedings before the Commission. The Commission would like to develop a comprehensive understanding of these potential implications through this Proceeding and then to apply that understanding in a consistent manner in future decisions.[13]

The UAD proceeding spanned more than 4 years, at one point being paused in deference to additional court proceedings which the Commission felt could result in additional guidance for it to consider. The AUC's comprehensive decision[14] was issued in November 2013 and provides a wonderfully comprehensive history of the treatment of utility assets and of the proceeds (or burdens) of their disposition in the years leading up to and since *Store Block*. Section 2.8 of the Decision sets out 19 principles which the Commission derives and defines based on *Stores Block* and the cases since, and which provide a comprehensive

[11] See *Ibid* at paras 67–69.

[12] AUC, "Notice of Commission Initiated Proceeding, Application no. 1566373, Proceeding ID No. 20" (2 April 2008), online (pdf): <www.auc.ab.ca/regulatory_documents/proceedingdocuments/2008/1566373.pdf>.

[13] *Ibid* at 1–2.

[14] UAD Decision, *supra* note 9.

articulation of the "*no acquired rights*" principles now commonplace in public utility regulation in Canada.[15] The UAD Decision was ultimately given the imprimatur of the courts,[16] and has since been followed by the AUC, including in the two October 2019 wildfire decisions that are the subject of this case comment.

Consideration of all of the principles and nuances addressed by the AUC in the UAD is well beyond the scope of this essay. One conclusion is particularly apt, however, to understanding the October 2019 wildfires decisions of the Commission, and thus to consideration of the flare sent up by the Commission in each of those two decisions; the role of depreciation in allocating the benefits and burdens of utility asset disposition.

It must first be understood that utility assets are depreciated in groups, rather than individually. Generally regulatory accounting directs that assets be grouped, and periodically depreciation studies are done to determine the remaining depreciation attributable to the group of assets, based on in service dates and expected asset service life. A result is the extremely low likelihood that any individual asset in the group will reach the end of its depreciation life in accord with the depreciation life for the asset group as a whole. On average, however, as assets come and go, the asset group's depreciation expense will allow the utility to recover its investment in the assets. In the UAD Decision the Commission summarized the role of depreciation as follows (watch for the emphasis on "ordinary" and premature asset retirements):

> Examination of the depreciation methods employed by utilities in Alberta and the retirement provisions in the 1963 gas utility accounting regulation and the Commission's Uniform System of Accounts reveals that the principles expressed by the Supreme Court of Canada and applied by the Alberta Court of Appeal, had been built into these instruments and, it appears, informed their development. The depreciation and retirement methodologies reflect the statutory requirement as interpreted by the Alberta Court of Appeal that assets no longer used or required to be used for utility service must be removed form rate base.
>
> Most of the time, this is accomplished through the ordinary retirement of assets when they are no longer used or required to be used. Ordinary retirements are those that occur when the asset has reached the end of its useful utility service life. At this point, it is considered fully depreciated. It is removed from utility service (and rate base) and its acquisition cost and salvage value have been fully recovered from the customers who received service through that asset either during that period or through a depreciation adjustment made for that purpose after the fact. In the case of removal of assets from rate base before they are fully depreciated, any future revenues or losses from those assets are for the account of the utility shareholders.[17]

The Commission then proceeded to its ultimate conclusion:

> These observations lead to the conclusion that there is no need for changes to regulations or rule changes to give effect to the courts' decisions. The principles upon which they are based already serve as the foundation for the legislation, regulations and rules in place.[18]

Essentially, if the utility has experienced a history of such events and consequent impairments,

[15] *Ibid* at para 102.

[16] *Fortis Alberta Inc. v Alberta (Utilities Commission),* 2015 ABCA 295, leave to appeal to SCC refused, 36728 (21 April 2016).

[17] UAD Decision, *supra* note 9 at paras 334–35.

[18] *Ibid* at para 336.

then those events will be included in the most recent asset depreciation study and thus already factored into the asset group depreciation provisions included in rates to be paid by customers. So customers are already excused from paying residual cost for ordinary retirements through asset group depreciation policies. Only extraordinary retirements require Commission intervention for allocation of residual values (benefits or burdens) to the utility.[19]

Which brings us back to the AEL Fort McMurray and Wood Buffalo wildfire decisions of the AUC issued in October 2019. In each of those cases, in order to determine whether the residual value of the impaired or destroyed assets was to be allocated to the shareholder (as a result of an extraordinary retirement) or the ratepayer (as a result of an ordinary retirement), the AUC sought to determine, as a matter of fact, whether AEL's most recent depreciation study contemplated such retirements (in which case they were ordinary) or not (in which case they were extraordinary). That determination, in turn, depends on a finding of fact of whether the most recent depreciation study incorporates historical data which includes events and consequent asset impairment of essentially similar characteristics to the events and consequent impairments at hand.

In the case of the Wood Buffalo wildfire, the AUC found that there were no historically similar events and thus no incorporation of such exigencies in AEL's depreciation provision. The residual value of the destroyed assets was thus for the account of the utility and its shareholders. In the case of the Fort McMurray wildfire, the specific facts led the AUC to the opposite conclusion, such that the residual value of the destroyed assets was for the account of the utility customers.

THE LONGER TERM PUBLIC INTEREST

So there is the explanation.

For those left puzzled, you are not alone.

Acting Commission Member Lyttle of the AUC, who was one of the panelists on AEL's GTA application in which the Fort McMurray wildfire asset impairments were considered was also concerned about the "depreciation" mechanism for application of the *Stores Block* law regarding utility asset ownership and its burdens and benefits. While Member Lyttle agreed with the outcome — that utility customers should be responsible for the Fort McMurray wildfire losses and damages — he was concerned that:

> The continued treatment of ordinary retirements and extraordinary retirements in accordance with the UAD decision will eventually erode the symmetry of gains and losses underlying the basic principles of property ownership and corporate law applicable to Alberta utilities as established by the Supreme Court in the *Stores Block* decision.[20]

Commissioner Lyttle went on to explain his concerns:

> The application of the UAD decision has resulted in the Commission determining, based on the evidence, if depreciation experts have anticipated a particular retirement event when they completed their last depreciation study. If there are similar events that can be said to have been reasonably assumed to have been anticipated or contemplated in the previous depreciation study, then the retirement is an ordinary retirement and customers continue to pay the undepreciated costs of the retired asset. If the event has not been so contemplated, then the unrecovered costs are for the account of the shareholder. The next depreciation study, however, will now incorporate this new

[19] See UAD Decision, *supra* note 9 at paras 285ff, 302–05 (For non-accountants, this is a fairly complex conceptual framework. It is well articulated in section 4.5. This articulation is in turn informed by a consideration of utility depreciation accounting by the Commission commencing in section 4.4)

[20] Fort McMurray Wildfire Decision, *supra* note 1 at para 67.

> event in the determination of depreciation parameters so that if a similar event occurs thereafter, the resulting retirements will no longer be considered extraordinary. In other words, a nature-related event that might have been considered extraordinary in the past would now be considered ordinary because the opportunity to have contemplated the event in a depreciation study has now occurred. This exercise is likely to lead to inconsistent regulatory treatment over time of similar nature-related events in determining what constitutes ordinary and extraordinary retirements of utility assets. The ultimate logical outcome of this iterative process is that, eventually, all retirement events are considered ordinary. As detailed in paragraph 19 above, AET rebuttal evidence argued that Mr. Kennedy's average service life analysis "fully contemplated and accounted for future forces of nature events." Ultimately, with no extraordinary retirements, shareholder losses would never occur, an outcome at odds with principles detailed in the *Stores Block* decision. This is problematic when the courts have indicated that the regulatory framework is "meant to balance the need to protect consumers as well as the property rights retained by owners." Any risk of loss with respect to the utility's original investment would not be for the account of the owner of the property. Instead, losses would be borne asymmetrically by customers, which is inconsistent with the principles of property ownership and corporate law.
>
> Ultimately, as natural events are considered ordinary in all, or virtually all, circumstances, the UAD test for extraordinary retirement versus ordinary retirement will be moot.[21]

One more observation by Acting Commissioner Lyttle is worth particular note:

> The capacity needed to operate the electric transmission facility in Fort McMurray is still required for utility service. In my view, to assign the loss to the account of shareholders, as detailed in the UAD decision, the event would have to also eliminate or alter the need to provide the service. The need for the utility to have the capacity to deliver the service in Fort McMurray continues. The utility service remains used or required to be used by the public. Accordingly, the undepreciated capital costs of the destroyed assets continue to be associated with the service that is used or required to be used by the public and should continue to be recovered from customers.[22]

Acting Commissioner Lyttle would have deemed the residual value of the assets impaired or destroyed by the Fort McMurray wildfire to the account of customers since those assets were already in ratebase and had been deemed prudent, and continued to be required for the provision of utility service when destroyed (and ultimately replaced).

On the one hand, then, following the logic eloquently outlined by Acting Commissioner Lyttle, customers ultimately bear all asset costs. This is not what *Stores Block*, and the law, requires.

On the other hand, if the shareholder, in the course of providing utility service, incurs a material impairment or destruction of utility assets not previously experienced, they are stuck with the residual costs of the assets. That is, in this most material risk, they are saddled with the burdens.

Heightening this shareholder exposure is the uncertainty of how a commission would, in

[21] *Ibid* at paras 73–74.

[22] *Ibid* at para 83.

any particular fact situation and faced with any particular historical depreciation study, allocate the residual costs of assets destroyed by natural events outside of the utility's control.

Any way you cut it there is either increased customer cost, whether directly or through what utility shareholders would argue will be increasing costs of capital resulting from significant and unpredictable risk.

POST-*STORES BLOCK* UTILITY REGULATION

The AUC Hearing Panels in both the Fort McMurray and the Wood Buffalo wildfire decisions addressed the conundrum, in essentially verbatim terms, under the heading "*Future Considerations*." Noting that the guidance provided by the courts in, and since, *Stores Block*, "*limits the Commission's flexibility in dealing with cost allocation upon the retirement of utility assets, both those reasonably anticipated and those that are unanticipated,*"[23] both Hearing Panels of the Commission issued what some commentators read as a call for legislative help. In a post-Pandemic world of extraordinary events and business risks, the AUC's cautions merit careful consideration, and are an apt way to conclude this essay:

> Although the Court of Appeal emphasized that the Stores Block line of cases remains good law, it also noted that more than a decade of incremental litigation on individual, fact specific Commission decisions has arguably resulted in some "deleterious effects on regulation of utilities in Alberta." In making this observation, the court indicated that the Commission would have greater flexibility to deal with UAD matters in the absence of this line of court decisions and reminded lawmakers that they have the ability to consider these issues from a broader public policy perspective should they wish to alter the status quo and provide the Commission with greater discretion in addressing UAD fact-specific issues…
>
> The Commission appreciates the difficulty utilities face operating in an environment where they must anticipate reasonably foreseeable future events, not just to properly align depreciation parameters but also to reduce the risk of shareholder losses due to extraordinary retirement. Notwithstanding these efforts, utilities recognize that shareholder losses are likely to occur despite having acted prudently in conducting their operations. Similarly, it is not in the interest of customers that they pay higher rates that reflect risk-adjusted returns or depreciation parameters and investment decisions that factor in every possible retirement contingency. It is also not in the interest of customers that utilities incur higher borrowing costs or that the delivery of safe and reliable service be compromised due to financial hardship resulting from an extraordinary retirement. Further it is in the interest of neither utilities nor customers to engage in continual fractious debate in characterizing retirements. Again, no party benefits if utilities are compelled to respond to negative economic incentives by adopting risk-averse policies that impede regulatory efficiencies or improvement in service or reliability where prudent investment would otherwise occur. These are perhaps some of the possible deleterious effects on the regulation of utilities in Alberta noted by the courts.[24]

One final piece of context; prior to *Stores Block* the Alberta position on allocation

[23] Fort McMurray Wildfire Decision, *supra* note 1 at para 87; See also Wood Buffalo Wildfire Decision, *supra* note 2 at para 130.

[24] *Ibid* at paras 88–89; See also *Ibid* at paras 131–32.

of the proceeds of utility asset disposition, sanctioned by the courts, was to share benefits, and burdens.

The AUC's decisions both then concluded as follows:

> UAD matters are complex and include not only the allocation of risk for ordinary and extraordinary retirements, but also involve disposition of utility property, the withdrawal of utility property for non-regulated purposes, the underutilization of utility assets and the determination of a fair return on utility investment. Each aspect of these issues goes directly to the setting of just and reasonable rates in the context of the applicable law and the relevant circumstances.
>
> The Commission makes the above comments in the expectation that they will encourage debate on the evolution of public utility regulation in Alberta while the Commission continues to carry out its "main function of fixing just and reasonable rates ('rate setting') and in protecting the integrity and dependability of the supply system"[108] as directed by the legislation as interpreted and applied by the courts.[25] ■

[25] *Ibid* at paras 90–91(Footnote 108 in original: *Stores Block*, *supra* note 10 at para 7); See also *Ibid* at paras 133–34.

