

**IN THE MATTER OF AN ARBITRATION TO DETERMINE
THE 2014 STEWARD OBLIGATION FOR THE BLUE BOX PROGRAM**

B E T W E E N:

ASSOCIATION OF MUNICIPALITIES OF ONTARIO and THE CITY OF TORONTO

Applicants

- and -

STEWARDSHIP ONTARIO

Respondent

STATEMENT OF DEFENCE OF STEWARDSHIP ONTARIO

A. INTRODUCTION AND OVERVIEW

1. The Applicants, the Association of Municipalities of Ontario (“**AMO**”) and the City of Toronto (“**Toronto**”) (collectively, the “**Municipalities**”), have a regulatory obligation pursuant to O. Reg. 101/94, *Recycling and Composting of Municipal Waste* (the “**Municipal Waste Regulation**”), to, among other things, adopt systems for the collection and diversion of certain defined wastes away from landfills. This regulation was made pursuant to the *Environmental Protection Act*, R.S.O. 1990, c. E. 19 as am. (the “**Environmental Protection Act**”).

2. In particular, the *Municipal Waste Regulation* requires the Municipalities to, within their respective jurisdictions, “establish, operate and maintain a blue box waste management system” [emphasis added] to deal with defined recyclable materials (the “**Blue Box Waste Management Systems**”).

3. In contrast, the blue box program at issue in this Arbitration (the “**Blue Box Program**”) was not created pursuant to either the *Municipal Waste Regulation* or the *Environmental Protection Act*. The Blue Box Program is a waste diversion program that was requested, approved and amended by the Ontario Minister of the Environment (the “**Minister**”) pursuant to *An Act to Promote the Reduction Reuse and Recycling of Waste*, which is more commonly known by its short title, the *Waste Diversion Act*, 2002, S.O. 2002, c. 6 (the “**Waste Diversion Act**”).

4. The *Waste Diversion Act* does not impose any stand-alone obligation on the Respondent's members (the "**Stewards**") to indemnify or otherwise pay the Municipalities for any share of the costs incurred by the Municipalities to establish, operate and maintain their Blue Box Waste Management Systems as required under the *Environmental Protection Act*. Similarly, the *Waste Diversion Act* does not impose any obligation on the Municipalities to participate in the Blue Box Program created pursuant to the *Waste Diversion Act*, the Municipalities can choose to not participate or to implement a waste diversion strategy that goes beyond what is set out in the Blue Box Program (and thus incur additional costs that are not the result of the Blue Box Program).

5. However, to the extent that the Municipalities do participate in the Blue Box Program, and meet the terms and conditions of the Blue Box Program, subsection 25(5) of the *Waste Diversion Act* requires the following:

"A waste diversion program developed under this Act for blue box waste must provide for payments to municipalities to be determined in a manner that results in the total amount paid to all municipalities under the program being equal to 50 per cent of the total net costs incurred by those municipalities as a result of the program." [emphasis added]

6. The words "as a result of the program" are essential to a proper understanding of the subsection. The payment obligations of the Stewards are defined and limited by the terms and conditions of the Blue Box Program requested, approved and amended by the Minister. Similarly, the Municipalities' entitlement to funds under the Blue Box Program is defined and limited by the terms and conditions of the Blue Box Program as approved by the Minister. In the absence of a Minister requested and approved waste diversion program—as that term is used in the *Waste Diversion Act*—for blue box waste, the Stewards would have no payment obligations and the Municipalities would have no program funds from which to draw.

7. The Blue Box Program—which was requested, shaped, amended and approved by the Minister—complies with subsection 25(5). At no time were the Minister's decisions to approve or amend the Blue Box Program challenged by the Municipalities by way of judicial review. At no time prior to the commencement of this Arbitration—a period of over 10 years since the Blue Box Program was first approved and over 9 years since it was amended—did the Municipalities ever take the position that the Minister in any way acted *ultra vires* in relation to the approval or amendment of the Blue Box Program. This position is advanced for the first time in this Arbitration.

8. As set forth below, pursuant to the *Waste Diversion Act*, the Minister has ultimate control and discretion over the scope, goals, form and contents of the Blue Box Program. A central fact of this Arbitration is that in 2002 the Minister specifically requested and provided specific direction with respect to the original Blue Box Program, which was submitted to the Minister in early 2003 and then approved by the Minister. Then, in late 2003, after the Provincial election, the Minister specifically requested, provided specific direction and approved amendments to the original Blue Box Program. In particular, the Minister requested and subsequently approved amendments that dealt with cost containment issues and were intended to limit the meaning of “total net costs” of the municipalities incurred as a result of the Blue Box Program for the purposes of subsection 25(5) of the *Waste Diversion Act* in a manner that takes into account cost containment principles (the “**Cost Containment Plan**”).

