# ONTARIO CANCELS WIND AND SOLAR CONTRACTS

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**O**ver the last decade governments around the world have increased their efforts to transition towards a low carbon economy. A major initiative in this effort has been the introduction of feed in tariffs or FIT contracts to promote renewable energy. Wind and solar have been at the forefront.

Ten countries and five US states led this initiative. Ontario was the first in North America and invested more capital than any other jurisdiction with the possible exception of Spain. All that came to a crashing halt on July 13 when the new Ontario government, elected on June 7, cancelled 559 wind and solar contracts.

On July 13, 2018, Greg Rickford, Minister of Energy, directed the Independent Electricity System Operator (IESO) pursuant to subsections 25.32(5) and (11) of the *Electricity Act*, 1998[1], to wind down the Feed-In Tariff (FIT) programs, undertaken by the IESO stating:

> *Since the introduction of the Feed-in Tariff (FIT) program in 2009 and the Large Renewable Procurement (LRP) initiative in 2014, the IESO has entered into a significant number of renewable energy contracts. These procurement initiatives have contributed to the cost pressures facing electricity consumers across all sectors of the economy, including residential, farming, small business and industrial consumers.*
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> *The IESO's recent system planning work indicates that Ontario's current contracted and rate regulated electricity resources are sufficient to satisfy or exceed forecasted provincial needs for the near term and that there are other means of meeting future energy supply and capacity needs at materially lower costs than long-term contracts that lock in the prices paid for these resources.*
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> *The IESO's system planning analysis indicates that the adequacy and reliability of supply can be maintained while winding down certain FIT and LRP contracts and that it would be in the best economic interests of Ontario's electricity ratepayers, in respect of the FIT program, to wind down contracts where the IESO has not issued Notice to Proceed and, in respect of the LRP program, to wind down contracts where the IESO has not notified the contract counterparty that all Key Development Milestones have been met.*[2]

The Directive stated:

> *In accordance with the authority I have pursuant to subsections 25.32(5) and (11) of the Act, I hereby direct the IESO to take all necessary steps in respect of the*

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1 *Electricity Act, 1998*, SO 1998, c 15, schedule A, s 25.32(5), (11).

2 *Minister's Directive To: The Independent Electricity System Operator*, OIC 1003/2018, (2018 O Gaz), online: < https://www.orec.ca/wp-content/uploads/2018/07/directive-20180713-wind-down-FIT-and-LRP.pdf>.

*Initiative, as follows:*

*1. To immediately take all steps necessary to wind down all FIT 2, 3, 4 and 5 contracts where the IESO has not issued Notice to Proceed.*

*2. To immediately take all steps necessary to wind down all LRP I contracts where the IESO has not notified the LRP I contract counterparty that all Key Development Milestones have been met.*

*3. To take all other steps which are necessary or desirable in order to facilitate the full and complete implementation of this Directive, as soon as is practicable.*[3]

**Background**

Feed in tariffs were first developed in Europe starting with Germany in 2004 and followed by the Czech Republic in 2005, Italy in 2007, Spain in 2008, and the UK in 2010.

In North America, Ontario was the leader when it first introduced Feed in Tariffs in 2006 followed by a substantial revision in 2009 through the *Green Energy Act*.[4] Ontario was followed by California in 2008, Vermont and Maine in 2009 and New York in 2012. The federal government in the United States relied mainly on tax credits, which proved to be a very effective tool without some of the liabilities of feed in tariffs.

The concept behind feed in tariffs was the same in all jurisdictions. These were long-term contracts for renewable energy at attractive prices. In some jurisdictions the contracts guarded against future changes with price adjustment clauses or amendments to volume commitments. Some like Ontario had few adjustments except for price increases.

In most jurisdictions a common problem developed. Governments for different reasons changed the incentive programs either by reducing the incentives or eliminating them entirely. Most countries discovered that this new renewable energy was very expensive power. The cost often exceeded what utilities could charge for it. In Spain this "electricity tariff deficit" as it came to be known, reached €26 billion. No estimate is made of the Ontario deficit but it was significant. And customers objected. It turned out that wind in particular was expensive power. It was often located in remote locations with significant transmission costs to bring it to market.

There may have been good reasons for the amendments but investors were not amused. When that happens, investors seek damages in local courts or through arbitration under international investment treaties.

There are two reasons why investors often choose arbitration. First, as the Ontario Court found in *Trillium Wind*,[5] there is often no remedy under domestic law. There, the plaintiff sought $2 billion in damages when the Ontario government cancelled the offshore wind FIT program. The company claimed breach of contract, unjust enrichment, negligent misrepresentation, misfeasance in public office and intentional infliction of economic harm. The court threw out all but one of the claims on the ground that the government's decision to stop financing windfarms was a policy decision and immune from suit. The Court of Appeal agreed but admitted that there was one claim that could proceed – the claim for misfeasance in public office – not the easiest claim to prove.