THE NEW NAFTA AND CANADIAN ENERGY REGULATORS

*Gordon E. Kaiser**

On July 1, 2020 the *North American Free Trade Agreement*[1] or NAFTA came to an end. After 24 years, NAFTA was replaced by a new agreement called the *Canada-United States-Mexico Agreement*.[2] The main impact as far as the energy sector is concerned was elimination of the famous Chapter 11 dispute resolution provision. Chapter 11 of NAFTA gave private investors the right to bring claims directly and unilaterally in the host country. This was unique at the time when the arbitration world was dominated by state to state proceeding. Chapter 11 requires the following:

a. the host must treat the foreign investor and its investments with 'treatment no less favourable than that it accords, in like circumstances, 'to its own investors'[3] or 'to investors of any other country';[4]

b. the host must provide investments the better of the treatment accorded to its own investors or to the investors of any other country;[5]

c. the host must provide investments 'fair and equitable treatment and full protection and security';[6]

d. the host is prohibited from imposing certain trade distorting performance requirements such as requiring a given level of domestic content;[7]

e. The host must not directly or indirectly nationalize or expropriate an investment of tale measures tantamount to nationalization or expropriation with various exceptions requiring fair market value compensation.[8]

The state to state proceedings continue under the new agreement.[9] However, the private action is gone and there are transition provisions. Investors harmed prior to July 1, 2020 have three years to bring the claim.[10]

Chapter 11 has had a major impact on the energy sector in Canada. To put things in perspective, there have been 40 NAFTA

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[1] *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 (entered into force 1 January 1994) [*NAFTA*].

[2] *Canada-United States-Mexico Agreement*, 30 November 2018, Can TS 2020 No 5 (entered into force 1 July 2020) [*CUSMA*].

[3] *Ibid*, article 1102.

[4] *Ibid*, article 1103.

[5] *Ibid*, article 1104.

[6] *Ibid*, article 1105.

[7] *Ibid*, article 1106.

[8] *Ibid*, article 1110.

[9] See *Ibid*, Chapter 31.

[10] See *Ibid*, Chapter 14, Annex 14-C.

decisions to date. Of those, 17 were against Canada, 11 were against the United States, and 12 were against Mexico. Canada has managed to lose nine cases. Mexico has lost five, while the United States have lost none.

Of the 17 cases against Canada, the energy sector accounts for four[11] — with three more currently before tribunals.[12] The purpose of NAFTA was to promote foreign investment. Certainly the Canadian energy sector was a major beneficiary. Canadian oil and gas exploration as well as pipelines are dominated by American investment.

The original NAFTA agreement was negotiated over five years. An agreement in principle was signed by President Reagan and Prime Minister Mulroney at the Shamrock Summit in Québec City in 1985. It was called the Shamrock Summit because the two Irishmen treated their dinner guests to a fine rendition of the song, When Irish Eyes are Smiling. Twenty-four years later when Prime Minister Trudeau and President Trump signed the new agreement in Buenos Aires, no one was singing.

One thing the Canadians and the Americans agreed on was that Chapter 11 should be scrapped. Canada believed that it had lost too many NAFTA arbitrations. But both countries disliked the fact that foreign investors could use NAFTA to override domestic legislation that both governments believed was in the public interest. In October 2017, 230 law and economics professors asked President Trump to remove the Chapter 11 dispute resolution provision from NAFTA.[13] That letter referred to Chief Justice John Roberts' dissent in *BG Group, PLC v Republic of Argentina*[14] claiming that NAFTA arbitration panels held alarming powers to review the laws and "effectively annul the acts of its legislature and judiciary." NAFTA arbitrators, the Chief Justice said "can meet literally anywhere in the world and sit in judgment on the nation's sovereign acts." The October 2017 letter is set out in Appendix A. It is an interesting analysis.

Nowhere was this conflict clearer than in the Canadian energy sector where the decisions of Canadian energy regulators and legislation enacted by provincial governments was constantly challenged by U.S. investors.

In *Mobil Investments Canada Inc.* (Mobil) and *Murphy Oil Corporation* (Murphy), two American companies questioned a decision of the Canadian Newfoundland Offshore Board.[15] Mobil and Murphy first went to the Canadian courts.[16] When that failed they brought a NAFTA claim where they succeeded. In *Mesa Power Group LLC* and *Windstream Energy LLC*, American investors challenged the Ontario government's administration of its feed in tariff program which was used to promote renewable energy.[17] That resulted in the largest NAFTA award against Canada. In *Mercer International Inc.*, a U.S. company filed a C$250 million NAFTA claim against Canada based on the actions of the British Columbia Utilities Commission and BC Hydro, a government owned utility serving the

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[11] *Mobil Investment Canada Inc. and Murphy Oil Corp. v Canada* (2015), ARB(AF)/07/4 (International Centre for Settlement of Investment Disputes) [*Mobil*]; *Mesa Power Group LLC v Government of Canada* (2016), 2012-17 (Permanent Court of Arbitration) [*Mesa*]; *Windstream Energy LLC v Government of Canada* (2016), 2013-22 (Permanent Court of Arbitration) [*Windstream*]; *Mercer International Inc. v Government of Canada* (2018), ARB(AF)12/3 (International Centre for Settlement of Investment Disputes) [*Mercer*].

[12] Lone Pine Resources Inc., "Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and Chapter Eleven of the North American Free trade Agreement" (6 September 2013) at para 14, (ICSID Case No. UNCT/15/2) [Lone Pine Resources]; Westmorland Mining Holdings LLC, "Notice of Arbitration and Statement of Claim Under the Arbitration Rules of the United Nations Commission on International Trade Law and Chapter Eleven of the North American Free trade Agreement" (12 August 2019), (ICSID Case No. UNCT/20/3) [Westmorland Mining]; Tennant Energy LLC, "Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and Chapter Eleven of the North American Free trade Agreement" (1 June 2017), (PCA Case No. 2018-54) [Tennant].

[13] Joseph Stiglitz et al., "230 Law and Economics Professors Urge President Trump to Remove Investor-State Dispute Settlement (ISDS) From NAFTA and Other Pacts" (25 October 2017), online (pdf): *Columbia University* <www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/2017%20Letter%20to%20Pres.pdf>.

[14] 572 US 25 (2014).

[15] *Mobile*, *supra* note 11 at para 1.

[16] *Hibernia Management and Development Co. v Canada-Newfoundland Offshore Board*, 2008 NLCA 46, aff'g 2017 NLTD 14 [*Hibernia*].

[17] *Mesa*, *supra* note 11 at para 207; *Windstream*, *supra* note 11 at para 5.

entire province.[18] Again the investors went to the Commission first. When that failed they went to NAFTA and ended up with an award.

In Lone Pine Resources Inc., a US-based exploration company launched a claim against the province of Québec's decision to suspend oil and gas exploration under the St. Lawrence River. [19] That case is still before the tribunal. Another case still before a tribunal is Westmoreland Mining Holdings LLC.[20] There, a U.S. company brought a C$470 million claim related to the Alberta government's decision to eliminate the generation of electricity by coal. The investor is not questioning the legislation but the lack of compensation they received.

Canadians have also used the NAFTA Chapter 11 provisions to advance their own interests. The most famous claim and the largest in history was the US$15 billion claim TransCanada brought against the United States when former President Barack Obama refused to grant TransCanada a permit to build the Keystone XL pipeline.[21] That claim was withdrawn when President Trump was elected. In his first day on the job President Trump granted the essential presidential permit to TransCanada. A Presidential permit was required for Keystone XL because the pipeline crossed an international boundary. That challenge is not over. There is a presidential election coming in November. The front runner, Joe Biden, has indicated he will cancel Keystone XL if elected. Stay tuned.

At the end of the day, the question is does the removal of Chapter 11 create problems for the Canadian energy industry. That is an important question and we will address it in the Conclusion. There is good news and bad news. It depends on what kind of investor is involved. Is it a Canadian investor or a U.S. investor? Is the investment in Canada or the United States? Before turning to that question, it is useful to review the NAFTA arbitrations in the Canadian energy sector to date.

THE NAFTA ENERGY ARBITRATIONS

There have been four NAFTA decisions dealing with the Canadian energy sector to date. There are three more cases underway. They all involve claims by American investors challenging the decisions of Canadian energy regulators or energy legislation enacted by provincial governments. They include decisions by the Canada-Newfoundland Offshore Petroleum Board to change its regulations, the British Columbia Utilities Commission to set electricity pricing, an Ontario government decision not to grant onshore wind contracts, an Ontario government decision to suspend offshore wind programs, a decision by the Québec government to ban fracking under the St. Lawrence River and a decision by the Alberta government to eliminate the generation of electricity by coal. These are all the decisions by provincial governments or their energy regulators. Under NAFTA, the government Canada is required to defend. If Canada loses, Canada sends the bill to the province.

Mobil Investments Canada Inc. and Murphy Oil Corporation

In August 2007, two American companies, Mobil Investments Canada (Mobil) and Murphy Oil Corporation (Murphy) filed a NAFTA claim for C$60 million against Canada.[22] The two U.S. companies were partners in an offshore drilling project off the coast of Newfoundland, which was regulated jointly by the federal government and the province through the Canada Newfoundland Offshore Petroleum Board.

In order to obtain a license to drill, the companies had been required to submit proposals to the Board to approve their development plan. That plan included commitments regarding research and development. The Board provided guidelines, none of which required specific expenditure

[18] *Mercer*, *supra* note 11 at paras 2.3–2.27, 2.68.

[19] Lone Pine Resources, *supra* note 12 at para 10.

[20] Westmoreland Mining, *supra* note 12.

[21] Trans Canada Corporation & Trans Canada Pipelines Limited, "Under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States and the Institution Rules and Arbitration Rules of the International Centre for Settlement of Investment Disputes and Chapter 11 of the North American Free Trade Agreement - Request for arbitration" (24 June 2016) at paras 15, 91.

[22] Mobil Investments Canada Inc. & Murphy Oil Corporation, "Request for Arbitration" (1 November 2007) at paras 1–4.

amounts. The Board changed this practice in 2004 and introduced new guidelines with specific expenditure targets. The Claimants objected to the new guidelines arguing that they represented a fundamental shift in regulation that undermined the project. Mobil and Murphy first went to the courts.[23] When that failed Mobil and Murphy brought a NAFTA claim. In May 2012, a Tribunal majority found that Canada had violated NAFTA Article 1106.[24] Three years later the tribunal ordered damages of C$13.9 million.[25] A set-aside application by Canada was dismissed by the courts.[26]

Mobil brought a second claim for future damages relating to the 2012 to 2015 time period. That was not covered in the original award.[27] Despite Canada's objections that the second claim was barred by the three-year time limit under NAFTA and the doctrine of *res judicata*, the panel allowed the claim to proceed.[28] The parties subsequently extended the damage time period to 2036, the date when the Mobil oil projects in Canada would end. The parties then reached a settlement. It was incorporated into a Consent Order issued by the tribunal on February 4, 2020, granting further damages of C$35 million.[29]

Mesa Power Group

In 2011, Mesa Power Group LLC (Mesa), a U.S. corporation owned at the time by the late Texas oil tycoon T. Boone Pickens, filed a C$775 million claim against Canada relating to the Province of Ontario's decisions in awarding power purchase agreements under the Ontario Feed-in Tariff (FIT) program.[30] These were 20 year agreements under which the government agreed to buy a fixed quantity of electricity at fixed prices. The goal was to increase the supply of renewable energy.

Mesa claimed that Canada adopted discriminatory measures, imposed minimum domestic content requirements, and failed to provide Mesa with the minimum standard of treatment, in violation of NAFTA's investment provisions. In the end, the tribunal dismissed all of Mesa's claims and ordered Mesa to bear the cost of the arbitration, C$2.2 million, as well as Canada's legal costs of nearly C$1.9 million.

Mesa argued that the reason it did not receive any FIT contracts was that the program was mismanaged and Mesa was discriminated against when Ontario granted unwarranted preferences to two other applicants.

The Ontario Power Authority (OPA) had launched the FIT program in October 2009. During the first round of contacts, the OPA reviewed 337 applications and granted 184 contracts, for a total of 2500 MW of capacity. The second round of contracts took place in February 2011. Forty FIT contracts for a total of 872 MW were issued. The third round took place in July 2011, resulting in 14 contracts totalling 749 MW.

Mesa filed six applications under the FIT program. They were unsuccessful in all three rounds. The problem was that all of the Mesa projects were located in Bruce County. In order to obtain a contract, all applicants had to demonstrate was that they had the right to connect to the transmission system. Mesa was unable to obtain transmission connection because of the transmission constraints in Bruce County. Mesa also argued that the failure to acquire transmission access was because of flaws in the contracting process and preferences granted to two other parties, namely NextEra Energy (an affiliate of Florida Power and Light) and the Korean Consortium led by Samsung.

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[23] *Hibernia*, *supra* note 16.

[24] *Mobil Investments Canada Inc. and Murphy Oil Corp. v Canada* (2012), ARB (AF)/07/4 at 490 (International Centre for Settlement of Investment Disputes).

[25] *Mobil*, *supra* note 11 at para 178.

[26] *Attorney General of Canada v Mobil et al.*, 2016 ONSC 790.

[27] *Mobil Investments Canada Inc. v Canada* (2018), ARB/15/6 (International Centre for Settlement of Investment Disputes).

[28] *Ibid* at para 100.