9. In furtherance of the Cost Containment Plan, and with the agreement and participation of the Municipalities through a committee contemplated in the approved Blue Box Program, a KPMG-led consortium was engaged to develop the methodology to calculate “total net costs” for the purposes of the Blue Box Program as amended by the Cost Containment Plan (the “**Best Practices Project**”). The Best Practices Project was a one year, \$2 million effort that resulted in a two-volume, 268 page report, which created a model for the annual calculation of “total net costs” in a manner consistent with the Blue Box Program as amended by the Cost Containment Plan (“**Best Practices Model**”). This Best Practices Model is the basis upon which “total net costs” are to be calculated based upon objective measures. The Municipalities were active participants in this exercise.

10. Based on the Municipalities’ Claim, the Municipalities now appear to wish to pretend that neither the Cost Containment Plan nor the Best Practices Model ever happened, nor that they were involved in the development of the Best Practices Model and the identification of municipal best practices through MIPC, a committee mandated by the approved Blue Box Program. They also seek to have this arbitration ignore the fact that they have in each year since the Best Practices Model was developed actively participated in a “Best Practices Committee” (a subcommittee of the MIPC committee) to agree on appropriate input changes to the Best Practices Model for the purpose of determining the Municipalities’ annual “total net costs” under ss. 25(5) of the *Waste Diversion Act*.

11. Indeed, the Municipalities now seek to essentially ignore the events of the past 10 years and to attack the very basis upon which the parties have conducted themselves. The Municipalities’ position now is that the Minister acted *ultra vires* in requesting and approving the

Cost Containment Plan and that the Cost Containment Plan and the Best Practices Model are not relevant to the Stewards' obligation under subsection 25(5). According to the Municipalities, the phrase "total net costs" has no limit (other than what they spend), and the municipalities have a virtual blank cheque from the Stewards.

12. The Municipalities' position is simply incompatible with the language of the *Waste Diversion Act*, the specific language of subsection 25(5), the broad discretion given to the Minister under the *Waste Diversion Act* to shape and approve the Blue Box Program, the administrative structure that was created by the Blue Box Program and the conduct of the parties over the past 10 years.

13. The Blue Box Program, as originally approved by the Minister, contained a section on cost containment, which was subsequently amended and expanded, at the Minister's direction, through the Cost Containment Plan. It was entirely within the Minister's discretion and power to require that a Cost Containment Plan be incorporated into the Blue Box Program. In essence, the Municipalities are seeking to use this Arbitration to collaterally attack legitimate Ministerial decision-making, which the Municipalities have never previously challenged. The Municipalities seek, in effect, a declaration that the Minister acted *ultra vires* in a proceeding in which the Minister is not a party.

14. For the reasons set forth below, Stewardship Ontario submits that, if this Arbitration is to be bifurcated, the first part (Phase 1) of the Arbitration should deal with a determination of what principles and methods govern the calculation of the 2014 Annual Steward Obligation for the Blue Box Program (namely Issues 1 and 4 as set out in paragraphs 3 and 4 of the Municipalities' Claim) and that, if necessary, the second part of the Arbitration (Phase 2) should focus on the determination of the quantum and the means of payment (namely, Issues 2 and 3 as defined in paragraph 3 of the Municipalities' Claim).

15. For the purposes of Phase 1, Stewardship Ontario respectfully requests that the Arbitrator declare that for the purpose of calculating the 2014 Steward Obligation, the Best Practices Model, with the values of the input parameters amended as agreed to by the parties or, if necessary, determined by the Arbitrator, shall be used to calculate the "total net costs" of the Municipalities for the purposes of subsection 25(5) of the *Waste Diversion Act*.

B. STEWARDSHIP ONTARIO

16. Stewardship Ontario is incorporated pursuant to section 24 of the *Waste Diversion Act*. The Minister has designated Stewardship Ontario as the Industry Funding Organization (the “**IFO**”) for two waste diversion programs that have been established under the *Waste Diversion Act*, including the Blue Box Program.

17. Stewardship Ontario is a not-for-profit corporation funded by the industries, namely the Stewards, that are the brand owners or first importers of products and packaging materials that are managed under its two waste diversion programs. Although some Stewards are large companies as suggested by the Municipalities in the Claim, the majority of Stewards are small businesses.

