ONTARIO ENERGY BOARD

IN THE MATTER OF an Application by the Ontario Power Authority for review and approval of its integrated power system plan ("IPSP") and approval of its proposed procurement process.

Comments by the Council of Canadians on the Issues Proposed to be Heard in the Review of the IPSP

Having reviewed the proposed list of issues submitted by the OPA, we have the following submissions to make with respect to the need to add to, or clarify, the scope of these issues.

For the purpose of elucidating the relevance of issues relating to international and domestic trade agreements, we have attached Appendix "A" which provides an overview of the relationship between these agreements, and the policies and measures that will be required to implement the IPSP.

IDENTIFYING RISKS AND FACTORS RELEVANT TO THE ISPS

References:

- *The Electricity Act*, s. 25.30

  > (4) The Board shall review each integrated power system plan submitted by the OPA to ensure it complies with any directions issued by the Minister and is economically prudent and cost effective. 2004, c. 23, Sched. A, s. 34.

- *Report of the Board on the Review of, and Filing Guidelines Applicable to, the Ontario Power Authority's Integrated Power System Plan and Procurement Processes.* Dec 27, 2006 (OEB Report). *Part One: The IPSP, Section E, the Overall Plan:*

  > The OPA should provide a description of the plan, including conservation, generation and transmission resource initiatives, together with the following:
  >
  > i.) the evaluation criteria (economic, environmental and social) used in developing the plan and the manner in which the criteria were applied;
  > . . .
  > vii.) a supporting sensitivity analysis, including all financial risks, high and low

forecast risks and other significant risks; [p. 25]

- Ontario Regulation 424/04 Integrated Power System Plan (IPSP Reg.) S. 2(1)

  6. Identify factors that it must consider in determining that it is advisable to enter into procurement contracts under subsection 25.32 (1) of the Act. Reg 2:1(6) identify factors re procurement.

- *OEB Report II. Principles Guiding Review of Procurement Processes; B. Procurement Process Elements; 2. Competitive Procurement:*

  (ii) identify the criteria that will be used to evaluate each proposal, how those criteria will be applied or evaluated and the weight given to each criterion. The criteria must be applied in a consistent and fair manner to all proponents, and should include the following:

  . . .

  j. major project risks, such as delays in implementation, regulatory risks and financial risks and obligations of electricity consumers (such as the financial risk of non-performance by the counterparty),

- Supply Mix Directives: 2, 4, 5, and 6.

Rationale:

As illustrated by the overview of international trade, investment, services and procurement rules that are attached as Appendix "A", these rules impinge in a variety of ways on the measures that may be needed to implement the IPSP. For this reason it is important that the constraints imposed by these trade regimes be identified in order to avert or ameliorate the risk of trade agreement-based challenges and claims to such measures. Failure to do so will heighten the risks these regimes present to the security and reliability of electricity supply to the Ontario consumers, and may also undermine the realization of the Supply Mix Directives.

For example, to what extent may obligations to maintain certain levels of electricity exports to the United States under Article 605 of NAFTA, impede Ontario's ability to phase out coal-fired generation and meet other IPSP goals? Similarly, to what extent may the right of foreign owned power producers to access US markets adversely impact the realization of IPSP plans, including those arising from the supply mix directive?

ISSUE 1: DOES THE IPSP IDENTIFY THE CONSTRAINTS IMPOSED BY, AND RISKS ASSOCIATED WITH, INTERNATIONAL TRADE RULES AND THE AGREEMENT ON INTERNAL TRADE, CONCERNING TRADE, SERVICES, INVESTMENT, AND PROCUREMENT AS THESE RULES APPLY TO THE ELECTRICITY SECTOR?

ISSUE 2: DOES THE IPSP IDENTIFY MEASURES THAT MIGHT BE TAKEN TO AMELIORATE THE RISKS THESE RULES PRESENT, AND FOR THE PURPOSE OF MAINTAINING FUTURE POLICY AND REGULATORY FLEXIBILITY?

THE RELIABILITY OF NATURAL GAS SUPPLIES

References:

- IPSP Reg. s. 2(1)

  3. Identify opportunities to use natural gas in high efficiency and high value applications in electricity generation.

- OPA Draft Issues List: Issue (1) 4.

- Supply Mix Directive 4.

Rationale:

Several factors pose a significant risk to the security of natural gas supply to Ontario. These include:

- declining western Canadian supplies;
- increased competition for existing and new gas supplies, including those generated by the rapid expansion of tar sands production;
- ongoing export obligations to the United States;
- plans to remove important gas supply infrastructure that provided Ontario with access to WCSB supplies;[1] and
- uncertainty about offshore LNG supplies that represent the only significant potential for new supply to Ontario markets.[2]

ISSUE: 3: TO WHAT EXTENT IS THE IPSP BASED ON A REALISTIC

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[1] See the Keystone Pipeline Project, http://www.neb.gc.ca/clf-nsi/rthnb/pplctnsbfrthnb/kystn/kystn-eng.html#a_s_03

[2] National Energy Board: *Canada's Conventional Natural Gas Resources, a Status Report*: http://www.neb.gc.ca/clf-nsi/rnrgynfmtn/nrgyrprt/ntrlgs/cndscnvntnlntrlgsrsrc/cndscnvntnlntrlgsrsrc-eng.pdf

ASSESSMENT OF FUTURE NATURAL GAS SUPPLIES TO ONTARIO?