[29] *Mobil Investments Canada Inc. v Government of Canada* (2020), ARB/15/6 at para 20 (International Centre for Settlement of Investment Disputes).

[30] Mesa Power Group LLC, "Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement" (4 October 2011) at paras 6, 72.

Mesa argued that this conduct amounted to a breach of Article 1105(1) of NAFTA, which reads: "Each Party shall accord to investments of investors of another Party treatment in accordance with International law, including fair and equitable treatment and full protection and security."

The tribunal rejected the allegation that the OPA had mismanaged the program and did not treat all applicants fairly, noting that the OPA had retained an independent monitor to administer the FIT program. The tribunal also discounted the charge that NextEra Energy had met with government officials, noting that this was common practice in the industry and there was no evidence of any preference.

The most contentious part of the Mesa allegations related to the Korean Consortium agreement. Mesa had argued that the agreement between Ontario and the Korean Consortium unfairly diminished the prospects for other investors including Mesa that were already participating in the renewable energy program by setting aside transmission capacity for the Korean Consortium that was intended for FIT applicants.

Mesa also argued that Ontario was less than transparent in negotiating the agreement, and issued inaccurate and incomplete information. Canada responded that there was nothing manifestly arbitrary or unfair when a government enters into an investment agreement that grants advantages to an investor in exchange for investment commitments. It turned that Samsung had agreed to build manufacturing facilities in Ontario.

Windstream Energy

In October 2012, Windstream Energy LLC (Windstream) filed a claim against the government of Canada for C$475 million. Following a 10-day hearing in 2016, a panel of three arbitrators issued an award of nearly $26 million, relating to Ontario's decision to suspend all offshore wind development.[31] Windstream really turned on the legitimacy of the moratorium issued by Ontario to defer all offshore wind generation and the conduct of the Ontario government following the announcement of that moratorium. The panel accepted Windstream's argument that the government's decision frustrated Windstream's ability to obtain the benefits of the 2010 contract it had signed with the OPA.[32]

In November 2009, Windstream submitted 11 FIT applications for wind power projects, including an application for a 300 MW, 130-turbine offshore wind project near Wolfe Island in Lake Ontario. The OPA offered Windstream a FIT contract in May 2010, which Windstream signed in August of that year. Under the contract, the OPA would pay Windstream a fixed price for power for 20 years. In total, the contract was worth C$5.2 billion.

During this period, the Ontario government was conducting a policy review to develop the regulatory framework for offshore wind projects, including a proposed 5 km shoreline exclusion zone. The policy review ceased on 11 February 2011, when the government of Ontario decided to suspend all offshore wind development until further research was completed.

The main ground for the Windstream claim was that the Ontario decision was arbitrary and was based on political concerns that the wind contracts would increase electricity rates. Windstream argued that the government really had no intention of pursuing scientific research. Canada, in response, said that Ontario was entitled to proceed with caution on offshore wind development and that NAFTA does not prohibit reasonable regulatory delays. Windstream made a number of claims under the NAFTA. The most important (and the only one that succeeded) was a breach of Article 1105(1), the Minimum Standard of Treatment provision, which reads: "Each Party shall accord to investments of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." In finding that there was a breach, the tribunal questioned whether the real rationale for the moratorium was the need for more scientific research. Just as important was the tribunal finding that Ontario made little, if any, efforts to accommodate Windstream, and seemed to deliberately keep Windstream in the dark.

[31] *Windstream*, *supra* note 11 at 515.

[32] *Ibid* at para 380.

There was a further claim by Windstream that Ontario had violated Article 1102 of NAFTA by granting Windstream less favourable treatment than was accorded to other entities in similar circumstances. It was argued that the treatment of Windstream was less favourable than the treatment Ontario granted to TransCanada (now TC Energy).

Both TransCanada and Windstream were parties to power purchase agreements with the OPA that guaranteed a fixed price for electricity. Both contracts were terminated. However, when Ontario terminated the TransCanada contract, Ontario awarded TransCanada a new project and compensated TransCanada for the costs of the cancellation. In contrast, Ontario failed to do the same thing for Windstream following the offshore moratorium. The tribunal concluded that TransCanada was not in like circumstances.

There was no question that the TransCanada project was different from the Windstream project. TransCanada had a contract with the OPA to build a gas generation plant in Mississauga, near Toronto. The local residents were not happy with this, and the Liberal government cancelled the project in the heat of the provincial election. To keep TransCanada happy, the OPA negotiated an agreement that reimbursed them for their costs and gave them a new contract in another area.

The tribunal concluded that the two projects were totally different and were not "in like circumstances."

Mercer International

In 2012 Mercer International (Mercer), a U.S. company, filed a C$250 million NAFTA claim against Canada.[33] The claim related to the company's investment in a pulp mill located in Castlegar, British Columbia. The mill also operated an energy generation facility fuelled by biomass, which qualified as renewable energy under British Columbia regulation.

The claim related to actions by BC Hydro, a government owned utility, that provided electricity to most of British Columbia and the British Columbia Utilities Commission, which regulated the distribution of electricity in that province. Two utilities provided electricity in British Columbia. The first was BC Hydro, which serves most of British Columbia. The second was FortisBC, which provides electricity to a small portion of the province including the Mercer pulp mill in Castlegar.

The central issue was that Mercer was engaged in the arbitrage of power and BC Hydro and the British Columbia Utilities Commission took steps to prevent it.[34] Mercer required a significant amount electricity for its own use at its mill. For some time, Mercer was allowed to purchase that electricity from FortisBC at low cost-based rates. At the same time, Mercer was able to sell the renewable electricity generated at its facility using biomass at market rates.

Mercer alleged that BC Hydro and the British Columbia Utilities Commission through their joint action had a created new regulatory regime that required Mercer to use its own self-generated electricity first before selling electricity to the grid at market prices.[35] This removed the arbitrage profit. Mercer argued that the other pulp mills in British Columbia were doing the same thing and it was being discriminated against, contrary to NAFTA Articles 1102, 1103, and 1503. The tribunal ruled against Mercer and ordered Mercer to pay Canada's costs of C$9 million.

There were a number of complexities in this case. First, Canada argued that the BC Hydro conduct was shielded by the government procurement protections in Article 1108(7) of NAFTA. The panel also questioned whether the Commission ruling was discriminatory contrary to Article 1102, 1103, and 1503 of NAFTA.[36] It turned out that Mercer was the only pulp mill buying electricity from FortisBC, the others were being served by BC Hydro, and therefore they were not on the same footing or subject to the same regulatory ruling.

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[33] Mercer International Inc, "Notice Of Intent To Submit A Claim To Arbitration Under Chapter Eleven And Articles 1503(2) And 1502(3)(A) Of The North American Free Trade Agreement" (26 January 2012) at para 91.

[34] *Mercer*, *supra* note 11 at para 2.6–2.7.

[35] *Ibid* at par. 7.53.

[36] *Ibid* at para 7.40.

There was also question of whether Mercer was late filing its claim and violated the three-year time limit under article 1116 and 1117 of NAFTA. The limitation period involved a review of the earlier NAFTA decision in Grand River.[37] The question about was what was the date that the investor first acquired or should have acquired knowledge of the alleged breach and the resulting damage. The panel ultimately found that some of the claims were time barred.[38]

It should be noted that Mercer first raised this complaint before the British Columbia Utilities Commission which ruled against it.[39] The Commission decision effectively ruled that self-generating customers had to first supply their requirements from their own production before they could purchase embedded low-cost power from FortisBC.

The panel ruled that the facts did not support a finding of discriminatory treatment, dismissing the application and awarding costs against Mercer.

Lone Pine Resources

In September 2013, Lone Pine Resources Inc. (LPRI), a U.S.-based gas and exploration company, launched a US$119 million challenge against Canada under NAFTA.[40] The claim relates to the Province of Québec's suspension of oil and gas exploration under the St. Lawrence River. The moratorium was part of a wider Québec suspension of fracking, a form of horizontal drilling that has already been suspended in different U.S. states and Canadian provinces.

Québec declared the moratorium in 2011, in order to conduct environmental impact studies concerning the use of the chemicals involved and the impact on groundwater. This was of particular concern given that the permits that Lone Pine had acquired cover land directly under the St. Lawrence River.

LPRI alleged that the moratorium contravenes Article 1105 (minimum standard of treatment) and 1110 (expropriation).[41] More specifically, the claimant alleged that the passing of the legislation that created the moratorium was arbitrary, unfair and inequitable, and was based on political and populist grounds rather than actual environmental research. The claimant alleged that the revocation of the license expropriated its investment without compensation.

The government of Canada responded that the action is a legitimate measure in the public interest that applies indiscriminately to all holders of exploration licenses that are located under or near the St. Lawrence River.[42] Canada argues that the legislation was enacted by a fundamental democratic institution in Québec and was preceded by numerous studies that established the need to achieve an important public policy objective, namely the protection of the St Lawrence River.

Canada argues that the minimum standard treatment guaranteed in Article 1105 of NAFTA does not protect investors' legitimate expectations. Even if this were the case, Canada says no representative of the government of Québec communicated to the claimant any guarantee, promise, or specific assurance that could create legitimate expectations relating to the development of hydrocarbon reserves and resources that may be found beneath the St. Lawrence River.

Canada has also argued that the disputed measure does not substantially deprive LPRI of its investment because the legislation only revokes one of five exploration licenses

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[37] *Grand River Enterprises Six Nations Ltd. v United States of America* (2011), UNCITRAL (International Centre for Settlement of Investment Disputes).

[38] *Mercer*, *supra* note 11 at para 8.3.

[39] *Re An Application by British Columbia Hydro and Power Authority to Amend Section 2.1 of Rate Schedule 3808 ("RS 3808") Power Purchase Agreement* (6 May 2009), G-48-09, online (pdf): *BCUC* <www.bcuc.com/Documents/Proceedings/2011/DOC_27267_A2-3_05-06-09_G-48-09_BCH_Amend%20Section%2021%20RS%203808%20PPA.pdf>.

[40] Lone Pine Resources, "Claimant's Memorial" (10 April 2015) at para 408, (ICSID Case No. UNCT/15/2).

[41] Lone Pine Resources, *supra* note 12 at para 14.

[42] Government of Canada, "Réponse à l'avis d'arbitrage" (27 February 2015) at para 86 (ICSID Case No. UNCT/15/2).

granted.[43] Finally, Canada points out that the act is a legitimate exercise of the government of Québec's police power and accordingly the measure cannot constitute expropriation.

Keystone XL

In most of the NAFTA energy arbitrations, the United States is the Claimant and Canada is playing defense. The one exception took place in 2016 when TransCanada (now TC Energy), a company based in Calgary, Alberta, filed a US$15 billion NAFTA investor claim against the United States after former President Barack Obama rejected their application for a presidential permit to approve the construction of the Keystone XL pipeline.[44]

In January 2015 both the House and the Senate passed legislation that approved Keystone XL, but failed to get the two-thirds majority required to override a presidential veto.[45] When President Obama exercised his veto, TransCanada filed a claim under NAFTA arguing that the denial of the presidential permit for Keystone XL was arbitrary, unjustified, and breached the U.S. Administration's NAFTA obligations. A presidential permit was required for Keystone XL because the pipeline crossed an international boundary.

This all turned around when Donald J. Trump won the next election and moved into the White House. One of the first acts by the new president was to sign an Executive Order approving the 1179-mile line.[46] Two days later TransCanada withdrew the NAFTA claim.

Westmoreland Mining

In August 2019, Westmoreland Mining Holdings LLC (Westmoreland), a U.S. company, filed the C$470 million damage claim against the government of Canada for breaches by the province of Alberta of article 1102 and 1105 of NAFTA.[47] In 2013, Westmoreland acquired a number of coal mines, including the "mine-mouth" operations in Alberta at issue in this dispute. Mine-mouth coal operations are coal mines located adjacent to power plants so that the coal can be delivered to the power plant economically.

The value of Westmoreland's investment was threatened in November 2015 when a new Alberta provincial government announced its "Climate Leadership Plan." Alberta, which historically had relied primarily on its abundant coal supply to fuel its power plants, decided that it wanted to eliminate all power emanating from coal by 2030. Alberta agreed to pay out nearly $1.4 billion to three coal-consuming power utilities, all of which were Albertan companies. Two of the three, TransAlta and Capital Power, also owned interests in "mine-mouth" coal mines" and the compensation valued those assets. Westmoreland, unlike the three Alberta companies, was not compensated for the early closure of its mines.

When the coal payouts were issued to the companies, Alberta's Energy Minister stated that they were intended to compensate for the "economic disruption to their capital investments" caused by the sudden policy shift and to "provide investor confidence and encourage them to participate in Alberta's transition from coal." Westmoreland argued that Alberta's plan to "compensate Albertan coalmine operators for the loss of their investments, to the exclusion of the only American coalmine operator, denied Westmoreland national treatment under Article 1102 and treated the company unfairly and inequitably, in violation of NAFTA Article 1105."[48]

Canada in its defense disputes the claimant's allegation that Alberta coal mine operators were paid millions of dollars for the economic disruption to their operations when none was paid to the only American coal mine operator. Canada claims that no company or individual

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[43] *Ibid* at paras 16–17.

