Energy Probe Research Foundation's Recommendations for Public Hearings No. 2 & 3: Provincial Government: Functions & Resources

The provincial government should limit itself to strictly regulating water and wastewater systems.

The provincial government's role should be to regulate water and wastewater systems and to enforce the law. Successive governments have utterly failed to carry out their regulatory responsibilities. Although the problem has come to the public's attention only recently (as environmental and labour organizations have protested budget and staff cuts at the Ministry of Environment), it predates the Harris government by many years. According to the Canadian Environmental Defence Fund (CEDF), "MOE has maintained a *de facto* non-enforcement policy for municipalities spanning three decades." In fact, the province has known nothing but: As Jamie Benidickson's expert report so aptly shows, the reluctance to prosecute municipalities dates back as far as the late nineteenth century.

The failure of regulation is hardly surprising, since, in our largely public system, governments that prosecuted municipalities would be prosecuting themselves. Politicians and bureaucrats see municipalities as "children of the province" and describe the relationship as "very close." Their paternalism extends to their financial relationship: The province has for many decades provided generous capital grants for municipal facilities. The province also operates 161 municipal water plants and 233 municipal sewage facilities through the Ontario Clean Water Agency. Self interest encourages a gentle approach to enforcement: Strict enforcement of statutes and regulations would mandate expensive repairs and upgrades that provincial governments would ultimately have to pay for or implement. Conflicting loyalties and objectives thus paralyse governments that own, operate, or finance the water and wastewater systems that they must also regulate.

Understanding that these deeply rooted conflicts have long prevented the provincial government from cracking down on poorly performing municipalities is extremely important. In the absence of such an understanding, it is all too easy to point the finger at the Harris government's aversion to regulation and its deep cuts to the MOE staff and budget. As much as we decry those cuts, and as much as we recognize that enforcement requires staff and money, we know that restoring positions and budgets alone will not produce good regulation. Only by eliminating the many conflicts that now bind the government can we free it up to regulate. The following recommendations are designed to do just that.

The provincial government should adopt a coercive – rather than a cooperative – approach to the enforcement of laws governing public health and the environment.

The province has chosen a cooperative rather than a confrontational approach to water supply. Dialogue, education, encouragement, assistance, trust, and a strong bias against prosecution have

characterized the relationship between the ministry and municipalities. Jim Jackson suggested to the Inquiry that the government's cooperative approach dated back to the 19th century: "The legislature apparently expected people to do the right thing with respect to water works."

The province has been unduly solicitous of municipalities' concerns and capabilities. Before making demands, Erv McIntyre told the Inquiry, the ministry has always taken into consideration "the cost and the ability of the municipality to pay for the costs." It has patiently worked with municipalities that violate laws governing public health and the environment, sometimes developing corrective plans that take years to implement.

It is difficult to imagine law enforcement officials giving other criminals this kind of leeway. The police are not known to cooperate with thieves or murderers in order to help them comply with the law. Even squeegee kids and welfare cheats are dealt with harshly and face mandatory minimum penalties. Why, in contrast, are environmental crimes so widely tolerated?

Coercive law enforcement exists not only to punish wrongdoers but also to discourage "wrong-doing." It is powerfully prophylactic. A cooperative approach to law enforcement provides weaker deterrence and punishment alike. We have seen where the province's cooperative approach has taken us: In 2000, more than half of the province's water facilities were out of compliance with provincial standards. Between June 2000 and February 2001, the province's Medical Officers of Health issued 246 boil water advisories.

In its review of international best practices for environmental compliance assurance, the Executive Resource Group (Valerie Gibbons) stressed that cooperative approaches to abatement only work when backed up by the credible threat of coercive enforcement action. It cited a 1996 survey of corporate environmental managers, conducted by KPMG, that found that companies implement best environmental management practices because they have a legal duty to comply with regulations and are concerned about the potential for Board of Directors liability.

The provincial government's enforcement of public health and environmental laws should be conducted as a normal police operation through the Ministry of the Solicitor General.