ISSUE 4: TO WHAT EXTENT DOES THE IPSP IDENTIFY MEASURES OR INITIATIVES THAT MAY NEED TO BE TAKEN TO ADDRESS THESE RISKS AND ENHANCE SECURITY OF NATURAL GAS SUPPLY TO THE PROVINCE?

INNOVATIVE STRATEGIES AND ALTERNATIVES TO PROCUREMENT

References:

- *Electricity Act*, 25.31(2)
- IPSP Reg 2(1);

  (2) Identify and develop innovative strategies to accelerate the implementation of conservation, energy efficiency and demand management measures.

  (6) Identify factors that it must consider in determining that it is advisable to enter into procurement contracts under subsection 25.32 (1) of the Act.

- OEB Report: Alternatives to OPA Procurement, pp. 27-28

Rationale:

Provincial policies have long favoured initiatives, actions, and investments to reduce and manage energy demand in the province, but to date, results have at best been mixed. For various reasons the market has failed to deliver many cost effective demand and conservation measures, and the effectiveness of the present strategies for addressing this long-standing market failure have yet to be proven. Other jurisdictions have adopted innovative approaches which appear to have been more successful in this regard -- among these are Energy Efficient Vermont[3] and the Vermont Energy Investment Corporation. Such initiatives provide appropriate institutional capacity to plan and implement efficiency, conservation and demand initiatives by providing a focused mandate and the resources needed to achieve these goals.

ISSUE 5: DOES THE IPSP PROPERLY IDENTIFY ALL IMPORTANT INNOVATIVE STRATEGIES FOR ACCELERATING THE IMPLEMENTATION OF CONSERVATION, ENERGY EFFICIENCY AND DEMAND MANAGEMENT

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[3] Efficiency Vermont provides technical assistance and financial incentives to Vermont households and businesses, to help them reduce their energy costs with energy-efficient equipment and lighting and with energy-efficient approaches to construction and renovation.

MEASURES, INCLUDING THE POSSIBILITY OF RESTRUCTURING THE OPA, OR RECOMMENDING THE CREATION OF A NEW INSTITUTION TO BETTER ACHIEVE THIS MANDATE.?

PROCUREMENT CONTRACT DISPUTES

Reference:

- *Electricity Act* 25:32: Resolution of procurement contract disputes

  (3) The parties to a procurement contract shall ensure that the contract provides a mechanism to resolve any disputes between them with respect to the contract.

Rationale:

Companies or individuals who qualify as foreign investors under NAFTA have the right to invoke dispute resolution under that trade agreement, to claim damages arising from government measures which affect investment interests acquired, for example, in consequence of entering into a procurement contract with the OPA. The fact that such a contract may specify that such disputes be resolved before a domestic court, or other domestic forum, cannot operate to deny the investor the right to also, or alternatively, file a claim for damages under NAFTA. The general nature of the rights that may be asserted in this regard are described in Appendix "A" to these submissions.

ISSUE 6: DO IPSP PROPOSED PROCUREMENT PROCESSES RELATING TO THE SETTLEMENT OF DISPUTES ARISING UNDER A PROCUREMENT CONTRACT PROPERLY TAKE INTO ACCOUNT THE RIGHTS OF FOREIGN INVESTORS AS THESE ARE SET OUT IN NAFTA?

WATER AND POWER GENERATION

References:

- OEB Report: see *Achievement of renewable energy targets* at p.6 and Renewable energy generation resources at p. 20
- *Electricity Act*, s. 25.30(1) (a) (ii)
- Supply Mix Directive #2
- *Electricity Act*, 25.31(2)

- *Electricity Act*, 25.32(1)

Rationales:

Climate change and other factors are expected to have significant impacts on the hydrologic cycle that may produce greater variability, diminished supplies, warming and other pressures on hydroelectric and other forms of power production.[4] At the same time the potential for large scale water shortages in the United States may increase pressures to divert or export Canadian water to the U.S. [5]

A not unrelated concern arises from the need to ensure that Ontario water resources are protected as a public trust and basic human right, not as a commodity or private property interest. Yet NAFTA and other trade agreements provide a basis for asserting claims to water as a tradable good, or investor right.[6] This requires that OPA procurement agreements not, either directly or indirectly, provide a basis upon which proprietary claims to water might be asserted.

ISSUE 7: DOES THE IPSP PROPERLY ACCOUNT FOR THE IMPACTS OF CLIMATE CHANGE AND OTHER ADVERSE PRESSURES ON THE HYDROLOGIC CYCLE ON THE AVAILABILITY OF WATER FOR POWER GENERATION PURPOSES?