[44] Trans Canada Corporation & Trans Canada Pipelines Limited, "Request for Arbitration" (24 June 2016) at para 91, online (pdf): <www.state.gov/wp-content/uploads/2019/05/Notice-of-Arbitration.pdf>.

[45] US, The White House, *Message from the President of the United States returning without my approval S. 1, The Keystone XL Pipeline Approval Act* (S Doc no 114-2) (Washington, DC: US Government Publishing Office).

[46] US, The White House, *January 24, 2017 Presidential Memorandum Regarding Construction of the Keystone XL Pipeline* (Federal Register 82:18) (Washington, DC) at 8663.

[47] Westmorland Mining, *supra* note 12 at para 111.

[48] *Ibid* at para 13.

received any payment from the government of Alberta with respect to any interest in a mine under the governments 2015 Climate Leadership Plan designed in part to eliminate the generation of electricity by coal.

Canada further claims that the plan took no policy stance on continued coal mining in the province. Rather Canada argues that the payments in question were voluntary payments that the government of Alberta undertook in 2016 to provide the owners of six coal-fired generating units in the province with an incentive to reduce carbon emissions by moving from generating electricity by coal to generation by natural gas. Canada argues that the payments had two objectives. The first was to reduce emissions from electricity generation. The second goal was to ensure that the generating plants would continue operating and provide electricity to the Alberta grid. The province believed that this could be achieved by converting the coal plants to gas-fired generation plants. Put simply Canada says that Westmoreland was not a generating unit and did not qualify. In short, Westmoreland was not "similarly situated" to the electricity generators that received the payments.

This is an argument similar to the argument that Canada made in *Windstream*.[49] There Windstream had argued that Canada treated TransCanada more favourably when Ontario made significant payments to encourage TransCanada to terminate operations when at the same time no payments were made to Windstream. Canada pointed out that TransCanada was very different from Windstream. Windstream was a wind generator. TransCanada was a gas plant. They were entirely different operations and the rationale for the payments was entirely different. The tribunal in *Windstream* accepted the distinction. This argument will no doubt be central in Westmoreland.

Tennant Energy

The latest energy arbitration against Canada under NAFTA is Tennant Energy (Tennant).[50] This is a follow-on case to *Mesa* and relies on much of the evidence developed in that case. Tennant, based in Napa California filed a claim in June 2017 against Canada for C$116 million related to a breach of Article 1105 of NAFTA.

As in *Mesa* the claim related to the actions of the province of Ontario in awarding contracts under the FIT contracts developed under the *Green Energy Act*.[51] Like *Mesa*, Tennant claims that the FIT contacting process was unfairly manipulated to favour the Korean Consortium to the detriment of all the other applicants.

Tennant argues that not only was there unfair manipulation, the province deliberately failed to release information which would put all parties on a level playing field. These steps Tennant argues were inconsistent with Canada's obligations under NAFTA including Article 1105 of Chapter 11. Tennant claimed for wrongful actions:

a. Ontario unfairly manipulated the award of access to the electricity transmission grid, resulting in unfair treatment to the investors.

b. Ontario unfairly manipulated the dissemination of program information under the FIT program.

c. Ontario unfairly manipulated the awarding of Contracts under the FIT program.

d. Senior officials improperly destroyed necessary and material evidence of their internationally unlawful actions in an attempt to avoid liability for their wrongfulness.

The damages sought had a unique twist. Of the C$116 million claimed C$35 million related to "moral damages" that the investor suffered from "the improper actions of the Respondent including improper measures to suppress its wrongful conduct and for the gross unconscionable conduct of Ontario in the maladministration of the program resulting in the abuse of process and detriment to the Investment and the Investor." This is the first NAFTA case claiming moral damages. It appears to be the arbitration version of punitive

[49] Windstream, *supra* note 11.

[50] Tennant, *supra* note 12.

[51] *Green Energy and Green Economy Act*, 2009, SO 2009, c 12, Schedule A.

damages. Not only does this case borrow on the evidence from *Mesa* it also relies on evidence from *Trillium*,[52] a common law tort case discussed in the next section. *Trillium, Mesa*, and *Tennant* are all in the same boat. They are challenging arbitrary acts of the Ontario Government in connection with wind projects. Of particular interest is the fact that in *Trillium*, the plaintiff, brought an action for spoliation claiming that senior Ontario government officials destroyed documents relevant to the case. Tennant also relies on that evidence to support its claim of wrongful conduct and abuse of process. The matter is currently proceeding before the tribunal.

THE COMMON LAW REMEDIES

Disguised Expropriation

Chapter 11 is history, but no one is crying. In fact, a remedy created by the Supreme Court of Canada in 2018 may provide investors with even greater protection than Chapter 11 of NAFTA provided. In *Lorraine (Ville) v 2646-8926 Québec inc.*, the Supreme Court created a common law remedy for de facto or disguised expropriation.[53] Unlike the Chapter 11 remedy, this can be used by both foreign and domestic investors. In fact, the first application is an energy case involving LGX Oil and Gas (LGX). There, LGX brought a C$60 million claim against Canada on the basis that an order two years earlier by Environment Canada had devalued their oil and gas wells in southern Alberta.[54] That order prohibited construction and noise activities in April and May of each year, which was the mating season for the greater sage grouse.

The concept of expropriation deals with the power of a public authority to deprive a property owner of his or her property and the benefits from that property. In the *Lorraine* case, the Supreme Court Canada defined in some detail what it called "disguised expropriation" or "de facto expropriation." Essentially, disguised expropriation involves an abuse of power. That occurs when a public authority exercises its regulatory power unlawfully in a manner inconsistent with the purpose of the legislation it is acting under. At the end of the day, the court must assess the reason why the government acted in the way it did. In that sense, the court is exercising a function similar to an arbitrator in a NAFTA case. Recall that in *Windstream*, the tribunal questioned whether the real rational for the moratorium the province placed on offshore wind projects was the need for more scientific research. It was significant, the tribunal found, that Ontario made little if any effort to accommodate Windstream and seemed to deliberately keep Windstream in the dark. The word deliberate is important.

In the case of disguised expropriation, the court must determine whether the act is discriminatory on unjust. In short, there must be a finding of abuse of power and/or bad faith.

In the *Lorraine* case, the Supreme Court considered whether the environmental regulation at issue was legitimate. The plaintiff had purchased a lot in a residential area in the town of Lorraine in Quebec with the intention to subdivide the property for residential construction. A few years later the town adopted a bylaw that turned half of the property into a conservation area preventing the plaintiff from constructing residential properties.

The court indicated that the plaintiff had two remedies confirming an earlier decision of the Supreme Court in *Canadian Pacific Railway Co. v Vancouver (City)*.[55] There, the railway was unsuccessful because the court found that the City of Vancouver had not acted in bad faith,

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[52] *Trillium Power Wind Corporation v Ontario (Natural Resources)*, 2013 ONCA 683 [*Trillium*].

[53] *Lorraine (Ville) v 2646-8926 Québec inc.*, 2018 SCC 35 [*Lorraine*].

[54] *LGX Oil + Gas Inc et al. v Attorney General of Canada* (3 December 2015), Calgary, Alta, ABQB 1401-10147 (Statement of Claim); See also *LGX Oil + Gas Inc (Receiver of) v Attorney General of Canada* (16 May 2018), Calgary, Alta, ABQB 1501-14562 (Amended Statement of Claim) (The Plaintiffs are LGX Oil & Gas Inc., by its Court-appointed receiver and manager Ernst & Young Inc.; The City of Medicine Hat; Lintus Resources Limited; Swade Resources Ltd.; WF Brown Exploration Ltd.; Barnwell of Canada Ltd.; and Spyglass Resources Corp. The Amended Statement of Claim revised an initial damages figure of C$60MM to C$123.6MM); See also *The City of Medicine Hat et al. v Attorney General of Canada et al.* (3 January 2014), Calgary, Alta, FC T-12-14 (S 18.1 Application for Judicial Review, LGX Oil and Gas and the City of Medicine Hat, which had interests in the Manyberries oil production site that was affected by the sage grouse order, brought a judicial review and constitutional challenge of the sage grouse order at the Federal Court of Canada.).

[55] 2006 SCC 5.

and had acted within its authority. The result in *Lorraine* was different however. The court did find that the town had acted in bad faith and stated that the plaintiff could either seek a declaration that the town had acted outside its authority or — in the alternative — could claim an indemnity or payment to reflect the value it had lost. There was however a problem in that the plaintiff had missed a limitation period but nonetheless the court's statement if respect to the law and the right's of plaintiff's in the case of disguised expropriation is very clear. The rights under the common law are just as strong as the rights that foreign investors have or at least had under NAFTA. The difference here however is that they are available to both foreign and domestic investors.

Good Faith in Contract Performance

In 2014, the Supreme Court of Canada released its decision in *Bhasin v Hrynew*,[56] a ground breaking decision that recognized a common law duty of good faith in the performance of contracts. Five years later on December 19, 2019, the same court heard two appeals together on the same issue. One case was from British Columbia,[57] the other was from Ontario.[58] The decision has yet to be released but the general view is that it will move this important area of the law forward. The court noted that the duty of honesty does not require a party to disclose material to the contracting parties, but, a party cannot actively mislead or deceive the other contracting party in relation to the performance of the contract. As Justice Cromwell explained:

> This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is a simple requirement not to lie or mislead the other party about one's contractual performance.

The Supreme Court decision in *Bhasin* is novel. It recognized a new common law duty that applies to all contracts. The new duty is one of honest performance which means the parties must not lie or knowingly mislead each other about matters linked to the performance of a contract. The court did recognize that the common law is not permitted to override express contract terms. Put differently defendants cannot be faulted under the good faith doctrine for performing in a manner that is entirely consistent with the contracts express terms. The law in this area in Canada is moving forward. The concept is not as strong in American law where good faith and implied obligations are restricted to filling in contractual gaps.[59]

Misfeasance in Public Office

In the last decade, the tort of misfeasance in public office has become commonplace. In Canada this cause of action dates back to 1959 and the famous *Roncarelli v Duplessis*[60] decision by the Supreme Court of Canada. There the Premier of Québec improperly ordered the manager of the Québec liquor Commission to revoke Roncarelli's liquor license because Roncarelli had provided bail money to several Jehovah witnesses arrested by the Premier. The Supreme Court of Canada found that the Premier had no grounds for ordering this and had acted with malice.

Not much happened until the House of Lords' decision in *Three Rivers District Council v Bank of England*[61] in 2001 and the Supreme Court of Canada followed suit in *Odhavji Estate*[62] two years later.

The plaintiffs in *Three Rivers* were 6000 depositors the Bank of Credit and Commerce

[56] 2014 SCC 71 [*Bhasin*].

[57] *Greater Vancouver Sewerage and Drainage District v Wastech Services Ltd.*, 2019 BCCA 66.

[58] *CM Callow Inc. v Zollinger*, 2018 ONCA 896.

[59] Stephen Burton, "Breach of Contract and Common Law Duty to Perform in Good Faith" (1980) 94 Harv L Rev 369.

[60] *Roncarelli v Duplessis*, [1959] SCR 121, 16 DLR (2d) 689.

[61] *Three Rivers District Council v Bank of England*, [2000] UKHL 33.

[62] *Odhavji Estate v Woodhouse*, 2003 SCC 69.

International (BCCI) in London who had suffered economic losses due to the fraud and eventual liquidation of BCCI. The depositors brought a claim for misfeasance against the senior officials of the Bank of England who they claimed had acted in bad faith in licensing BCCI as a deposit taking institution. The creditors complained that the Bank of England officials should have taken steps to close down the BCCI given that "known facts cried out for action."

The main issue in *Three Rivers* was the required state of mind of the defendant or what is typically described as malice. The general view was that malice required some degree of bias or personal ill will against the plaintiff or something that came to be known as targeted malice. In *Roncarelli*, for example, the plaintiff had established that the defendant Premier of Québec had a deliberate intention to harm the plaintiff restaurant owner for his involvement with the Jehovah Witnesses. He specifically ordered the revocation of the plaintiff's liquor license in order to cause the plaintiff financial harm.

We then move to the Supreme Court of Canada and the decision in *Odhavji Estate*. The Court of Appeal for Ontario was divided on whether mere breach of the statue was sufficient to ground a claim for misfeasance in public office or whether the tort required abuse of power or authority. The majority concluded the mere breach of statutory obligation was not sufficient for the claim and struck out the claim. The Supreme Court of Canada reversed and restored the claim. Iacobucci J. writing for a unanimous court concluded that the tort is not limited to abuse of statutory power, but was "more broadly based on unlawful conduct in the exercise of public functions." He stated that the tort "could be included in a broad range of misconduct" and the essential question was whether "the alleged misconduct is deliberate and unlawful." In addition, he stressed the public authorities disregard for the plaintiff's interest stating:

> Liability does not attach to each officer who blatantly disregards his or her official duty, but only to a public officer who, in addition, demonstrates a conscious disregard for the interest of those who will be affected by the misconduct in question. This requirement establishes the required nexus between the parties.