The claims available in international arbitration, whether under NAFTA or the Energy Charter Treaty under which many of the European cases are brought, include direct and indirect expropriation of the investment, discrimination against a specific investor, denial of fair and equal treatment and denial of legitimate expectations – all claims not available under domestic law.

The second reason investors prefer arbitration is that many of the investors are foreigners and they prefer an arbitration panel to the domestic courts particularly where the claim is against the government of that country.

In both the UK and Canada investors challenged

3 *Ibid,* at 4.
4 *Green Energy and Green Economy Act, 2009,* SO 2009, c 12, schedule A.
5 *Trillium Wind Power Corp. v. Ontario*, 2013 ONCA 6083.

changes to renewable incentive programs in the local courts. In the UK that has been successful[6] but not in Canada.[7] In Canada, investors have also challenged reductions in incentive programs in two NAFTA arbitrations. One of those, *Windstream*[8], resulted in very substantial victory for the investors. In the other, *Mesa Power*[9], the investor lost.

More extensive litigation has occurred in Europe, particularly in Spain, where 30 investment treaty arbitrations have been filed, along with 7 cases against the Czech Republic and 9 cases against Italy. Virtually all of those have been filed under the *Energy Charter Treaty*.[10]

The first three international arbitration awards dealing with government decisions to cut back incentive programs in renewable energy were handed down in 2016. The first was *Charanne*[11] in January 2016, a claim against Spain under the ECT. This was followed by *Mesa Power* in May of 2016 and *Windstream Energy* in December 2016. In both *Charanne* and *Mesa Power,* the complainants were unsuccessful. In *Windstream Energy* the complainant was successful and received an award of C$25 million, the largest Canadian NAFTA award to date.

The second decision dealing with the Spanish reforms was *Eiser Infrastructure*[12]. There, an ICSID panel in May 2017 ruled that Spain must pay €128 million to British-based Eiser Infrastructure Limited and its affiliates. Spain defeated a third ECT claim in *Isolux*[13] the following year. There have been 9 arbitrations filed against changes to the Italian renewable programs to date. In the first, *Blusun*[14], a €187 million claim, Italy was successful in its defense.

If we try to determine the general principles established by the four European and two Canadian cases it would be this: These decisions are about "incentive" programs. That is the magic word.

Government incentive programs create legitimate expectations on the part of investors.

Legitimate expectations are a key component of fair and equitable treatment, a concept that runs throughout most international investment treaties.

The general rule is that governments can introduce new legislation that changes incentive programs provided they do not target or discriminate against a specific investor, contravene a promise to a specific investor, or introduce retroactive measures. These principles do not always apply but they are the red flags.

The strange twist to some is that if the investor is foreign and protected by an investment treaty they will have a cause of action. If the investor is domestic they are out of luck.

**The Impact**

The new government canceled 758 solar and wind contracts claiming that the savings would yield $790 M in savings to Ontario taxpayers. Two of those contracts were wind contracts. The first was Otter Creek, a 15 MW wind project near Wallaceburg. The second was the Strong Breeze project, a 57 MW project south of Belleville. The rest of the contracts were smaller solar contracts with the result that wind account for about 25 per cent of the cancellation capacity.

All of these contracts were contracts where the government had not issued an NTP or Notice to Proceed. That meant that on cancellation, the amount of compensation payable by the government could be calculated by the formulas set out in the contracts without additional penalties.

However, there was a third wind contract. This was the White Pines wind project, an 18.5 MW project in Prince Edward County. Unlike the other wind contracts, this was a FIT 1 contract which had already received its NTP.

6 *Secretary of State for Energy and Climate Change v. Friends of the Earth et al,* 2011 EWHC 3575.
7 *SkyPower v. Ministry of Energy, 2012* OJ No. 4458 at para 84; 2013 ONCA 683, 117, OR (3d) 721.
8 *Windstream Energy LLC v. Government of Canada,* PCA Case No. 2103-22, 27 September 2016.
9 *Mesa Power Group LLC v. Government of Canada,* PCA Case No. 2002-17, 24 March 2016.
10 *The Energy Charter Treaty,* 17 December 1994, EECH/A1/X.
11 *Charanne v. Kingdom of Spain,* Case No. 062/2012, ECT, January 2016.
12 *Eiser Infrastructure Limited and Energia Solar Luxembourg Sari v. Kingdom of Spain,* ICSID Case No. ARB /13/36.
13 *Isolux Netherlands,BV v. Kingdomof Spain,* SCC Case V2013/153 (Spain) [*Isolux*].
14 *Blusun SA, Jean-Paul Lecorcier and Michael Stein v. Italy,* ICSID Case No. ARB./14/3.