ISSUE 8: ARE IPSP PROPOSED PROCUREMENT PROCESSES AS THESE MAY CONCERN CONTRACTS FOR ELECTRICITY SUPPLY THAT IS DERIVED FROM HYDROELECTRIC OR OTHER SOURCES THAT DEPEND UPON ACCESS TO WATER RESOURCES, CONSISTENT WITH THE MANAGEMENT AND CONTROL OF WATER RESOURCES AS A PUBLIC TRUST?

PROCUREMENT

References:

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4 Environment Canada The Canada Study: Climate Impacts and Adaptation. http://www.on.ec.gc.ca/canada-country-study/intro.html and also see Des O'Neill,
Threats To Water Availability In Canada – A Perspective, which is also available on the Environment Canada website: http://www.nwri.ca/threats2full/perspective-e.html

5 Andrew Nikiforuk, On the Table: Water, Energy and North American Integration October 16, 2007, The Munk Centre for International Studies' Program on Water
Issues:http://www.powi.ca/pdfs/waterdiversion/waterdiversion_onthetable_new.pdf

6 Joseph Cumming and Robert Froehlich, Chapter XI and Canada's Environmental Sovereignty: Investment Flows, Article 1110 and Alberta's Water Act, University of Toronto Faculty of Law (2007) 65(2) U.T. Fac. L. Rev 107 – 135.

- OEB Report Part II
- *Electricity Act*, 25.31 and 25.32
- Procurement Process Regulation
- Supply Mix Directives,

Rationale:

Procurement contracts will often be comprised of highly complex legal agreements that will often have significant implications for consumer prices, and determine how the significant risks engendered by such contracts will be allocated.

ISSUE 9: DO THE OPA'S PROCUREMENT PROCESSES PROVIDE FOR SUFFICIENT TRANSPARENCY AND OVERSIGHT TO ENSURE APPROPRIATE PROTECTION FOR CONSUMER INTERESTS, INCLUDING REQUIREMENTS FOR PUBLIC DISCLOSURE AND INDEPENDENT AUDITS?

FACILITATING IMPLEMENTATION

References:

- OEB Report: Part I: 2 F. Facilitating Implementation of the IPSP: Regulatory Consistency and Streamlining and G. Implementation of IPSP Initiatives.

  It is important that there be accountability for implementation of the IPSP. The OPA and other parties that are regulated by the Board will therefore be expected to work diligently towards implementation of initiatives that have been included in the approved IPSP. Consideration may be given to using the regulatory tools that are at the Board's disposal (such as the imposition of licence conditions) as required or appropriate to facilitate the implementation of projects identified in the IPSP. [p.11]

Rationale:

International and domestic trade rules impose significant constraints on the ability of governments and regulators to impose certain conditions on the rights of investors and service providers to establish and provide energy services, including their rights to access export markets.

ISSUE 10: HAS PROPER ACCOUNT BEEN TAKEN OF ONTARIO'S

OBLIGATIONS UNDER INTERNATIONAL AND DOMESTIC TRADE AGREEMENTS THAT MAY IMPINGE ON THE BOARD'S EXERCISE OF ITS AUTHORITY TO FACILITATE THE IMPLEMENTATION OF IPSP?

APPENDIX "A" To submissions of the Council of Canadians on Issues Relevant to the OEB Review of the IPSP.

The Application Trade, Investment, Services and Procurement Rules to the Electricity Sector

The following brief overview is intended to illustrate the relevance of international and domestic trade agreements to various issues addressed by the IPSP.

Since the advent of the Canada-US Free Trade Agreement in 1989 the scope of international trade law has greatly expanded. During this period the ambit of international trade rules has grown to encompass government policies and laws relating to foreign investment, services, and procurement including those relating to the electricity sector.

Unlike the GATT, the new generation of international trade agreements are binding and enforceable. Moreover, under North American Free Trade Agreement (NAFTA) investment rules, foreign investors have for the first time been accorded the right to unilaterally invoke binding international arbitration to enforce their rights under a trade agreement to which, of course, they are not parties. The explicit extension of these disciplines to provincial and municipal government, Crown Corporations, and non-governmental organizations represents another significant departure from the historic norms of international trade law.

Assessing the potential impact of international trade rules concerning investment, services, procurement, intellectual property and technical regulations is a difficult challenge given the unprecedented and largely untested character of these international rules. However, the consequences of misapprehending or failing to comply with these requirements are likely to be costly and difficult to correct.

Unless otherwise exempt, most NAFTA and World Trade Organization (WTO) disciplines apply to federal, provincial and local government measures.[7] Article 201 of NAFTA further stipulates that *unless otherwise specified, a reference to a state or province includes local governments of that state or province.* Furthermore NAFTA investment and services rules explicitly delineate the obligations of provincial and local governments. The General Agreement on Trade and Services (GATS) under the World Trade Organization also applies to provincial and local governments.