Around the same time, another important decision was released in England. In 2006 in *Watkins v Home Office & Ors*[63] the House of Lords established that misfeasance in public office was not actionable unless there is damage. In 2008, another important decision of the Court of Appeal in Ontario was released in *Ontario Racing Commission v O'Dwyer*.[64] Rouleau J. writing for the court found for the plaintiff where he stated the Commission had engaged in "unhelpful and misleading correspondence with the plaintiff" the and Commission officials were "reckless, indifferent or willfully blind to the illegality of their actions and the potential harm to the plaintiff." This type of language is remarkably similar to what the NAFTA panel found in *Windstream*.

The tort of misfeasance in public office has also been used in a number of Canadian energy cases. In *Granite Power Corp. v Ontario*,[65] the Court of Appeal for Ontario allowed the plaintiff to proceed with a misfeasance claim against the Ontario government for acts it took in the privatization of the Ontario power industry. The plaintiff, Granite Power, was a small private utility company located in Gananoque, Ontario. Since 1885, Granite Power had supplied electricity to Gananoque. The company had an exclusive agreement to supply power to the town from 1994 to 2014. However in 1997, the Ontario government change the provincial energy policy to allow new competition. The statute that created that regime allowed the province to grant exemptions to private suppliers like Granite to continue their exclusive agreements with small municipalities. Granite Power applied to the government for such an exemption.

Ontario granted the requested exemption in 2002. However, between 1998 and 2002 the government's communication had been

[63] [2006] UKHL 17.

[64] 2008 ONCA 446.

[65] [2004] OJ No 3257; 72 OR (3d) 194.

noncommittal and ambiguous. The government allowed advertising that suggested that Granite Power's monopoly to serve the town was likely to disappear. To add insult to injury the town used the new provincial policy to challenge the exclusive agreement it had with Granite Power. Granite Power argued that the government's delay and lack of candor had caused its supply agreement to become worthless and claimed damages from the provincial government for that loss.

The Court of Appeal for Ontario allowed Granite Power claim for misfeasance in public office to proceed finding that there were sufficient allegations that the province acted maliciously and in bad faith. Specifically it was alleged that the province had deliberately delayed its decision whether to grant an exemption to Granite Power. This made it difficult for Granite Power to make critical business decisions. The Province was also accused of promoting its new energy policy in a fashion that allowed new retailers to get a foothold in the community. The Court of Appeal concluded that these allegations, if proved, would support a successful claim for misfeasance in public office.

The next energy decision involving this cause of action was *Saskatchewan Power Corporation v Swift Current (City)* in 2007.[66] There, the plaintiff complained that Saskatchewan Power, a state owned utility, had used its monopoly position to engage in predatory pricing and had amended the terms of service in its supply contract unilaterally. The plaintiff argued that this amounted to misfeasance in public office.

The defendant brought a motion to strike the claim on the basis that the plaintiff had not identified any human being as having the requisite bad faith or malice to make up the tort. The defendant argued that the Corporation was incapable of having the necessary malice or intent. The Saskatchewan Court of Appeal held that this was not fatal to the claim. The Court interpreted public office broadly stating that there was no reason to distinguish between the officeholder and the office itself.[67] The claim was allowed to proceed.

We then come to the *Trillium* case in Ontario.[68] This case is close to the fact situations in the NAFTA arbitrations in *Mesa* and *Windstream*.

Trillium Power Wind Corporation (Trillium), a Toronto-based developer building offshore wind turbines in Lake Ontario, applied to lease provincial land under Ontario's wind power policy and had been granted applicant-of-record status by the Ministry of Natural Resources. That status gave Trillium three years to test the wind power. After that, the company could proceed with an environmental assessment and obtain authorization to operate the wind farm.

Trillium subsequently notified the Ontario Ministry of Natural Resources that the company intended to close a C$26 million financing for the project. On the same day the government of Ontario issued a moratorium on offshore wind development, including by developers like Trillium that had applicant-of-record status. The government issued a press release stating that the projects were cancelled pending further scientific research.

Trillium brought a number of claims against the Ontario government seeking $2 billion in damages. The claims included breach of contract, unjust enrichment, negligent misrepresentation, misfeasance in public office and intentional infliction of economic harm. The province brought a motion to strike the Trillium statement of claim on the basis that it did not disclose a reasonable cause of action. The motion was successful. The motion judge found that the government decision to close the wind farms was a policy decision and therefore immune from suit.

The motion judge also found that the fact that Trillium had been granted applicant-of-record status did not amount to a contractual relationship between Trillium and the government. The motion judge concluded that the claim should be struck because it was plain and obvious that the claim could not succeed at trial.

Trillium appealed on two grounds: first, misfeasance in public office was a tenable claim

[66] 2007 SKCA 27.

[67] See also *Georgian Glen Development v Barrie*, [2005] OJ No 3765; 13 MPLR (4th) 194 (Where the court found that a municipality could be a public officer for the purpose of the tort).

[68] *Trillium*, *supra* note 52.

as a matter of law; and second, the claim had been adequately pleaded. The Court of Appeal for Ontario agreed. It was not clear that the claim of misfeasance in public office would necessarily fail. Moreover, Trillium had properly pleaded that the province's actions were taken in bad faith for improper purpose. The Court also found that the government's decision was made to harm Trillium specifically. While the Court of Appeal did agree with the motions judge that a government decision involving political factors was not the basis for a cause of action, but there was an exception for irrational acts of bad faith. The facts in this case were unique. It was clear that Trillium's announcement disclosing new financing triggered the government action. And, as the court concluded, that Trillium should be entitled to proceed based on the allegations that the government specifically targeted Trillium. The court was clear that decisions motivated by political expediency do not constitute bad faith for the purpose of a tort claim, stating as follows:

> Ministerial policy decisions made on the basis of "political expediency" are part and parcel of the policy-making process and, without more, there is nothing unlawful or in the nature of "bad faith" about a government taking into account public response to a policy matter and reacting accordingly.

The court found that in order to make out "bad faith" for the purpose of the tort of misfeasance in a public office, Ontario must have acted deliberately in a manner that was "inconsistent with the obligations of its office."

Trillium never found its way to trial but *Capital Solar Power Corporation v The Ontario Power Authority*[69] did. The plaintiff, Capital Solar Power was a small business that submitted applications to the microFIT Program operated by the OPA, an agency of the Ontario government. These applications were submitted on behalf of their customers. In submitting these applications Capital Solar Power relied on the microFIT rules and pricing schedule provided by the OPA.

On October 31, 2011 the OPA announced a new pricing schedule. The rules required that the OPA provide 90 days' notice of any changes. The OPA did not provide that notice.

As result of the new price changes Capital Solar Power lost all of its potential customers. Capital Solar Power then filed a claim against the OPA for misfeasance in public office because the OPA had amended the microFIT Program without 90 days' notice.

The court rejected the claim finding that it was not issued for any improper purpose and there was no element of bad faith or dishonesty the OPA's actions. The court found the OPA made the changes in accordance with the direction from the Minister of Energy and the OPA was attempting to achieve a balance amongst common interests.

There was also some discussion of damages. The court reduced the damage claim from C$3 million to C$450,000. In the end the court did not award any damages because the plaintiff had failed to establish liability against the OPA with respect to misfeasance in public office. The case reinforces the importance of the proposition that when it comes to the tort of misfeasance in public office an essential component is that the plaintiff must establish a clear intent on the part of the public official to harm the defendant or at least that she or he should have known that harm would result. That is known as "reckless disregard."

STATE TO STATE CLAIMS

There is no question that NAFTA has had a significant impact on the Canadian energy sector. It certainly has stimulated investment in the sector. And American investors have taken advantage of Chapter 11 to question energy policy and regulatory decisions made in British Columbia, Alberta, Ontario, Québec and Newfoundland and Labrador. Ontario has been the bad boy with three cases project to date questioning the provinces management of the FIT contract program under the *Green Energy Act*.

Going forward, things will be different. Private investors from United States no longer have any right to bring a NAFTA action on their own

[69] 2019 ONSC 1137.

volition in Canada. The Canadian investors have lost a similar right in the United States. The loss impacts the American investors most. They are the ones that have been most active under Chapter 11 of NAFTA.

While the right to bring a private action is gone, the state to state action continues. This of course requires the investor to convince the government to bring an action, which is not always easy.

The new NAFTA regime is complicated in that it creates two classes of investors, priority investors and non-priority investors. The priority investors are investors that are parties to a government contractor in one of five sectors: oil and gas, power generation, telecommunications, and infrastructure. The protection available to priority investors under the new NAFTA is largely the same as under the old NAFTA.

For the non-priority investors the new NAFTA it is not nearly as attractive as the old NAFTA. First of all, there is a requirement that those investors must exhaust all legal remedies in the local courts before they can bring the claim under the new NAFTA. These investors cannot bring a NAFTA application until they have a final decision from the local courts or 30 months have passed by. This may be of little concern to the energy sector however. Investors in oil and gas and power generation qualify as priority investors and will not face this limitation.

CONCLUSION

The fact that Chapter 11 dispute resolutions has been abolished between Canada and the United States may not turn out to be that significant. The common law cases under the misfeasance in public office tort have not been that successful. But it looks like the cases under the new common law actions, disguised expropriation, and good faith in contract performance, are much more promising. There is no reason to believe that American investors will not take advantage of this developing law. In fact, non-priority investors will be required to. As far as the Canadian regulators and governments are concerned, they should pay attention to the fact that these new causes of action, unlike NAFTA, are not limited to foreign investors and include domestic investors. While the publicity surrounding NAFTA has focused on foreign investors because they were the only ones that could exercise that remedy, the fact is just as much investment in renewable energy throughout Canada comes from domestic investors as foreign investors. Put differently, the surveillance and policing of dubious policy decisions that discriminate against particular parties is not going away. If anything, it will increase.

One last comment may be in order. While investors may continue to have protection through common law remedies. A treaty is a treaty. The Government liability is clear Common law remedies however are still subject to legislation and most jurisdictions have some form legislation setting out various forms of Crown Immunity. That argument is being raised in the Trillium case before the Ontario Courts. It will be an important decision. ■

APPENDIX A

230 Law and Economics Professors Urge President Trump to Remove Investor-State Dispute Settlement (ISDS) From NAFTA and Other Pacts

October 25, 2017

Dear President Trump:

Last year, more than 200 U.S. law professors and economics professors sent a letter urging Congress to oppose the Trans-Pacific Partnership (TPP) because it included the controversial Investor-State Dispute Settlement (ISDS) regime that is also at the heart of the North American Free Trade Agreement (NAFTA). The letter included prominent supporters of "free trade" who considered the negative consequences that ISDS poses for our legal system as overriding grounds to oppose the TPP.

We are writing to urge you to remove ISDS from NAFTA, as well as to leave ISDS out of any future trade or investment pact.

ISDS grants foreign corporations and investors rights to skirt domestic courts and instead initiate proceedings against sovereign governments before tribunals of three private-sector lawyers. In those proceedings, foreign investors can demand taxpayer compensation for laws, court rulings and other government actions that the investors claim violate loosely defined rights provided in a trade agreement or investment treaty. The merits of those rulings are not subject to appeal, but are fully enforceable against the U.S. government in U.S. courts.

As Chief Justice John Roberts noted in his dissent in BG Group PLC v. Republic of Argentina, ISDS arbitration panels hold the alarming power to review a nation's laws and "effectively annul the authoritative acts of its legislature, executive, and judiciary." ISDS arbitrators, he continued, "can meet literally anywhere in the world" and "sit in judgment" on a nation's "sovereign acts."

The problem with ISDS is not that it allows private corporations to sue the government for conduct that harms the corporations' economic interests. Indeed, U.S. domestic law already recognizes the importance of granting private citizens and entities (including foreign corporations) the power to take legal action against the government in order to help promote effective implementation of the law and adherence to the Constitution.

However, through ISDS, the federal government grants foreign investors - and foreign investors alone - the ability to bypass the robust, nuanced, and democratically-responsive U.S. legal framework. Foreign investors are able to frame questions of domestic constitutional and administrative law as treaty claims, and take those claims to a panel of private international arbitrators, circumventing local, state, or federal domestic administrative bodies and courts. ISDS thus undermines the important roles of our domestic and democratic institutions, threatens domestic sovereignty, and weakens the rule of law.

Over the past two centuries, the United States has established a framework of rules that govern lawsuits against the government and continually refines them through democratic processes. These include rules on court procedures and evidence, which are designed to ensure the fairness, legitimacy and reliability of proceedings; on who may bring lawsuits and under what circumstances, which are designed to balance the right to sue with the need to ensure that government action is not made impossible due to unlimited litigation; on the power of courts, which are designed to ensure that judges do not overly intrude on legitimate policy decisions made by elected legislatures or executive officials; on appropriate remedies, which are crafted to achieve policy aims such as deterrence, punishment, and compensation; and on the independence and accountability of judges

Freed from the rules of U.S. domestic procedural and substantive law that would have otherwise governed their lawsuits against the government, foreign corporations can succeed in lawsuits before ISDS tribunals even when domestic law would have clearly led to the rejection of those companies' claims. Corporations are even able to re-litigate cases they have already lost in domestic courts.

It is ISDS arbitrators, not domestic courts, who are ultimately able to determine the bounds of proper U.S. administrative, legislative, and judicial conduct.