The only way this contract could be cancelled was to create special legislation designed to do that. That is exactly what the new government did when they enacted the *White Pines Project Termination Act*.

All of the wind contracts cancelled had one thing in common – they were strongly opposed by the community in which they were located. However, White Pines had a special feature. The NTP had been granted by the previous government during the writ period. The new government argued that this was exceptional and unauthorized. The standard practice was that during the writ period, the existing government should not enter into new contracts or make significant regulatory decisions which could bind the conduct of a future government.

While there has been a great deal of publicity regarding these cancellations it is evident that they represent a small percentage of the capacity that the IESO has contracted for under the FIT program. Today the total wind capacity contracted for by the IESO is 4500 MW. The cancelled wind only amounts to 29 MW less than 1 per cent of the total. In the case of solar, the total megawatts contracted for by the IESO by the end of 2017 was 1659 MW. The cancelled solar was only 333 MW or 20 per cent. The number of contracts was large but the volume was small.

**The Compensation**

The next question is what compensation are parties entitled to when the government cancels a long term contract? There is no doubt that the legislature has the power to cancel contracts subject to constitutional limitations. In the case of renewable energy contracts those contracts are clearly within the constitutional jurisdiction of the provincial government. A very helpful Report[15] on this topic was recently prepared by Bruce Pardy, of the Queens University Faculty of Law. It is worth reading.

These principles apply to actions in the local courts. However, where the projects are owned by foreigners, those investor may have rights under investment treaties with Canada. That is a different situation. We saw this in *Windstream Energy,* where the Complaint was successful in a NAFTA arbitration held in Toronto and received an award of $25 million. That claim resulted from the Province of Ontario's decision to terminate the offshore wind program. In the case of White Pines, the owner is German not American, and would not qualify for NAFTA protection. However, there may be protection for that investor under the recently agreed to CETA trade agreement with the European Union.[16] However, the legislation Ontario enacted to deal with White Pines has enough flexibility to allow the province to strike the appropriate agreement with the White Pine project.

In Ontario all FIT contracts contain a mutual "termination for convenience" provision in section 2.4. This can only be exercised before the IESO issues a Notice to Proceed. Where the IESO exercises this right it is required to pay the Supplier's Preconstruction Development Costs. Those must be substantiated by the supplier and are subject to the Preconstruction Liability Limits contained in the contract. These limits are based on a fixed lump sum plus an amount per kilowatt of contract capacity.

Later, FIT contracts such as FIT 4 and FIT 5 and the LRP contracts also have a pre-NTP termination right called a Keystone Development Milestone or KDM. This right is also mutual. In addition, they have a post NTP termination for convenience right, which the IESO calls an Optional Termination. The IESO, however, cannot exercise this right after the Commercial Operation Date or COD. Section 9.6 of the LRP contract contains a detailed formula to calculate the termination compensation. FIT 4 and FIT 5 contracts which were launched after LRP contain a similar formula. The one good thing that can be said about the Ontario FIT contracts is that they contain well thought out provisions for termination at different construction stages and detailed formulas to calculate the compensation. This is something that most European contracts missed.

The White Pines contract is a special case.

15 Bruce Pardy, "Fit to be Untied: How a new provincial government can unravel Feed-In Tariff electricity contracts", Commentary, CCRE Commentary, April 2018, online: <https://www.thinkingpower.ca/PDFs/Commentary/CCRE%20Commentary%20-%20FIT%20to%20be%20Untied%20by%20Bruce%20Pardy%20-%20April%202018.pdf>.

16 The Comprehensive Economic and Trade Agreement (CETA) between the European Union and Canada was signed October 20 2016 but the Investment Court System (ICS) is still not in force.

White Pines was a FIT 1 contract. In those contracts there is no section 2.4 provision. There was originally, but on August 2, 2011, just before the fall election of that year, the OPA was directed by the government to waive its section 2.4 termination rights in those contracts. As a result, the government was forced to introduce special legislation called the *White Pines Wind Project Termination Act*[17] to deal with this project.

The special legislation terminated the FIT contract dated May 4, 2010, that had been awarded to White Pines. Section 5 of the Act also extinguished any cause of action White Pines might have against the Crown, current or former members of the Executive Council, or any current or former employee agent of the Crown. No proceeding under any statute may be brought against those persons even if the proceeding was commenced before the Act comes into force.[18]

In terms of compensation the Act provides that no person is entitled to any compensation except that provided under section 6 of the Act. Section 6 sets out the formula to determine compensation and provides that White Pines can only recover its expenses incurred to date to develop the project. No recovery is allowed for lost profits. The Act expenses cannot exceed fair market value. The Act also provides that any dispute under this legislation must be determined by arbitration under the *Ontario Arbitration Act.*[19]

This is very comprehensive legislation and allows the government complete flexibility in determining a settlement including the ability to pass further legislation establishing the maximum amounts payable and/or the method of determining that maximum amount.