Both international trade regimes also apply to the National Energy Board and the Ontario Energy Board and other institutions which exercise regulatory authority concerning the electricity sector. NAFTA and GATS disciplines also apply to Crown Corporations, which are obligated to observe

[7] Under NAFTA Measures are defined to mean *any law, regulation, procedure, requirement or practice*. Under the Services Agreement of the WTO, "measure" *means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form...*

many of the constraints that apply to governments. Several of these constraints would also apply to the public entities established by *The Electricity Act,* including the Ontario Power Authority.

Thus Chapter Fifteen of NAFTA: *Competition Policy, Monopolies and State Enterprises* sets out disciplines the purpose of which is, *inter alia*, to ensure that any privately owned monopoly that it designates or any government monopoly that it maintains or designates, acts in a manner consistent with NAFTA requirements in the exercise of any regulatory, administrative or other government authority that has been delegated to it.

Similarly, GATS Article VIII : *Monopolies and Exclusive Service Suppliers*, provides that:

> *1. Each Member shall ensure that any monopoly supplier of a service in its territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with that Member's obligations under Article II and specific commitments.*
>
> *2. Where a Member's monopoly supplier competes, either directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights and which is subject to that Member's specific commitments, the Member shall ensure that such a supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with such commitments.*

Certain NAFTA and WTO rules also apply to non-governmental organizations. For example, the GATS applies to measures taken by *non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities* [GATS Article I:3.].

In many respects the principles and requirements of these international trade agreements have been given expression by the Agreement on Internal Trade (AIT) among provincial and the federal government. Moreover Ontario is considering expanding its commitments under the AIT in accordance with efforts to establish a Trade Investment and Labour Mobility Agreement (TILMA) along the lines of an agreement entered into by British Columbia and Alberta.

NAFTA Energy Rules

While the NAFTA and WTO Agreements are both established on the foundation provided by the GATT, there are several features that distinguish the two regimes. Among the more important of these are rules concerning trade in energy goods which are set out in Chapter 6 of the NAFTA. [8]

Article 602 of this Chapter describes the scope of its application as follows:

[8] These largely replicate the provisions of its prototype in the Free Trade Agreement, with Mexico claiming reservations and exemptions from several of the more onerous obligations of these disciplines.

> *This Chapter applies to measures relating to energy and basic petrochemical goods originating in the territories of the Parties and to measures relating to investment and to the cross-border trade in services associated with such goods, as set forth in this Chapter.*

Measures concerning investment in this sector and the delivery of energy services would also be subject to NAFTA investment and services disciplines. However, in the event of conflict between NAFTA investment rules concerning the energy sector and those set out in Chapter 6, the latter prevails.

With respect to export controls, and unlike the trade in goods provisions of the WTO, NAFTA energy rules prohibit the use of charges or taxes on energy goods [Article 604]. In other words, NAFTA precludes the adoption of a two price energy policy that would distinguish between domestic and export users in any class of energy consumers.

Another critical departure from GATT and WTO principles is set out in Article 605 which effectively guarantees export consumers a proportional share of Canadian energy resources in perpetuity. While export controls are allowed to relieve domestic shortages, they may only be applied proportionately, with a continuing share being guaranteed to export markets reflecting flows for a 36 month period before supply restrictions were imposed. We will return to consider the application of these NAFTA rules more thoroughly in Part IV.

NAFTA Investment Rules

Chapter 11 of NAFTA establishes a number of broadly framed constraints on government measures that may affect foreign investors. These include the obligations to ensure that such measures are consistent with the requirements of *National Treatment* [Article 1102], *Most Favoured Nation Treatment* [Article 1103] and a *Minimum Standard of Treatment* [Article 1105]. Chapter Eleven also establishes blanket prohibitions against certain *Performance Requirements* [Article 1106] and government measures that may be considered to represent expropriation [Article 1110].

In addition to these substantive obligations, another remarkable feature of Chapter 11 is the right of private enforcement it accords foreign investors. Under Articles 1121 and 1122 foreign investors of a NAFTA party have a virtually unqualified right to claim damages for violations of the broadly-worded constraints established by the chapter.[9]

[9] Under Article 1122 Canada has unilaterally consented to international arbitration of claims arising under the Chapter notwithstanding the absence of any contractual relationship with the foreign investor. While foreign investor must waive their rights to pursue similar claims before domestic courts they need not exhaust domestic remedies before resorting to international dispute resolution [Article 1121].

These disputes are then decided, not by Canadian courts or judges, but by international arbitration panels [Article 1120]. These tribunals in turn operate under international law and according to procedures established for resolving international commercial disputes.[10]

NAFTA investment rules have in fact recently been invoked to challenge Canadian measures directly concerning the energy sector. In this regard, two US based oil companies have initiated procedures under Chapter 11 to recover damages against Canada which they claim arose from requirements for R & D spending imposed by the Canada- Newfoundland Offshore Petroleum Board. The companies allege that these requirements are prohibited by NAFTA investment rules concerning performance requirements. [11]

The constraints on performance requirements are set out in Article 1106 which proscribes certain forms of investment regulation on both foreign and domestic investors alike. Article 1106 provides in part that**:**

[10] C. Chinkin, *Third Parties in International Law*, (Oxford: Clarendon Press, 1993) at 248-249.