Under the current regulatory system, policy-making, operations, abatement, and enforcement all fall under one ministry: the Ministry of Environment (and its Clean Water Agency). These different functions demand different values, approaches, and cultures. Abatement may be cooperative, while enforcement must be coercive; abatement may be proactive and enforcement reactive. The inevitable conflicts diminish the effectiveness of the enforcement function.

The incompatibility of the environment ministry's different functions arose in the expert meeting of May 23. AMO pointed out that it is difficult for one ministry to provide support and strong enforcement at

the same time. The two require different models; strong enforcement changes the nature of the relationship. CEDF noted that the blending of technical support with command-and-control can lead to "permission creep." Regulated parties play the system to extend the boundaries of compliance and to put off deadlines.

Establishing an Ontario Environmental Protection Agency under the Ministry of the Solicitor General would reduce the conflicts that now impede strict enforcement. It would distance policy making and abatement from enforcement. It would help depoliticize enforcement, making it more objective and less subject to fiat. It would transform enforcement into an independent, straightforward, policing function.

Under the current system, enforcement can be undermined by the abatement division's previous communication with the accused. This risks "abuse of process" and "officially induced error" challenges. Separating abatement from enforcement will reduce the potential for such challenges.

The provincial government should grant no one the right to contaminate a source of water.

Farmers, industrial polluters, and sewage treatment plant owners should be responsible for ensuring that their wastes do not impair the quality of water. Criminal and tort liability should apply.

The provincial government should restore full tort liability for the owners and operators of water and sewage utilities. In order to allow tort liability to function properly, and to empower affected individuals, the provincial government should eliminate the numerous protections from tort liability that it has created. Specifically, it should:

> Repeal section 331 of the Municipal Act. The section shields municipalities, council members, and municipal employees from common-law liability for poorly operating water and sewage systems by forbidding nuisance proceedings in connection with the escape of water or sewage from water or sewage works.
>
> Repeal section 50 of the Municipal Act. The section protects municipal employees through the provision of liability insurance and the payment of damages or costs awarded against them.
>
> Repeal section 59 of the Ontario Water Resources Act. The section effectively immunizes sewage works from tort challenges by deeming them to be operated by statutory authority as long as they are in compliance with the Ontario Water Resources Act and with the Environmental Protection Act.

More generally, the provincial government should ensure that nothing in provincial acts legalizes utilities' nuisances. It should replace permits granting power to pollute with those permitting activities on the condition that they do not violate others' rights. In all relevant acts, it should include "savings clauses"

that preserve plaintiffs' rights to bring tort actions against those who harm them.

The provincial government should establish an economic regulator to oversee water and wastewater utilities.

Generally speaking, Ontario's water and wastewater systems are in poor condition and require massive investment in upgrading and in new facilities. For efficiency and fairness reasons, the rates that water users pay should be sufficient to recover the real costs of providing those services, including the annualized cost of the capital invested. Significant rate increases will be required in many, perhaps most, Ontario communities.

Since water and wastewater users cannot be protected through competition, some process is needed to assure consumers that the rate increases are fair. Those providing the capital required to bring Ontario's water and wastewater systems up to even minimal standards of performance also need assurances that the process is fair. Without assurances that their capital will be returned, they will not invest in the systems.

Because politicians have proven themselves generally unwilling to endorse rates that recover full costs, rates should be set outside of the political system. An independent system of economic regulation should be introduced. The fundamental purpose of economic regulation should to legitimize necessary rates.

Decades of experience with economic regulation of Ontario's privately-owned natural gas distribution utilities provide a proven model for water and wastewater utility regulation. As demonstrated in gas, water and wastewater utility rates should be determined by an independent, quasi-judicial economic regulator charged with determining just and reasonable rates and protecting the public interest. Public participation in the regulatory process should be encouraged. Due process protections should be available to all parties. Regulator accountability will be enhanced if regulators are made subject to judicial review.

