Confidential and Solicitor-Client Privileged

Ministry of the Attorney General
Briefing Note
Civil Law Division
ENERGY/MEDG/MRIS/MOI/ADO

Summary of Application by *National Steel Car Limited v. Independent Electricity System Operator, Ministry of Attorney General (Ontario), Minister of Energy (Ontario)*

A. Issues:

1. Whether all or some portion of the Global Adjustment (GA) constitutes an unconstitutional tax and an invalid regulatory charge or, in the alternative, an invalid tax?

2. In the alternative, if the GA is found to be a tax, whether it contravenes s. 3 (1) of the *Taxpayer Protection Act*, (Ontario)("*Taxpayer Protection Act*")?

B. Background:

The following describes the current legal challenge to the GA as its set out in the Applicant's Notice of Application. This note does not attempt to provide arguments designed to refute the allegations which will be necessary to provide at a future stage.

In the first direct challenge to the GA that LSB is aware of, National Steel Car Limited (the "Applicant") has commenced a legal proceeding against the Independent Electricity System Operator (IESO), Ministry of Attorney General (Ontario) (MAG), Minister of Energy (Ontario) (the "Respondents") by way of Notice of Application filed with the Ontario Superior Court on August 1, 2017. The Notice of Application alleges that all or a portion of the Global Adjustment (GA) is an unconstitutional tax rather than a valid regulatory charge.

Specifically, the Applicant seeks the following relief:

- A declaration that the revenues, or some portion of the revenues, collected for all or some portion of the GA by the IESO is an unconstitutional tax and not a valid regulatory charge and that all or some of the GA is *ultra vires* (beyond the proper scope) of the *Electricity Act, 1998* (EA);
- In the alternative, if the GA is a tax, a declaration that it is invalid as it contravenes s.3(1) of the *Taxpayer Protection Act* which relates to the requirement that Government hold a referendum which authorizes the legislation (e.g. the provisions encapsulating the GA amendments) before the EA was amended to include those provisions;
- A declaration that all or some portion of the GA may not be legally charged to the Applicant (or others) based on the constitutional arguments as above;
- An order declaring that the Applicant is entitled to repayment of monies it paid to the IESO for the GA, or some portion of it, in the period from July 31, 2015 to July 31, 2017,

plus what the Applicant pays for the GA, or some portion of it, from July 31, 2017 to the date of Judgment;

- An order declaring that the Applicant is entitled to be provided with a complete accounting of all payments made to all generators of electricity that comprise the GA, the use of the funds raised through the GA and complete details as to how much, to whom and for what purposes the GA is charged; and
- Pre-judgment and post-judgment interest, costs, and other relief.

The Application was made on the following grounds:

- The GA is an indirect tax imposed by a regulatory body to fund the Ontario government's policy initiatives; and
- The GA is *ultra vires* the *Constitution Act, 1867* (Canada) as it is in pith and substance an indirect tax.

C. Analysis:

The GA was established in 2004 pursuant to EA s.25.33 and O. Reg. 429/04 (Payments Re: Section 25.33 of the Act), and is comprised of various elements including those related to the FIT and MicroFIT contracts. Section 25.33 of the EA requires the Independent Electricity System Operator (IESO) to make adjustments to electricity prices separate from the wholesale market price of electricity, to provide for additional payments to electricity generators and other market participants. This provision was first introduced in 2004 to provide an incentive for the construction of electrical generating capacity at a time when there was insufficient capital investment in generation based on market price alone.

The IESO enters into long-term contracts with some electricity generators which guarantee the generators a fixed revenue amount (either absolute or per unit of generation) on the basis that the market price alone is insufficient to incent capital investment at the levels necessary to create the needed capacity and supply. When the wholesale electricity price in a month is below the contract/regulated price for a given generator, the adjustments made by IESO imposes a charge on consumers to make up the difference. This process is known as the "Global Adjustment" (GA). The GA includes the costs of other electricity-related activities such as conservation, and demand-management (CDM), as well as demand response (DR).