[11] The pleadings and other documents relating to the case can be found at http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/MobilInvestments.pdf

> 1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
>
> (e) to restrict sales of goods ....in its territory .... by relating such sales in any way to the value of its ....foreign exchange earnings; [emphasis added]

Neither NAFTA nor WTO procurement rules would apply to the OPA, however by entering into procurement agreements with companies owned, in whole or in part, by foreign investors, NAFTA investment rules would nevertheless be engaged. These engender the risk of investor-state claims challenging conditions to a procurement agreement on the basis that it offends the constraints imposed by Article 1106, or other NAFTA investment rules.

While on the subject of procurement, it is important to note that unlike international procurement regimes, the procurement disciplines of the Agreement on Internal Trade do apply to provincial governments, and to a certain extent, provincial government entities.

Finally in this regard, the right of foreign investor to seek recourse through international arbitration my not be superceded or abrogated by the terms of any procurement agreement it may enter into. This is clearly established by the a decision rendered by Mr. L. Yves Fortier in a case heard under the auspices of the International Centre for the Settlement of Investment disputes which is reported on the Worldbank website: http://www.worldbank.org/icsid/cases/awards.html.

In deciding that Vivendi was entitled to have its claim adjudicated under the bilateral investment treaty ("BIT"), the tribunal concluded:

> *In accordance with the general principle ... whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper and applicable law — in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract ....* [Para. 96]

Electricity Related Services

The other category of international trade rules that are relevant to the privatization of Ontario's electricity sector are those concerning services. These are set out in Chapter 12 of the NAFTA and in the GATS. However, the status of electricity under these regimes is uncertain and neither may apply to delivery of electricity as a service *per se*. While some energy products clearly fall in the goods category, the case for electricity is unclear for several reasons.[12] It is significant, however, that the US takes the unqualified position

[12] See note 22.

that power generation is a service.[13] Nevertheless, whether electricity is considered a good, service or both, it is clear that the supply of electricity involves many service activities including those related to: mining coal and uranium; drilling for oil and gas; designing and building power plants and other generation facilities; establishing and operating transmission and distribution networks; trading bulk electricity; marketing, supply and metering; managing related financial services and transactions, and operating customer billing and accounting systems.

While the GATS and Chapter 12 have similar features - there are significant differences in the coverage of these regimes. Under Chapter 12, coverage is universal for traded services subject to few exceptions and certain reservations for non-conforming measures. The GATS also applies universally to traded services except those delivered "in the exercise of government authority" [GATS Article I:3(c)]. However only certain GATS provisions apply across the board to all services. *National Treatment, Market Access, Domestic Regulation* and certain other key provisions apply only to service sectors with respect to which Canada has made specific commitments.

Another distinction between the two regimes concerns their respective definitions of trade in services. The GATS includes within the ambit of this definition, delivery of services through the commercial presence of the service provider in the jurisdiction where the service is provided. In other words, it includes the right of establishment for foreign service providers and, for that reason, has features analogous to NAFTA investment rules. This explains why the WTO has described it as the first multilateral agreement on investment.[14]

This point is fundamental to understanding the relevance of the GATS to Ontario's electricity sector. For example, the operations of a US-based energy service company in Ontario could be considered trade in services under the GATS, even where power was generated and consumed in the province. Of course such an undertaking would also represent an investment under NAFTA investment provisions, which is likely to render the application of GATS disciplines of secondary importance.

Finally, three other exceptions set out by these services agreements are germane. The first is set out in Annex V to the NAFTA and reserves Canada's right to maintain a quantitative restriction under Article 1207, namely the right of the National Energy Board to approve international transmission lines. Another is set out in Article XIV *bis* of the GATS which includes certain security exceptions, including measures "relating to fissionable and fusionable materials or the materials from which they are derived."

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[13] *WTO*: *Communication from the United States, Energy Services*, 18 December 2000, S/CSS/W/24.

[14] www.wto.org/wto/services/services.htm

Finally, Ontario has stipulated a reservation to the GATS, that applicants and holders of a water power site development permit be incorporated and resident in Ontario.[15]

Canada's GATS Obligations

As noted, the extent to which government prerogatives may be subject to GATS constraints depends upon the services it has listed to GATS schedules.[16] The United Nations Provisional Central Product Classification (UNCPC), upon which Canada has relied in listing its commitments under the GATS, does not list energy services as a separate category. However, a review of Canada's GATS schedule accordingly reveals an extensive number of commitments relevant to the energy sector.[17]

To appreciate the significance of the obligations that attach to listed services, consider the nature of the reservations that have been declared by the federal government and some provinces to qualify the commitments that Canada has made. For example, Alberta, Newfoundland and Nova Scotia have all declared reservations that would allow them to require that preference be given to local goods, services and workers with respect to large scale energy projects.[18]

But with the exception of construction services for hydraulic stations, Ontario has listed no reservations. Its failure to do so may reflect the fact that in 1994, when such reservations were nominated, it did not foresee the transformation of Ontario's electricity

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[15] GENERAL AGREEMENT GATS/SC/16, 15 April 1994, ON TRADE IN SERVICES (94-1015) - CANADA, Schedule of Specific Commitments.