In addition to the central problem of establishing a parallel and privileged set of legal rights and recourse for foreign economic actors operating here, ISDS proceedings lack many of the basic protections and procedures normally available in a court of law. There are no mechanisms for domestic citizens or entities affected by ISDS cases to intervene or meaningfully participate in the disputes; there is no appeals process and therefore no way of addressing errors of law or fact made in arbitral decisions; and there is no oversight or accountability of the private lawyers who serve as arbitrators, many of whom rotate between being arbitrators and bringing cases for corporations against governments.

Currently, NAFTA is the only ISDS-enforced agreement in force between the United States and a major capital exporting nation. That means that only a relatively small share of foreign direct investment in the United States - roughly 10 percent - is subject to ISDS claims. Yet ISDS is included in the draft text for the Transatlantic Trade and Investment Partnership (TTIP) and in the U.S. Model Bilateral Investment Treaty (BIT), which is the template for the U.S.-China BIT, both of which were being negotiated by the previous administration. The TTIP and China BIT would expand dramatically the share of foreign direct investment subject to ISDS claims in the United States - by at least 360 percent. While we have avoided losing an ISDS case to date, tribunals have ruled against the United

States on important elements of these cases, meaning it is only a matter of time before we lose a case, especially if ISDS remains in NAFTA and is further expanded in new agreements.

The United States has typically agreed to supranational adjudication only in exceptional cases and after resolving a range of complex considerations about the scope and depth of supranational authority over domestic policies and the available remedies to aggrieved parties. The inclusion of ISDS in U.S. trade and investment deals brushes aside these complex concerns and threatens to dilute constitutional protections, weaken the judicial branch, and outsource our domestic legal system to a system of private arbitration that is isolated from essential checks and balances.

Scholars across the political spectrum - from the Cato Institute's Daniel Ikenson to former Vice President Joe Biden's chief economist Jared Bernstein - have noted that there is no need for ISDS. U.S. firms that seek to offshore their investment to venues that do not have reliable domestic legal systems can purchase risk insurance or look for safer jurisdictions; remaining issues can be addressed through state-state dispute resolution, as is the norm under all other areas of international economic law. Moreover, they note, exposing the U.S. Treasury and our legal system to ISDS liability also has the perverse effect of subsidizing offshoring to or investing in countries with riskier or less developed legal systems by lowering the risk premium of relocating investment there.

For these reasons, we urge you to stop any expansion of ISDS - namely through the China BIT and the TTIP - and to eliminate ISDS from past U.S. trade deals, beginning with NAFTA.

Thank you for your consideration.

Organizational affiliation for all signatories is included for identification purposes only; individuals represent only themselves, not the institutions where they are teaching or other organizations in which they are active.

Joseph Stiglitz, Nobel Laureate in Economics, University Professor, Columbia University

Jeffrey D. Sachs, Professor of Economics, Director of Columbia University's Earth Institute, Columbia University

Robert B. Reich, Chancellor's Professor of Public Policy, University of California at Berkeley

For the complete list of authors, please refer to : www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/2017%20Letter%20to%20Pres.pdf

US ENERGY MERGERS: IS "NO HARM" THE RIGHT TEST?

*Scott Hempling**

In earlier articles and essays[1] I explained that the sales of public franchises for private gain, undisciplined by effective competition, produced a concentrated, complicated industry no one intended. Repeated 80 times over 30 years, electricity mergers have wasted economic resources, diverted value from customers to shareholders, weakened competitive forces and intensified intra-corporate conflict. Let's start with economic waste.

Price over performance: A loss to consumers and the economy

In both competitive and monopoly markets, acquisition targets choose their acquirers based on highest price. In competitive markets, that highest price will come from the most cost-effective performer. Its ability to compete successfully against others creates the expected revenue-to-cost margin that supports its acquisition price. Competitive markets align the interests of acquirer, target and customers.

Monopoly markets don't. Because a monopoly market lacks a competitive market's discipline, the highest-price acquirer won't necessarily be the best performer. If target utilities prioritized performance, competing acquirers would lower their offer prices and their costs, enabling post-merger service at lower rates. The economy gains. But target utilities choose their acquirers based on price instead of performance, so the economy loses. As do customers, because their utility has denied them what they pay for — service at a quality and cost that replicates competitive market outcomes.

But won't the highest offer price necessarily come from the most cost-effective performer? Not in a utility monopoly market, because the final product price is set not by competition but by regulators. The acquirer will base its high-price offer not on its expectation of beating its competitors but on its expectation of persuading regulators — persuading them to set rates above appropriate levels.

"No harm": The wrong benefit-cost ratio

Merger investors seek biggest bang for buck. Most regulators require only "no harm." This simple difference explains why merger gains go disproportionately to investors. No-harm conflicts with regulation's central purpose: to produce outcomes comparable to competition. In regulation, "no harm" means zero gain. In competition, zero gain would get any executive fired.

Competition forces continuous improvement — from horses to jet engines; from smoke signals to the world wide web. No competitive company succeeds by promising customers no harm. If commissions required merger applicants to act like competitive companies, targets would select acquirers based on performance rather than price. All interests would be aligned.

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[1] See Scott Hempling, "Inconsistent with the Public Interest: FERC's Three Decades of Deference to Electricity Consolidation" (2019) 7:2 Energy Regulation Q 33, online (pdf): <www.energyregulationquarterly.ca/wp-content/uploads/2019/07/ERQ_Volume-7_Issue-2_2019.pdf>; See also Scott Hempling, ""Regulatory Settlements": When Do Private Agreements Serve the Public Interest?" (2019) 7:3 Energy Regulation Q 71, online (pdf): <www.energyregulationquarterly.ca/wp-content/uploads/2019/10/ERQ_Volume-7_Issue-3-2019.pdf>; See also Scott Hempling, "Merger Rejected: Common Sense from Washington" (2019) 7:1 Energy Regulation Q 63, online (pdf): <www.energyregulationquarterly.ca/wp-content/uploads/2019/03/ERQ_Volume-7_Issue_1_2019.pdf>.

No-harm conflicts with classic prudence analysis. Suppose a utility has a worn-out, $10/hour widget. It buys a new$10/hour widget when an $8/hour widget of equal quality is available. If the utility CEO said, "We were prudent because we caused no harm," they'd be laughed out of the hearing room, and the commission would disallow $2/hour as imprudent. Similarly, a merger should be the least-cost means of producing a guaranteed benefit. No harm doesn't cut it.

Acquisition cost: Usually ignored

No one buys a rental property just because the rents cover the operating costs. If the rents don't also recover the acquisition cost, the purchase makes no economic sense. So when computing a deal's benefit-cost-ratio, the acquirer includes not just operating cost but acquisition cost.

Yet most commissions compare a merger's benefits to its costs without considering acquisition cost. The likely reason: Merger applicants don't seek, at least not explicitly, to recover the acquisition cost from their customers. So regulators view acquisition cost as the acquirer's problem. But if they omit acquisition cost from their benefit-cost review, they can't know if the deal is cost-effective. More economic waste.

Benefit-counting: Common regulatory errors

When comparing a merger's costs to its benefits, which claimed benefits should count as real benefits? Only those that are unachievable without the merger. Yet many merger applicants, and their regulators, include improvements that should happen without the merger. Real merger benefits offset merger costs. Counting ordinary improvements as offsets to costs means that customers effectively bear those costs. Consider two frequent claims: "economies of scale" and "best practices."

Economies of scale: Merger applicants talk of reducing duplication — like in customer billing, corporate accounting, shareholder relations and middle management. Big words, small potatoes. In 100-odd merger cases I've reviewed, in how many did the applicants present an economies of scale study conducted by someone not paid by them? None. In how many did they identify true scale economies not achievable by contracting rather than merging? Again, none.

"Best practices": Applicants' claims of best practices typically consist of generic references to mundane procedures rather than innovations outside the norm. Like any competitive company, a government-protected utility already has a duty to use best practices, merger or no merger. In other words, best practices are achievable without a merger. Replacing the target's quill pens and Roman numerals with computers and Arabic numbers merely brings prudence to the imprudent. No merger is necessary. As Judge Richard Posner wrote: "I wish someone would give me some examples of mergers that have improved efficiency. There must be some."[2]

Projecting merger benefits means comparing the merged company to the unmerged company, over time. A competitive company must improve over time or lose its customers; so must an unmerged company. When merger applicants attribute to the merger future improvements that should happen without the merger, they inflate merger benefits.

Items unrelated to the transaction: Merger applicants usually offer customers rate credits. If based on fact-based predictions of true merger savings, these payments should count as merger benefits. If not, they are persuasion payoffs. Counting them as merger benefits favours acquirers with cash over acquirers with merit. No sensible school gives students A's for donating to the teacher's retirement fund; no regulator should count rate credits unrelated to real merger savings.

* * *

Utility targets choose their acquirers based on price instead of performance. Too many commissions allow this economic waste by applying to mergers a standard of no-harm rather than maximum benefit to cost. And when assessing merger benefits and costs, commissions ignore acquisition cost; while counting as benefits operational improvements a prudent utility would achieve without a merger. By repeating these errors 80 times over 30 years, we make target shareholders better off while making customers, and the economy, worse off. We can do better. ■

[2] Richard Posner & C. Scott Hemphill, "*Philadelphia National Bank* at 50: An Interview with Judge Richard Posner" (2015) 80 Antitrust LJ 205 at 216 (referring to mergers generally).

RESOURCE PROJECTS AND THE HONOUR OF THE CROWN

*Martin Ignasiak, Sander Duncanson and Jesse Baker**

This case comment considers two decisions. The first is the Alberta Court of Appeal's decision in *Fort McKay First Nation v Prosper Petroleum Ltd*,[1] issued April 24, 2020, finding that the Alberta Energy Regulator (AER) improperly failed to consider the honour of the Crown separate from the duty to consult on Prosper's Rigel Oil Sands Project.

The second is The Nova Scotia Supreme Court's decision in *Sipekne'katik v Alton Natural Gas Storage LP*,[2] issued March 24, 2020, finding that Nova Scotia's Minister of Environment improperly failed to consult on asserted Aboriginal rights and title beyond the scope of the physical impacts of the project under consideration.

INTRODUCTION

Canadian courts have recognized that the "honour of the Crown" is a constitutional principle that seeks to reconcile pre-existing Aboriginal interests with the assertion of Crown sovereignty. The honour of the Crown is always at stake in the Crown's dealings with Aboriginal people, but the principle does not give rise to an independent cause of action. Rather, the honour of the Crown speaks to how certain Crown obligations must be fulfilled. Specifically, Courts have found that the honour of the Crown:

1. gives rise to a fiduciary duty when the Crown assumes discretionary control over a specific Indigenous interest;
2. gives rise to a duty to consult when the Crown contemplates an action that will affect a claimed but as of yet unproven Indigenous interest;
3. governs treaty-making and implementation, leading to requirements such as honourable negotiation and the avoidance of the appearance of sharp dealing; and
4. requires the Crown to act in a way that accomplishes the intended purposes of treaty and statutory grants to Indigenous peoples.[3]

While these four situations are the only areas where Courts have found the honour of the Crown to arise to date, it is possible that the above list may be expanded in the future.

Until recently, the principle of the honour of the Crown has been raised in regulatory proceedings and litigation as an ancillary argument to complaints about Crown consultation and the Crown's adherence to treaty obligations. Two recent court decisions out of Alberta and Nova Scotia, however, highlight that this principle may itself form the basis for successful challenges to regulatory decisions and may expand what was previously understood to be required by regulators and governments:

- *Fort McKay First Nation v Prosper Petroleum Ltd* (*Fort McKay*), in which

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[1] 2020 ABCA 163 [*Fort McKay*].

[2] 2020 NSSC 111 [*Sipekne'katik*].

[3] *Manitoba Metis Federation Inc v Canada (Attorney General)*, 2013 SCC 14 at para 73.

the Alberta Court of Appeal held that a regulator's mandate to consider the "public interest" includes an obligation to consider relevant issues of constitutional law, including the honour of the Crown separate from the duty to consult.[4]

- *Sipekne'katik v Alton Natural Gas Storage LP* (*Sipekne'katik*), in which the Nova Scotia Supreme Court held that the honour of the Crown required consultation on asserted Aboriginal rights and title beyond the scope of the physical impacts of the project under consideration.[5]

FORT MCKAY

Fort McKay concerned Prosper Petroleum Ltd.'s Rigel Oil Sands Project (Rigel Project) in Alberta and outstanding requests by Fort McKay First Nation (FMFN) for a Moose Lake Access Management Plan (MLAMP). The Rigel Project has also been the subject of other recent litigation that we have commented on.[6]

Since the early 2000's, FMFN has sought protection of a large area of land surrounding its "Moose Lake" Indian Reserves in northern Alberta through implementation of an MLAMP. Negotiations between the Government of Alberta and FMFN on an MLAMP have been intermittent, but included a Letter of Intent between former Premier of Alberta Jim Prentice and FMFN's Chief Boucher in 2015 to develop the plan within months. The content of the Plan remains subject to negotiations and has still not been finalized as of the date of this update.

The Rigel Project is proposed to be located within five kilometres of FMFN's Moose Lake Reserves, within the area proposed to be subject to the MLAMP. The Project was applied-for in 2013, shortly after the Project area was designated as being available for oil sands development in Alberta's Lower Athabasca Regional Plan (LARP). The Rigel Project is also immediately adjacent to the Dover Commercial Project, a much larger oil sands project that was approved by the Alberta Government in 2014 and is supported by FMFN.