**Lessons Learned**

The contracts established by the previous administration in Ontario had a number of deficiencies. First in the early days the government placed no limitations on the total quantity of power to be purchased under the program. The situation the province faces today is that it has committed to purchase power that it cannot use. The contracted supply far exceeds the demand.

There are only three solutions to this problem. First, the IESO can direct the suppliers to reduce the output from the contracted level. This happens regularly with respect to wind which blows at night when the power is not needed. Generally speaking wind generators are only generating approximately 35 per cent of their capacity. However, the FIT contracts force the government to purchase nearly 100 per cent of the capacity. These are essentially 'take or pay' contracts. This in effect increases the costs per MW to customers significantly. If you purchase 35 per cent but pay for 100 per cent your cost per MW is three times what you thought it was going to be

This lack of a capacity adjustment clause is a real problem. The IESO can either pay for power not transmitted or pay US customers to take the excess power off the grid. The IESO has also been forced to do this. Excess power has to be removed from the grid. That means selling the power at negative prices. In recent years the cost of negative price sales has been significant.

Annual price adjustments could have been considered. The German program from the beginning used annual rate reductions. The Ontario Energy Board for years has established five-year rate plans with rebasing at the end of five years, if rebasing the utility was over earning the prices were reset to bring the rates back in line with allowed rate of return and windfall gains from prior periods were shared equally between customers and the utility. A long-term 20 year contract with guaranteed volumes and prices with a price escalator is pretty close to a natural monopoly. In short, greater consumer protection could have been easily introduced.

Second, the contracts provided no adjustment for increased efficiency. The contract prices were set on the costs prior to the date the contracts were signed. However, the industry has encountered significant cost reductions in both wind and solar technology. These cost reductions fall directly to the suppliers bottom line increasing the contract rate of return significantly. If we assume that a fair rate of return is the return the OEB sets for Ontario

17 *White Pines Wind Project Termination Act, 2018,* SO 2018, c 10, schedule 2.
18 *Ibid,* s 5.
19 *Ibid,* s 6.

electricity distributors twice a year, the excess profits on most FIT contracts are substantial.

The contract terms can be criticized, but the real problem may have been the contracting process. The contracts were standard offer contracts awarded on a first-come-first-served basis. When the contract windows opened, the applications rolled in fast. It was first come first served. Most were accepted.

The early FIT contracting process in Ontario also discouraged community involvement. The contracts required only basic feasibility evidence. Developers competed with each other for leases. This meant that they signed leases on a confidential basis without the community knowing. The rules also allowed developers to flip leases and contracts with few restrictions. It was the wild west. Ultimately greater community involvement was mandated but in many cases it was too late.

A much more prudent process would have involved competitive bidding as the province of Alberta recently chose to do. The prices that Alberta obtained in its most recent bid were a fraction of the Ontario prices. It is true that costs. have fallen significantly since the first Ontario contracts were awarded but the lack of a competitive process did promote excessive costs The Alberta priced are half of the most recent Ontario contracts.

**Conclusion**

The new government did a good job of dealing with a difficult situation. Two things were very clear. First the power was very expensive. Second the Province did not need the power.

Some very reasoned analysis went into the solution. The new government decided to leave the FIT 1 contracts alone. It is true that this was where most of the capacity was; certainly in the case of wind which was the biggest problem. But that was also where the greatest litigation risk was.

Many of the FIT 1 contracts were owned by Americans and cancellation could lead to a NAFTA claim. Given the experience in Windstream that could be an expensive process with a costly result. The ability to deal with the FIT 1 contracts was also compromised by the former government's decision before the last election to remove the section 2.4 termination rights.

In theory the government could have passed special legislation to deal with other FIT 1 contracts like they did with White Pines. White Pines, however, was a special case. The NTP had been granted in the final days of the last government. Most of the other contracts were long past the NTP stage in any event. Some are already connected to the grid and others were close. Investors had sunk large amounts of money into the projects. Henvey Inlet for example which is 300 MW had raised $1 billion from foreign investors in early 2018.

Cancelling before NTP is entirely permissible under the contact and the damages were set out in the contract. Investors understood that when they invested. In the end the concern that the cancellations by the new government will compromise foreign investment in Ontario energy projects is likely overstated. ■