[16] The GATS listing process is complicated and allows a country to specify which precise GATS disciplines it is willing to embrace with respect to a particular sector. Commitments fall into three broad categories: *Market Access*, *National Treatment* and *Additional Commitments*. Moreover with respect each of these categories, a country may qualify or limit its commitments to certain modes of supply (e.g. cross border); a certain time frame; or, with respect to particular types of regulatory elements (e.g. controls on the number of service suppliers).
While the complexity of this regime provides ample opportunity for missteps, correcting an error is difficult and likely to be costly. In all of this a country is to be guided by GATS classification schedules which characterize services as belonging to particular sectors or sub-sectors. We return to consider the challenges presented by service sector classification regimes further below.

[17] These include: Engineering design services for civil engineering construction, industrial processes and production; Services incidental to mining, including drilling and field services and rental of equipment with operator and including site preparation; General construction work for civil engineering; Construction work for civil engineering, including for ... dams, ... mining and manufacturing, power and communications facilities, pipelines .... Communications services, including on-line data and information retrieval; Wholesale trade services; Environmental Services including waste management and air pollution control; Nature and landscape protection services; and Financial Services.

[18] Horizontal reservations apply across the board to all services listed by a particular jurisdiction. In addition to these reservations of general application, there are also much more specific reservations which have been listed for specific services and even modes of supply. The two reservations cited apply only to cross border supply and consumption abroad.

sector that would occur years later. However, once Canadian commitments under the GATS are declared, it is difficult to subsequently retract or qualify them.

Security and Reliability of Electricity Supply

The reliability of Ontario's electricity system depends upon a stable balance of supply with demand. Like any other supply/demand management regime, this necessarily entails the control of imports and exports which might otherwise de-stabilize the equilibriums carefully established between domestic producers and consumers.

As noted, the primary purpose of NAFTA energy provisions is to prohibit the imposition of export and import controls on energy goods and services. These free trade principles will surely facilitate system integration with the US, but they also conflict with the needs of supply/demand management to control flows both within and across provincial and international boundaries. This conflict raises a serious question about the compatibility of current trade rules with the imperative to ensure system reliability.

As noted, several NAFTA provisions constrain the capacity of governments to control energy imports and exports. The most important of these are delineated in Chapter Six of NAFTA: *Energy and Basic Petrochemicals*.

Article 603 incorporates the provisions of the *General Agreement on Tariffs and Trade* (GATT), with respect to prohibitions or restrictions on trade in energy. Critical in this regard is the general prohibition against all export and import controls concerning trade in goods, which is set out by Article XI of the GATT. While Canada is permitted to maintain import and export licensing for energy, these controls must respect the constraints imposed by the provisions of this Chapter,[19] as must Canadian regulators, Crown corporations and public sector monopolies.

Exports controls can only be imposed under the limited circumstances provided by certain exceptions to the general prohibition imposed by Article XI on such quantitative controls, such as:

- *preventing or relieving critical shortages on a temporary basis* [GATT Art. XI:2 (a)];

- *conserving exhaustible natural resources* [GATT XX(g)];

[19] Article 608.2 provides that Canada and the United States but not Mexico shall act in accordance with the terms of Annexes 902.5 and 905.2 of the *Canada United States Free Trade Agreement*. Annex 905.2 eliminated the least cost alternative test as a criterion to be applied by the NEB with respect to energy exports, and constrained the application of surplus tests in accordance with the requirements of Articles 902, 903, and 904 of the FTA. Annex 902.5 established the primacy of the International Energy Program which is an emergency energy sharing arrangement between Canada and the United States. The only reservation explicitly relevant to the electrical energy sector is for quantitative restrictions under Annex V of the NAFTA which preserves the requirement of the National Energy Board Act to approve the construction and operation of international electricity transmission lines.

- *ensuring essential supplies for domestic industries as part of a domestic government stabilization plan* [GATT XX(i)]; and,

- *dealing with matters essential to the acquisition or distribution of products in short supply* [GATT XX(j)].