The provincial government should not operate water and wastewater facilities. It should disband the Ontario Clean Water Agency (OCWA).

OCWA performs poorly, providing consistently substandard service for municipalities. In 2000, the Ministry of Environment found 41 of OCWA's water treatment facilities to be deficient. The agency's performance at its sewage treatment plants has been no more impressive: In 1999, approximately 35 of OCWA's sewage treatment facilities failed to meet provincial laws or guidelines.

OCWA was established in part to reduce the conflicts of interest that occurred when the Ministry of

Environment operated plants that it was expected to regulate. In fact, the conflicts remain, and continue to discourage the enforcement of the standards that the agency regularly violates. The agency is far too close to the government. It is government-owned and government-backed in terms of its risks and liabilities. It is closely overseen by the government, with MOE playing a dominant role. Close interpersonal connections tie OCWA to MOE: OCWA's employees initially came from the ministry, and senior management continue to travel between the two organizations.

Private-sector competitors see OCWA as the most serious impediment to the creation of a competitive environment in Ontario. Several complain that the agency enjoys a host of subsidies that give it an unfair advantage over them. The agency's reluctance to provide information about its operations or financing functions makes it difficult to determine the nature or extent of these subsidies. Private firms charge that the agency does not pay taxes, need not generate a profit, is bonded by the province, bears no capitalization charge, and can underbid competitors by subsidizing some operations through other contracts or activities. Other critics point to OCWA's having obtained a loan portfolio from the province at a considerable discount. Most of the agency's net income continues to come from the interest on these loans.

If the government choses to maintain OCWA, it should level the playing field to avoid undermining competition and discouraging private-sector involvement in the industry. It should create an arms-length relationship with the agency, withdraw all subsidies to it, impose a dividend policy that requires it to turn over surplus cash to the public, and hold it accountable for its performance by strictly enforcing environmental and health standards at its facilities.

If the government does not remove OCWA's special privileges, and if it insists on maintaining the agency as an operator of last resort, it should allow it to take jobs only if there is insufficient competition among other bidders.

The provincial government should encourage the privatization of municipal water and wastewater utilities.

We will provide detailed recommendations regarding privatization at a later hearing.

The government should phase out all direct and indirect subsidies to water and wastewater systems.

Decades of generous subsidies have had numerous harmful effects, both on municipalities and on consumers.

Grant programs have discouraged proper planning by municipalities and their utilities. They have

dampened innovation and creative management. They have rewarded municipalities that have not properly maintained their systems, have not built in allowances for depreciation, and have not made required investments in health and environmental safety. Investments have too often been determined not by need but by the availability of subsidies. In some cases, investment has been inadequate. (The province's capital requirements for water and sewage could exceed $32 billion in the next 15 years.) In other cases, investment has been excessive. Municipalities have overbuilt their infrastructure, sometimes to the point where they cannot afford to operate it.

Subsidies also adversely affect consumer behaviour. Subsidized consumers lack economic incentives to conserve water. Subsequent overuse has resulted in a demand for excess capacity. Subsidies also artificially skew investment and land-use decisions. Without receiving information about the costs of their resource use, businesses and individuals cannot make efficient choices about where to locate.

Subsidies also raise equity issues among consumers, as they involve a large transfer of wealth from urban residents to those living in smaller towns. Those living outside of towns have not benefited to the same degree: They must bear the often significant costs of their own wells and septic systems.

Subsidies have also discouraged private sector participation. Low investor confidence may be due to the underpricing of water services and the threat that politicians will intervene to keep costs low.

Removing subsidies will improve accountability, discipline providers, reduce the existing dependence of municipalities, reduce perverse incentives (including the incentives to overbuild facilities and to allow facilities to run down), encourage conservation, rationalize decisions regarding where individuals and industries locate, and facilitate greater private sector involvement.

If particular users cannot afford to pay the full cost of water and wastewater services, the provincial government should provide these individual users with cash subsidies unrelated to their usage. This will encourage equity, efficiency, conservation, and rational location decisions.