18. Although not relevant to this arbitration, Stewardship Ontario is not “part of” Canadian Stewardship Services Alliance Inc. (“**CSSA**”), as asserted by the Municipalities.¹ CSSA is a national, non-profit organization established to harmonize packaging and printed paper stewardship programs across the country. Stewardship Ontario is in the process of negotiating a Master Services Agreement with CSSA to provide back office support. Stewardship Ontario, however, remains a fully independent entity with its own Board of Directors.

C. THE GOALS OF THE *WASTE DIVERSION ACT*

19. Prior to the enactment of the *Waste Diversion Act* in 2002, the Municipalities had a pre-existing obligation to collect blue box waste under the *Environmental Protection Act* and specifically the Municipal Waste Regulation. That obligation remains in place.

20. The *Waste Diversion Act* was enacted to achieve specific waste diversion policy goals and is intended to promote the reduction, reuse and recycling of waste by influencing the behaviour of all participants along the waste creation and disposal chain including consumers/residents, industry, service providers and municipalities.

D. WASTE DIVERSION ONTARIO & THE DISCRETION OF THE MINISTER

21. To achieve these goals, the *Waste Diversion Act* established Waste Diversion Ontario (“**WDO**”), which is a corporation without share capital. WDO’s statutory mandate, as set out in section 5 of the *Waste Diversion Act*, includes, among other things:

¹ Municipalities’ Claim, para. 12.

- (a) developing, implementing, and operating waste diversions programs for designated wastes in accordance with the *Waste Diversion Act* and monitoring the effectiveness and efficiency of those programs;²
- (b) seeking to enhance public awareness of and participation in waste diversion programs;
- (c) seeking to ensure that waste diversion programs developed under the *Waste Diversion Act* affect Ontario's marketplace in a fair manner; and
- (d) determining the amount of money required by WDO and the IFOs to carry out their responsibilities under the *Waste Diversion Act*. [emphasis added]

22. Under the *Waste Diversion Act*, waste diversion programs are developed by WDO at the discretion and direction of the Minister. There is no obligation on the Minister to direct the creation of any specific waste diversion program and no obligation on WDO to create a waste diversion program in the absence of a request from the Minister. The key sections of the *Waste Diversion Act* relating to the creation of a waste diversion program are as follows:

- (a) **Creation of a Waste Diversion Program:** Section 23 provides that the Minister may require WDO, in co-operation with an IFO, to develop a waste diversion program for designated wastes.
- (b) **Contents of a Waste Diversion Program:** Section 25 sets out what the Minister may, may not and must direct WDO to include in a waste diversion program created pursuant to Section 23.
- (c) **Mandatory Contract with IFO:** Subsection 25(3) requires that the waste diversion program include an agreement between WDO and the designated IFO governing the role of the IFO in the implementation and operation of the program and governing the exercise of the IFO's powers under the *Waste Diversion Act*.
- (d) **Ministerial Approval:** Section 26 provides that the waste diversion program developed by WDO must include specified information for the Minister's consideration prior to approval.
- (e) **Ministerial Approval of Amendments:** Section 27 provides that the Minister may approve material changes to an approved program, and that no material changes to an approved program are to be made without Ministerial approval.

23. Accordingly, the Minister had complete control, discretion, and statutory decision-making power over the scope, form and contents of the Blue Box Program created under the *Waste Diversion Act*. Furthermore, pursuant to the *Waste Diversion Act*, WDO is statutorily bound and Stewardship Ontario, as the designated IFO, is contractually bound to implement and operate the approved Blue Box Program as directed and approved by the Minister. Except as provided for in the approved Blue Box Program itself, neither WDO nor Stewardship Ontario has any discretion with regards to the scope, form and contents of the Blue Box Program. Therefore, if

² As set out in subsections 23(2) and 25(3) of the *Waste Diversion Act* and as discussed below, WDO develops, implements, and operates waste diversion programs in co-operation with an IFO.

the Minister requires the inclusion of certain cost containment principles in the approved Blue Box Program, including in relation to the calculation of “total net costs” incurred by the Municipalities “as a result of the program,” WDO and Stewardship Ontario are obligated to comply with this directive.

E. SUBSECTION 25(5) OF THE *WASTE DIVERSION ACT*

24. As noted above, section 25 deals generally with the contents of a waste diversion program created under the *Waste Diversion Act*. Subsection 25(1) provides examples of items that may be included in a program. Subsection 25(2) lists certain items that may not be promoted by a program. As mentioned below, subsection 25(2) is the only restriction on the Minister’s discretion with respect to the contents of a program. Subsections 25(3) and (4) require a program agreement between WDO and the IFO.