However, the importance of ascertaining the actual ambit of these safeguards is greatly diminished by Article 605 which imposes the further constraint that even where these exceptions apply, such measures may be adopted or maintained only if:

> *(a) the restriction not reduce the proportion of the total export shipments of the specific energy or basic petrochemical good made available to that other Party relative to the total supply of that good of the Party maintaining the restriction as compared to the proportion prevailing in the most recent 36 month period for which data are available prior to the imposition of the measure .... ;*
>
> *(b) does not impose a higher price for exports of an energy or basic petrochemical good to that other Party than the price charged for such good when consumed domestically, ...and; by means of any measure such as licenses, fees, taxation and minimum price requirements. The foregoing provision does not apply to a higher price that may result from a measure taken pursuant to subparagraph (a) that only restricts the volume of exports; and*
>
> *(c) the restriction does not require the disruption of normal channels of supply to that other Party or normal proportions of the specific energy ... supplied to that other Party.*

In other words, notwithstanding reliability and supply problems that might impose brown-outs or black-outs in Ontario, Article 605 requires that exports to the US be maintained in the relative proportion that such exports represented of domestic supply prior to the imposition of such controls, but only if justified by the limited exceptions allowed under the GATT.

Indeed, the incompatibility of these trade constraints and electricity export controls was formally acknowledged under the *Power Corporations Act,* which stipulated that Ontario rules concerning the export of electricity by Ontario Hydro would prevail in the event of conflict with the free trade rules.[20]

NAFTA investor rights may also come into play in this context, quite independently of NAFTA energy rules. This risk was brought to light by in a Chapter 11 claim by Pope and Talbot, a Canadian subsidiary of a US lumber company.[21] In that case, Pope and

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[20] Power Corporation Act, R.S.O. 1990, c. P.18, s. 85(4) which refers to the substantially similar constraints of the Free Trade Agreement of 1988.

[21] Pope and Talbot v. Canada, Interim Award of the Tribunal, http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-e.asp#P&T

Talbot complained that the export quota it was allocated under the *Softwood Lumber Agreement* offended several NAFTA investment provisions.[22]

Canada lost the case for failing to meet its obligation under Article 1105 to accord the company "treatment in accordance with international law." In coming to that conclusion, the Tribunal read an obligation of administrative fairness into Article 1105, which it then concluded Canada had failed to meet. One should be cautious about making too much of the Tribunal's conclusions concerning Article 1105 because these were subsequently criticized by a Canadian Court,[23] and may have now been addressed by a statement by the NAFTA Parties indicating their intent to see this Article 1105 read more narrowly.[24]

The *Pope and Talbot* case is important however because Tribunal ruled that the company's "access to the US market is a property interest subject to protection under Article 1110",[25] flatly rejecting Canada's argument that US market access represented an abstraction incapable of founding a claim for expropriation. In other words, any attempt to limit energy exports, whether in conjunction with the imposition of price caps or otherwise, could interfere with a proprietary interest protected by Article 1110. This expansive definition of investment also transforms what would otherwise be a measure concerning trade in goods or energy services into one also concerning investment, and by doing so, renders it vulnerable to foreign investor damage claims.

In the Pope and Talbot case, access to US markets was unimpeded, the only question was whether exports would be exempt from import tariffs under the Softwood Lumber Agreement. In a case where foreign market access was actually denied, a claim would likely have a much better chance of succeeding.

Export Taxes

While generally permitted under WTO rules, export taxes, which would otherwise provide an effective mechanism for export control are, as we have noted, prohibited under NAFTA.

Article 603 also precludes the use of pricing as a substitute for quantitative export or import controls by proscribing: *in any circumstances in which any other form of quantitative restriction is prohibited, minimum or maximum export - price requirements and, except as permitted in enforcement of countervailing and antidumping orders and undertakings, minimum or maximum import-price requirements.*

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[22] Within quota limits, lumber could be exported to the US duty free. Above the limit, duties were charged and profits affected. Nevertheless Pope and Talbot was free to export as much lumber to the US as it could find a market for.

[23] See discussion infra, p.53.

[24] See note 28.

[25] Note 51, Para. 96.

Article 604 further provides:

> *No Party may adopt or maintain any duty, tax or other charge on the export of any energy or basic petrochemical good to the territory of another Party, unless such duty, tax or charge is adopted or maintained on:*
>
> *a) exports of any such good to the territory of all other Parties; and*
>
> *b) any such good when destined for domestic consumption.*

National Treatment of Foreign Energy Goods

In addition to NAFTA provisions which deal explicitly with import and export regulation, other trade disciplines impose constraints that are also likely to undermine efforts to balance supply and demand in Ontario's electricity market. Take, for example, the challenge of ensuring that Ontario not become too reliant upon export suppliers to meet its energy needs.[26]

Any effort to establish a quota for either export or domestic private power providers would clearly offend *National Treatment* obligations. These are set out in NAFTA Article 301 which provides in part:

> *1. Each Party shall accord national treatment to the goods of another Party in accordance with Article III of the General Agreement on Tariffs and Trade (GATT).....*
>
> *2. The provisions of paragraph 1 regarding national treatment shall mean, with respect to a state or province, treatment no less favourable than the most favourable treatment accorded by such state or province to any like, directly competitive or substitutable goods, as the case may be, of the Party of which it forms a part.*

While Ontario's power system was controlled by Ontario Hydro, would-be foreign competitors were accorded no less favourable treatment than their domestic counterparts - all were denied market access. But once access to the grid is provided to domestic producers and suppliers the same competitive rights must be accorded to foreign suppliers. Nor could the relative proportion of the domestic market which might be acquired by out of province energy providers be limited. The net effect of these requirements may place Ontario increasingly at the mercy foreign power suppliers to supply its energy needs.