In June 2018, after almost five years of regulatory review, the AER found the Rigel Project to be in the public interest of Alberta and approved it subject to Cabinet authorization.[7] In reaching its decision, the AER declined to consider whether the approval would frustrate negotiations between FMFN and Alberta related to the development of the MLAMP because, among other things (1) the AER has no jurisdiction to assess Crown consultation (by virtue of an express statutory provision), and (2) Cabinet was best positioned to decide whether MLAMP should be finalized before the project is allowed to proceed.[8]

The question on appeal was whether the AER improperly failed to consider the honour of the Crown and, as a result, failed to delay approval of the Rigel Project until the MLAMP negotiations were completed.[9]

Decision

The Alberta Court of Appeal (ABCA) held that the AER had an obligation to consider the honour of the Crown in relation to the MLAMP process and directed the AER to reconsider whether the Rigel Project is in the public interest after properly considering the honour of the Crown.[10]

The ABCA determined that the AER's mandate to consider the "public interest" includes an obligation to consider relevant issues of constitutional law such as the honour of the Crown (which the Court found was separate from the AER's lack of jurisdiction to

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[4] *Fort McKay*, *supra* note 1 at paras 38–43.

[5] *Sipekne'katik*, *supra* note 2 at paras 156–57.

[6] See Sander Duncanson et al, "Alberta Court gives Cabinet 10 days to decide on oil sands project" (2 May 2020), online: *Osler* <www.osler.com/en/resources/regulations/2020/alberta-court-gives-cabinet-10-days-to-decide-on-oil-sands-project>.

[7] *Re Prosper Petroleum Ltd. Rigel Project* (12 June 2018), 2018 ABAER 005 at para 1, online (pdf): *AER* <www.aer.ca/documents/decisions/2018/2018-ABAER-005.pdf>

[8] *Ibid* at para 182.

[9] *Fort McKay*, *supra* note 1 at para 28.

[10] *Ibid* at para 71.

consider the adequacy of Crown consultation). According to the Court, the matters that FMFN sought to put before the AER in relation to the MLAMP negotiations were "not limited to the adequacy of Crown consultation on this Project, but raised broader concerns including the Crown's relationship with the FMFN and matters of reconciliation [which] engage the public interest."[11] The Court found that these broader matters had not been removed from the AER's jurisdiction and were relevant to determining if the Project is in the public interest. Further, even if matters related to MLAMP could be better addressed by Cabinet, the Court held that the AER is not entitled to decline to address matters that fall within the scope of the "public interest."[12]

SIPEKNE'KATIK

Sipekne'katik concerned the Alton Natural Gas Storage L.P. Project (Alton Gas Project) in Nova Scotia and an appeal of the industrial approval (IA) for the Project's brine storage and discharge facility under Nova Scotia's *Environment Act*. Nova Scotia's Minister of Environment (Minister) dismissed Sipekne'katik's ministerial appeal of the IA after concluding that consultations with the Band had been sufficient. The question on appeal was whether the Minister made a "palpable and overriding error" when she concluded that the level of consultation was sufficient.[13]

Decision

The Nova Scotia Supreme Court (NSSC) held that the Minister's decision was not supported by the evidence and the Minister therefore committed palpable and overriding error when she concluded that the level of consultation with Sipekne'katik was sufficient. As a result, the Court reversed the Minister's decision and directed the parties to resume consultations for 120 days.[14]

The NSSC determined that consultation must focus on asserted rights and/or title and not on environmental impacts of a project *per se*.[15] While Sipekne'katik's asserted claims (including Aboriginal title) had not been proven or accepted by the government, the NSSC found that the honour of the Crown requires consultation on those claims so long as they are "factually credible."[16] The NSSC concluded that consultation on the Alton Gas Project was flawed because the Province never specifically engaged in a discussion of the asserted Aboriginal title claim or treaty rights during the consultation process. Rather, the consultation process focused exclusively on assessing, investigating, and mitigating, the potential environmental impacts of the Alton Gas Project.[17] The Court found that the Province should have completed a preliminary assessment of the strength of the Band's claim and potential impacts of the Alton Gas Project on that claim, and then given the Band the opportunity to review and comment on that assessment. The Province's failure to consult on the "core issue" of the Sipekne'katik's title claim meant that the Province precluded discussion of the full range of possible accommodation measures. The NSSC found that these flaws could not support a finding that the Province's consultation had been meaningful, deep or sufficient.[18]

IMPLICATIONS FOR REGULATORY PROCESSES

Fort McKay and *Sipekne'katik* both suggest that when Aboriginal groups raise concerns during the regulatory process that are beyond the scope of the project in question (such as regional land use plans and Aboriginal title claims), regulators and governments may need

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[11] *Ibid* at para 57.

[12] *Ibid* at para 64.

[13] *Sipekne'katik*, *supra* note 2 at para 68.

[14] *Ibid*, at paras 152, 164.

[15] *Ibid* at paras 129 (The NSSC cited *Clyde River (Hamlet) v Petroleum Geo-Services Inc.*, 2017 SCC 40, in which the Supreme Court of Canada (SCC) indicated that during consultation constitutionally protected rights must be "considered as rights, rather than as an afterthought to the assessment of environmental concerns", para 51. In that case, the SCC found that the National Energy Board's inquiry improperly focused on environmental concerns rather than on rights, para 45.)

[16] *Ibid* at para 85.

[17] *Ibid* at para 90.

[18] *Ibid* at para 152.

to conduct assessments into the credibility of those concerns and factor those concerns into their decisions and consultations on the specific project. This may significantly expand the role of public interest regulators from technical experts assessing a specific project's merits to supervisors of Crown conduct and treaty implementation. Governments may now also have to conduct preliminary strength of claim assessments whenever Aboriginal groups assert title (as they more and more frequently do), and consult on that specific issue in the content of every project's consultations. If widely implemented, these changes could fundamentally expand the obligations on regulators and governments across Canada and create new avenues for Aboriginal groups to legally challenge project approvals.

We note that both *Fort McKay* and *Sipekne'katik* involved unique facts where the provincial government in question had been made aware of an Aboriginal group's concern for years and had taken limited, if any, steps to address that concern. Courts have demonstrated an increasingly willingness to intervene in these types of circumstances to ensure that the honour of the Crown is upheld. It is unclear whether *Fort McKay* and *Sipekne'katik* represent a significant evolution in Aboriginal law in Canada, or whether those cases are limited in application to their unique facts. We recommend that project proponents, regulators and governments closely monitor how these cases are interpreted and applied by courts in the coming months to ensure each party's obligations in Crown consultation and treaty implementation are well understood and that Aboriginal risks on projects are appropriately mitigated. ■

MANITOBA HYDRO V MANITOBA PUBLIC UTILITIES BOARD: REDUCED RATES FOR INDIGENOUS PEOPLES OVERRULED

*Patrick Duffy**

In June 2020, the Court of Appeal of Manitoba released its decision in *Manitoba (Hydro-Electric Board) v Manitoba (Public Utilities Board)*[1] and overturned a utility board directive creating a special rate class for on-reserve First Nations in Manitoba.

While the court's decision ultimately turned on an interpretation of four intertwined Manitoba statutes, it raises the fascinating question of how long-standing principles of utility regulation should be interpreted and applied in light of the recognized need to advance reconciliation between Indigenous and non-Indigenous peoples.

As discussed below, the court's decision to overturn the special rate class demonstrates that efforts to further reconciliation with concrete action can run aground on the utilitarian principles of rate regulation. This outcome is sure to reprise long-standing disputes about the appropriate role of utility regulators *vis-à-vis* the government in setting and implementing social policy objectives.

BACKGROUND

Manitoba Hydro is a Crown corporation with a monopoly over the provision of power in Manitoba. Under subsections 39(2.1) and 39(2.2) of *The Manitoba Hydro Act* (the "*Hydro Act*"), the rates that Manitoba Hydro charges customers must be "the same throughout the province" and Manitoba Hydro is prohibited from classifying customers based "solely on the region of the province" in which they are located.[2] Subsection 43(3) of the *Hydro Act* states that the funds of Manitoba Hydro "shall not be employed for the purposes of the government."[3]

The rates that Manitoba Hydro charges customers are subject to review by the Public Utilities Board (PUB) under section 25 of *The Crown Corporations Governance and Accountability Act*[4] (the "*Crown Act*") and the *Public Utilities Board Act*[5] (the "*PUB Act*"). The PUB's mandate under section 77 of the *PUB Act* is to fix just and reasonable rates. Section 25 of the *PUB Act* provides that in setting Manitoba Hydro's rates the PUB "may take into consideration" a range of specific factors, including "*any compelling policy considerations*"

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[1] 2020 MBCA 60 [Court of Appeal Decision].

[2] *The Manitoba Hydro Act*, CCSM c H190, ss 39(2.1), (2.2).

[3] *Ibid*, s 43(3).

[4] CCSM c C336, s 25.

[5] CCSM c P280.

and "*any other factors*" that the PUB considers relevant to the matter.[6]

In 2016, Manitoba enacted *The Path to Reconciliation Act*[7] (the "*PTRA*") that defines reconciliation with Indigenous peoples and that aims to "promote measures to advance reconciliation" across government.[8] The *PTRA* identifies specific principles that the government must have regard for to advance reconciliation, including the need for "concrete and constructive action" to improve the relationships between Indigenous and non-Indigenous peoples.[9]

These four statutes — the *Hydro Act*, the *Crown Act*, the *PUB Act* and the *PTRA* — all played a role in the PUB's consideration of a General Rate Application filed by Manitoba Hydro seeking approval for, among other things, a 7.9 per cent general rate increase for all customer classes effective April 1, 2018.[10]

The PUB unanimously denied the proposed increase and instead ordered a 3.6 per cent average revenue increase. In addition, by way of a directive, a majority of the PUB ordered Manitoba Hydro to create a new rate class — the First Nations On-Reserve Residential customer class — that was to receive a zero percent increase.[11] The PUB stated the directive was in response to the degree of poverty on reserves and was consistent with the principle of reconciliation defined in the *PTRA*.[12]

One member of the PUB panel dissented on the directive to create an on-reserve class. The dissenting member opined that the PUB's directive was a departure from long-standing principles of utility regulation and that the PUB lacked jurisdiction to create a discriminatory customer class based on regions of the province.[13]

THE ARGUMENTS ON APPEAL

After an unsuccessful application before the PUB to vary the directive, Manitoba Hydro appealed the PUB's directive to the Manitoba Court of Appeal. The PUB actively participated in Manitoba Hydro's appeal of its decision[14] and the Consumers' Association of Canada (CAC) and the Assembly of Manitoba Chiefs (AMC) intervened in support of the PUB's directive.

The issues on appeal centered on whether the PUB had the jurisdiction to order Manitoba Hydro to create the on-reserve class and if it erred by intruding into social policy.

Manitoba Hydro argued that the PUB exceeded its jurisdiction in creating a new rate class and that the on-reserve class breached the prohibition in subsection 39(2.2) of the *Hydro Act* against creating classes based solely on the region of the province in which the customer is located. In support of its appeal, Manitoba Hydro relied upon the legislative history of subsections 39(2.1) and 39(2.2), which demonstrated that it was enacted to equalize rates among residential customers across the province. Prior to its enactment, rural and remote customers had paid more for the provision of power supplied by Manitoba Hydro.

Manitoba Hydro also asserted that the PUB had impermissibly intruded in social policy and erred by causing Manitoba Hydro to expend funds for the purposes of poverty reduction (a government purpose) in contravention of subsection 43(3) of the *Hydro Act*.

The PUB, supported by the CAC and AMC, asserted that it had broad jurisdiction under the *PUB Act* with respect to its review of rates charged by Manitoba Hydro and was empowered to consider social policy issues such

[6] *Supra* note 4, ss 25(4)(a)(viii)–(ix).

[7] CCSM c R30.5.

[8] *Ibid*, ss 1(1), 3(2).

[9] *Ibid*, s 2.

[10] Court of Appeal Decision, *supra* note 1 at para 1.

[11] *Ibid* at para 2.

[12] *Ibid* at para 19.

[13] *Ibid* at para 21.

[14] See *Ontario (Energy Board) v Ontario Power Generation Inc.*, 2015 SCC 44 at paras 41–62 for a discussion of an administrative tribunal's standing to participate in an appeal or review of its own decisions.

as energy affordability in Manitoba Hydro's rates. The PUB argued that the on-reserve class is not "solely based" on the region of the province, as it is defined by specific class members — members belonging to Manitoba First Nations, being residential customers and living on reserve. AMC argued that the PUB's directive was consistent with the *PTRA*.

THE COURT'S DECISION

The Court of Appeal granted Manitoba Hydro's appeal and overturned PUB's directive creating an on-reserve class. The court's decision can be broken down into four key points.