The Application challenges the particular subset of GA payments used to fund the Feed-In Tariff (FIT) program made under the amendments to the EA, adding EA s.25.35. These provisions were brought in by the *Green Energy and Green Economy Act*, *2009* which provides for the legislative basis for the FIT program, including the "guaranteed" contract prices to certain renewable electricity generators.

The application alleges that the GA payments made under FIT contracts primarily serve social policy purposes, such as redistributing energy costs (i.e.,. from Class A to Class B consumers) and incenting job creation, instead of benefiting [the majority of] electricity consumers who must pay the GA. Therefore, the Applicant's position appears to be that the extra costs of incenting economic development and furthering other, non-electricity policy objectives that they argue form part of the GA payments mean that the GA payments are an unconstitutional tax rather than a valid regulatory charge.

More particularly, the Applicant argues that the GA is an indirect tax imposed by a regulatory body to fund the Ontario government's policy initiatives for the following reasons:

- The Applicant argues that the legislative intent of the FIT program was to provide economic stimulus, to promote job creation, and to provide economic assistance to rural and Aboriginal communities in Ontario;
- The Applicant noted that no referendum pursuant to s. 3(1) of the *Taxpayer Protection Act* was undertaken prior to the enactment of s. 25.33 (1) of the EA; and
- The Applicant describes the Global Adjustment as being levied by the IESO onto Local Distribution Companies ("LDC"). LDCs then charge the Global Adjustment to the electricity consumers, without a markup. As such, the applicant's position is that the IESO indirectly charges the GA on the consumers of electricity in Ontario.

The Notice of Application also argues that the GA is intended for public purposes, because, it argues that:

- In effect, the GA paid by consumers increases even when less electricity is consumed, so the GA does not promote conservation.

- The GA only incents the behaviour of those to whom it is paid (e.g., generators of renewable electricity with FIT contracts), rather than the consumers who must pay it.

- The consumers who pay the GA neither create the need for the GA nor benefit from it.

- The different methodologies for the calculation of the GA between Class A and Class B electricity consumers results in unequal treatment. The Class A consumers who cannot self-generate electricity or cannot shut down operations during the 5 peak demand hours, pay disproportionately higher costs for the specified policy initiatives.

C. Recommendations/Next Steps:

- ENERGY to work with MAG-Constitutional Law Branch (CLB) in developing any responding materials and to assist in any defence of the Application conducted by MAG.

- Scheduling for litigation process steps (e.g., motions, hearings dates, etc.) has not yet been established.

- The IESO has issued its Notice of Appearance, signaling its intent to defend the application. MAG is expected to file its Notice of Appearance on August 14, 2017.

- The Applicant has to complete their evidentiary record by serving the third affidavit mentioned in their Notice of Application (from the CFO of National Steel Car). MAG CLB would then seek instructions on whether preliminary motions are needed.

- Ontario and the IESO would assemble and file their evidence.

- The applicant would have an opportunity to file reply evidence. Next would be cross-examinations on the affidavits filed by both sides, and undertakings arising out of those cross-examinations. Then there would be an exchange of written submissions followed by a hearing..

Prepared on: August 14, 2017

Prepared by: Claudia Xiao (Articling Student)
Articling Student
Legal Services Branch
MAG Civil Law Division
Ministry of Energy, Ministry of Economic Development and Growth, Ministry of Research, Innovation and Science, Ministry of Infrastructure, Accessibility Directorate of Ontario

Reviewed by: James P. H. Rehob
Senior Counsel
Legal Services Branch
MAG Civil Law Division
Ministry of Energy, Ministry of Economic Development and Growth, Ministry of Research, Innovation and Science, Ministry of Infrastructure, Accessibility Directorate of Ontario

Approved by: Carolyn Calwell
Legal Director
Legal Services Branch
MAG Civil Law Division
Ministry of Energy, Ministry of Economic Development and Growth, Ministry of Research, Innovation and Science, Ministry of Infrastructure, Accessibility Directorate of Ontario