National Treatment for Investors and Service Providers

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[26] While Ontario currently enjoys a surplus of supply, this status quo depends upon the continued performance of its nuclear facilities, and other factors which may shift over time, particularly if interconnection capacity is increased substantially.

Similar *National Treatment* obligations are delineated under NAFTA investment and services rules [Articles 1102, and 1202], as well as under the GATS for those services for which commitments have been made [Article XVII]. With respect to foreign investment, further constraints on export and import controls are established under the *Performance Requirement* provisions of NAFTA Article 1106. While these constraints are largely redundant with those delineated by the NAFTA and WTO disciplines noted above, their amenability to private enforcement procedures considerably elevates their importance.

In sum:

Under free trade disciplines, serious limits exist on the right to restrict access by domestic producers to US markets. Conversely, foreign producers must be accorded the same access to Ontario consumers as is available to their Canadian competitors. The effect of these constraints imposes a real challenge to ensuring the reliability of Ontario's electricity system where it depends upon effective regulation of supply and demand.

Moreover, the inherent lack of predictability associated with open borders undermines the capacity to make reliable predictions of future system needs, or to plan for them. This in turn is likely to compromise the long term reliability of the system as well.

One way to understand this problem is to appreciate that system reliability depends upon sophisticated and responsive regulatory control in which all supply and demand transactions are carefully managed - but trade disciplines superimpose a regime of de-regulation whenever those transactions cross international boundaries.

Environmental Protection and Conservation Exceptions

Under GATT rules, governments may rely upon certain listed exceptions as justification for departing from the strict constraints imposed by that trade regime. These are set out in Article XX of the GATT and include two exceptions that are particularly important for environmental, public health and conservation purposes. These concern measures that violate GATT constraints but are either:

> *necessary to protect human, animal or plant life or health,* or
>
> *[relate] to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production and consumption*

As interpreted by WTO dispute bodies, these exemptions have been given narrow application. However, neither of these exceptions is permissible under NAFTA investment rules.[27]

[27] See Article 2102:2.

It might nevertheless be argued that such measures would be permitted under Article 1114:1 concerning Environmental Measures, which provides:

> *Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. [emphasis added]*

Because this provision only applies to measures "otherwise consistent" with Chapter 11 it would not apply to a measure otherwise found to be in breach of the expropriation or other investment rules.[28] A similar problem exists with respect to NAFTA services disciplines.[29]

In the case of the GATS, certain Article XX exceptions are imported by Article XIV. But noticeably absent from this transposition is a counterpart to the conservation exception established by GATT Article XX(g). While this conservation exception has yet to be successfully invoked, the WTO has been willing to accord it putative support. It is also very clear that without the benefit of this exception, a host of conservation measures have no safeguard whatsoever.

Accordingly, under the GATS and the NAFTA investment and services regimes, governments are substantially denied recourse to the modest opportunity that GATT rules allow to defend government measures as being necessary for environmental or conservation purposes. In our opinion, the only conclusion that can fairly be drawn from these provisions is that they reflect a deliberate intent to subsume environmental and conservation goals to those of trade liberalization for services and investment.

CONCLUSION:

The preceding assessment describes some of the potential conflicts that may arise between the objectives and measures needed to implement the IPSP, and the limitations imposed by international and domestic trade law and regulation. It is difficult to predict whether such conflicts may erupt into full blown trade challenges or investor claims, but it is only reasonable to expect that the rights of foreign investors and service providers will be asserted where they establish investments in Ontario's electricity system.

Moreover, even a preliminary consideration of this framework of international trade law reveals its relevance to various issues addressed by the IPSP, including those relating to:

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[28] It is also unclear that environmental concerns would include public health measures, which are explicitly referenced in Article 1114:2. Accordingly, the omission of a similar reference to health in 1114:1 would likely be taken as deliberate.

[29] The application of Articles XX (b) and (g) are similarly not available to defend measures that may offend NAFTA services rules, notwithstanding Article 2101:2 which allows the Parties to adopt measures *that are not inconsistent with the provisions of this Agreement, including those relating to health and safety and consumer protection.*

secure and reliable electricity supply; consumer protection; procurement; and dispute resolution. We have indicated above where we believe these matters need to identified as issues that must be considered by the Board in carrying out its review of the IPSP.

All of this underscores the need to take the constraints imposed by these trade regimes into account in fashioning an electricity system plan for the province, so as to manage, and avert where possible, the risk of trade challenges and investor claims.