First, the court drew upon the Supreme Court of Canada's recent decision in *Canada (Minister of Citizenship and Immigration) v Vavilov*[15] to select the standard of correctness for its review of the PUB's decision.[16] The court held that all of the grounds of appeal advanced by Manitoba Hydro involved questions of jurisdiction, statutory interpretation and law and thus were reviewable for correctness.[17]

Second, the court sided with the respondents that the PUB has the jurisdiction to review Manitoba Hydro's customer classifications to ensure they are not unjust or unreasonable. In the court's view, the setting of customer classifications is an "inherent part of the setting of rates."[18]

Third, despite finding that the PUB could review Manitoba Hydro's customer classifications, the court found that the PUB had violated the statutory limits set out in the *Hydro Act* when exercising its jurisdiction to create the on-reserve class. In particular, the court pointed to the restrictions on regional rates under subsection 39(2.2) of the *Hydro Act*.[19] In the court's view, it was significant that the PUB had recognized in prior decisions that it could create customer classes provided that no geographic limitations were imposed on such a class.[20]

A key question tackled by the court was whether a reserve constituted a specific geographic region in the province.[21] In this regard, the court noted that reserves are defined as "tract[s] of land" under subsection 2(1) of the *Indian Act*.[22] A pivotal point in the court's reasoning was that, although the PUB created the on-reserve class to address poverty concerns, "treaty members who do not reside on reserve are not eligible, even if they are living in similar circumstances."[23] In the court's view, this demonstrated that "the defining circumstance for class membership is geographic location, not poverty or treaty status."[24]

In *obiter*, the court expressed its concern that "[h]owever well-intentioned, it cannot be just and reasonable for disadvantaged individuals on reserve to pay a lower price than similarly disadvantaged individuals located…elsewhere in the province."[25]

Fourth, the court held that the PUB exceeded its jurisdiction and violated the prohibition in subsection 43(3) of the *Hydro Act* against the use of Manitoba Hydro funds for government purposes.[26] Interestingly, the court held that the PUB is entitled to consider social policy, including bill affordability and purposes underlying the *PTRA*, but that does not equate to "the authority to direct the creation of customer classifications implementing broader social policy aimed at poverty reduction and which have the effect of redistributing

[15] 2019 SCC 65.

[16] Court of Appeal Decision, *supra* note 1 at paras 23–24

[17] *Ibid* at para 27.

[18] *Ibid* at paras 40–41.

[19] *Ibid* at para 47.

[20] *Ibid* at para 50.

[21] *Ibid* at para 51.

[22] RSC 1985, c I-5.

[23] Court of Appeal Decision, *supra* note 1 at para 53.

[24] *Ibid* at para 53.

[25] *Ibid* at para 55.

[26] *Ibid* at para 72.

Manitoba Hydro's funds and revenue to alleviate such conditions."[27] On that basis, the court concluded that the PUB's directive entered into a realm that is reserved for federal and provincial governments.[28]

OBSERVATIONS

The court's decision in this case raises a number of interesting considerations for those practicing in the area of utility regulation.

The court's ready adoption of a correctness standard for reviewing the PUB's decision, as directed by the *Vavilov* decision, is notable as the key that unlocked the door to a more taxing review of the PUB's reasoning by the court.[29] The analysis stands in stark contrast to the high levels deference that reviewing courts were providing to utility regulators interpreting their home statutes (or those closely connected to the regulator's functions) in the pre-*Vavilov* era. With the exception of the *PTRA*, all of the statutory provisions considered in this case were closely connected to the PUB's functions and its interpretation of those provisions would have been entitled to deference pre-*Vavilov*.

The court's decision on whether the PUB could create an on-reserve class turned largely on a provision specific to Manitoba Hydro that prohibited customer classification based on geographic location. The court recognized the legitimate role of social policy in rate-setting, but ultimately that could not overcome the very specific language of subsection 39(2.2) of the *Hydro Act*. While an argument could be made that the PUB's directive was motivated by factors other than regional discrimination, its effect was undoubtedly to create a distinction between classes based solely on geographical location, as illustrated by the court's comments on differential treatment of similarly situation on-reserve and off-reserve First Nations members.

However, while this point alone would have been dispositive of the appeal, it is notable that the court continued into a detailed discussion on whether the PUB had intruded into the realm of the federal and provincial governments. It is the court's discussion of this issue that is of most interest to those practicing in the area of utility regulation. Although the court's reasoning was anchored in the language of subsection 43(3) of the *Hydro Act*, it was not limited to that provision and the court explored more general principles on the role of social policy in utility regulation and its consideration in other provinces.[30] The court ultimately gave an unmistakable message that resonates beyond the specific Manitoba statutes at issue — social policy is best left to elected government and is not within the purview of utility regulators.

On this point, the court seems to have to come to a curious conclusion, particularly as it concerns the need to pursue the reconciliation of Indigenous and non-Indigenous peoples in Canada. The court stated that the PUB, under legislation enacted by an elected government, was "entitled to consider" social policy considerations (including bill affordability and the purposes of the *PTRA*). Yet the court effectively held that PUB was not entitled to *act* on those considerations because, if it were to do so, that would be intervening in the realm of the policy reserved for federal and provincial governments.[31] This reasoning begs the question: what is the point of directing a utilities regulator to "consider" social policy if it cannot act to address such considerations? This discrepancy is particularly notable in the context of the *PTRA* which, as noted above, includes a principle that calls upon government

[27] *Ibid* at paras 81–85.

[28] *Ibid* at para 87 (In an interesting aside, the court noted at para. 93 that the directive may actually, in some cases, amount to a subsidy to the federal government as the federal government pays for the hydro costs of persons living on reserve who are in receipt of employment income assistance).

[29] Other post-*Vavilov* decisions involving utility regulators include *Banfield v Nova Scotia (Utility and Review Board)*, 2020 NSCA 6, *Planet Energy (Ontario) Corp. v Ontario Energy Board*, 2020 ONSC 598 and *Enbridge Gas Inc v Ontario Energy Board*, 2020 ONSC 3616.

[30] The court cases considered by the court included *Dalhousie Legal Aid Service v Nova Scotia Power Inc.*, 2006 NSCA 74 and *Advocacy Centre for Tenants-Ontario v Ontario Energy Board*, 293 DLR (4th) 684, [2008] OJ No 1970 (QL), and *British Columbia Old Age Pensioners' Organization v British Columbia Utilities Commission*, 2017 BCCA 400.

[31] While the court's reasoning was limited to the redirection of Manitoba Hydro's funds to serve such purposes, it is difficult to conceive of a scenario in which the PUB could effectively address social policy considerations without somehow affecting the funds of Manitoba Hydro.

to take "concrete and constructive action" to further reconciliation.

The result of the court's decision is clear — the PUB cannot create a special on-reserve class. What is less clear is whether the PUB could create a special class for both on-reserve and off-reserve First Nations (perhaps even incorporating an income-tested threshold). Such a class would not offend subsection 39(2.2) of the *Hydro Act* and arguably "considers" social policy and the principles of the *PTRA*. However, it appears that such a class would still run afoul of the principles articulated by the Court of Appeal in this decision. In light of this outcome, it is reasonable for one to question whether the long-standing principles of utility regulation (often given reverential status by practitioners) should prevail when they collide with statutorily-endorsed principles of reconciliation. ■

CANADA ENERGY REGULATOR DENIES NGTL ABANDONMENT APPLICATION[1]

*Marie Buchinski and Stephanie Ridge**

On May 20, 2020, the Commission of the Canada Energy Regulator (CER) denied an application by NOVA Gas Transmission Ltd. (NGTL) for leave to abandon facilities that are part of NGTL's extensive system of pipeline and facilities in Alberta and British Columbia.[2]

NGTL brought the application primarily on the basis that the facilities to be abandoned were no longer economic. It argued that tolls for contracted volumes were not sufficient to justify the continued operation and maintenance of the facilities, and that continued operation would place an undue burden on NGTL and its rate payers, which was not in the public interest. The Commission disagreed, finding that the application was not in the public interest at this time and that there would be no undue burden on NGTL or its rate payers if the application was denied.[3] The Commission made the following findings:

- **The Public Interest Test:** The Commission confirmed that section 74 of the *National Energy Board Act* (now section 241(1) of the *Canadian Energy Regulator Act*)[4] does not prescribe a test that the Commission must apply when determining whether to grant leave to abandon. ***The Commission held that the test therefore is the public interest test.***[5]

- **Contract Termination:** In the circumstances of the NGTL application, abandonment of the facilities would result in a permanent discontinuance of service, requiring that existing contracts be transferred or terminated.[6] The Commission noted that neither it nor its predecessor appear to have considered a request for leave to abandon that is coupled with the termination of existing contracts associated with facilities that the proponent argues are no longer economic. ***The Commission stated that service obligations under contracts between commercial parties are not absolute, and that they cannot restrain the Commission's ability to determine the public interest. However, the Commission found it reasonable in the circumstances that shippers***

[1] This is a reprint of a recent posting to the Bennett Jones LLP blog (1 June 2020). See online: <www.bennettjones.com/Blogs-Section/Canada-Energy-Regulator-Denies-NGTL-Abandonment-Application>.

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[2] *Re Nova Gas Transmission Ltd. (NGTL) Application to Abandon the Etzikom Pipelines* (20 May 2020), MHW-006-2019, online: *CER* <docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90550/554112/3422050/3690360/3926907/C06388-1_CER_-_Letter_Decision_-_NOVA_Gas_-_MHW-006-2019_-_Abandonment_of_the_Etzikom_Pipelines_-_A7F7L5.pdf?nodeid=3926275&vernum=-2>.

[3] *Ibid* at 9.

[4] SC 2019, c 28, s 10, s 241(1).

[5] *Supra* note 2 at 2.

[6] *Ibid* at 3.

would not generally expect that their contracts may be terminated by NGTL given that shippers had contractual renewal rights, NGTL had no explicit right to terminate the contracts in the circumstances, and there was a lack of established history of NGTL terminating such rights. Given that the proposed contract terminations was a significant matter, it would need to be overcome by evidence demonstrating that the abandonment was in the public interest.[7]

- **Economic Viability:** Consistent with precedent from the National Energy Board, the Commission considered the economic viability of the specific assets (on their own) to be abandoned. ***The Commission determined that considerations of economic viability must be balanced with any public interest considerations.***[8]

- **Undue Burden:** NGTL argued that continued operation of the facilities that it proposed to abandon would place an undue burden on it and its rate payers. ***The Commission noted that NGTL provided no evidence of how or when it determines the point at which a deficiency is no longer acceptable; how the deficiency compared with those of other NGTL facilities; or it having explored alternative tolling arrangements to capture some of the value of the service, which might have reduced the burden.***[9]

Overall, in denying the request for leave to abandon, the Commission considered the economic viability of the specific facilities to be abandoned balanced with any public interest considerations. Importantly, the Commission found that NGTL's assessment of economic viability was flawed in part because it failed to meaningfully account for the value of the services provided by the facilities to be abandoned. Further, although the Commission was not persuaded that denying the application would lead to an undue burden on NGTL or its rate payers, it also found that NGTL did not attempt to reduce the burden on itself and its shippers, raising further questions about NGTL's assessment and process that led to the request for leave to abandon. In the end, the Commission was not persuaded that the proposed abandonment was in the public interest at this time, but left open the potential for NGTL to re-apply for abandonment in the future.

Given the Commission's concerns regarding the application, and NGTL's submissions that it not only has other smaller facilities on the NGTL System with remaining contracts that meet some of NGTL's abandonment criteria, but that NGTL expects the number of facilities with significant integrity costs relative to revenues will increase over time, the Commission strongly encouraged NGTL to develop a more effective process to identify and assess facilities for its future abandonment applications where there are matters such as contract terminations and potentially negative impacts on users of the facilities. The Commission provided NGTL with nine points of guidance, suggesting that NGTL's process for assessing and identifying facilities for abandonment should:

- be conducted in a predictable, transparent, and fair manner;

- ensure equitable treatment of shippers across the NGTL System;

- be responsive to the needs, inputs, and concerns of all impacted parties;

- factor in the relative impacts of abandonment versus continuation of service on all impacted parties;

- consider all options for reducing future revenue-to-cost shortfalls prior to filing an application for leave to abandon;

- provide shippers with the ability to meaningfully plan for and mitigate the impacts of the potential termination of service;

- allow impacted parties to make more informed decisions, by including

[7] *Ibid* at 6-7.

[8] *Ibid* at 7.

[9] *Ibid*.

criteria for identifying instances where the abandonment construction schedule should be established so as to avoid creating uncertainty that may require parties to make costly, irreversible choices to continue their business operations prior to a Commission decision on the abandonment application;

- be informed by meaningful consultations with the Tolls, Tariff, Facilities and Procedures Committee; and

- be documented and available to, at a minimum, NGTL's shippers.[10]

While the decision is directed at NGTL, it provides guidance to all proponents who may be considering applications for leave to abandon CER-regulated facilities. The decision provides guidance on the processes that should be considered by a proponent when it is determining what facilities to abandon, and what factors should be considered in that assessment process, particularly in circumstances where the abandonment will require contract terminations or will cause negative impacts on users.

The Commission's analysis of the approach used by NGTL to assess the economic feasibility of the facilities and of NGTL's assessment of undue burden is also instructive. The decision confirms that economic feasibility is not limited to a calculation of revenues and costs, but must also consider other factors, such as the value of the services provided by the facilities to be abandoned. Assertions of undue burden need to be supported by evidence, including evidence that the proponent looked at options in an effort to reduce the burden, such as through toll changes on the CER-regulated facilities. ■

[10] *Ibid* at 8.