25. Finally, subsection 25(5) deals with the Stewards’ payment obligations in the context of an approved waste diversion program:

A waste diversion program developed under this Act for blue box waste must provide for payments to municipalities to be determined in a manner that results in the total amount paid to all municipalities under the program being equal to 50 per cent of the total net costs incurred by those municipalities as a result of the program. [emphasis added]

26. The Stewards’ obligation is restricted to 50 percent of the “total net costs” incurred by municipalities “as a result of the program.” The term “program” is consistently used throughout the *Waste Diversion Act* to mean the program developed under the *Waste Diversion Act*. Indeed, the opening words of subsection 25(5) refer to a “waste diversion program developed under this Act.” Further, subsection 25(5) refers to “all municipalities under the program,” which signals that there is no obligation to municipalities that have not opted into the Blue Box Program. The Stewards’ obligation under subsection 25(5) must therefore be determined with respect to the Blue Box Program, as developed and approved and subsequently amended under the *Waste Diversion Act*, all at the direction and under the supervision of the Minister. In the absence of a program approved by the Minister under the *Waste Diversion Act* (in this case, the Blue Box Program), the Stewards would have no obligation.

27. In order to be eligible to receive funding under subsection 25(5), the Municipalities must comply with the terms and conditions of the Blue Box Program. The mere fact that the Municipalities are operating blue box waste management systems—as they were obliged to do under the *Environmental Protection Act* prior to the *Waste Diversion Act* and which they remain

obliged to do—does not give rise to any municipal funding entitlement from Stewards. The ability of the Municipalities to access funding pursuant to the *Waste Diversion Act* is conditional on the Municipalities' compliance with the terms and conditions of the Minister-approved Blue Box Program.

28. In this regard, it is also instructive to consider the French version of subsection 25(5). Given that the *Waste Diversion Act* was enacted in both languages, the French version is equally authoritative, pursuant to Ontario's *Legislation Act, 2006*.³ The French version of subsection 25(5) provides:

Le programme de réacheminement des déchets élaboré en application de la présente loi pour les déchets destinés à la boîte bleue doit prévoir le versement aux municipalités de paiements calculés de manière à ce que le total des paiements versés à toutes les municipalités dans le cadre du programme soit égal à 50 pour cent du total des coûts nets qu'elles engagent par suite du programme. [emphasis added]

29. Like the English version, the French version refers to “le programme” (the program) developed under the *Waste Diversion Act* and describes the Stewards' obligation as being “dans le cadre du programme” (in the context of the program) with respect to municipal net costs “par suite du programme” (as a result of the program). In both English and French, the term “program” is in the singular (not plural) and is typically preceded by a definite article (“the” or “le”), not by an indefinite article (“a” or “un”).

30. Consequently, subsection 25(5) cannot be construed as referring to all municipal blue box waste management systems (plural) that are operated pursuant to O. Reg. 101/94 under the *Environmental Protection Act*. Indeed, the Municipal Waste Regulation under the *Environmental Protection Act* does not even refer to a “program” and instead uses a different term (“blue box waste management systems”). The Stewards' funding obligation under subsection 25(5) is governed and defined solely by the approved and amended Blue Box Program.

F. THE BLUE BOX PROGRAM

31. On or around September 23, 2002, the Minister exercised his discretion pursuant to section 23 of the *Waste Diversion Act* and directed that WDO, not Stewardship Ontario, develop a waste diversion program for “blue box waste” (the “**Minister's 2002 Program Request**”).

³ *Legislation Act, 2006*, S.O. 2006, c. 21, Sch. 7, s. 65: “The English and French versions of Acts and regulations that are enacted or made in both languages are equally authoritative.”

Letter”). As noted above, Stewardship Ontario was subsequently designated as the IFO. The deadline for the submission of the Blue Box Program for the Minister’s approval was February 28, 2003.

32. The Addendum to the Minister’s 2002 Program Request Letter contained twelve items that the Minister specifically requested with respect to the development of the Blue Box Program:

1. Waste Diversion Ontario (WDO) shall develop a Waste Diversion Program for Blue Box Waste in accordance with all legislative requirements of the *Waste Diversion Act, 2002* (the *Act*).
2. WDO shall submit a public consultation plan to the Minister within one month of receiving the request for the program. The plan shall describe how the consultation requirements of the *Act* will be satisfied for the program.
3. The program shall include support for all materials designated as blue box waste under the *Act* and which are managed by or on behalf of Ontario municipalities.
4. The program shall support, at a minimum, all categories of wastes set out in Schedule 1 of O. Reg. 101/94 under the *Environmental Protection Act*.
5. The proposed funding rules under the program will designate and define as stewards under the program, brand owners and first importers into Ontario of products that result in blue box wastes under the program. The program will include a rule to exempt stewards under subsection 30(1)(e) of the *Act* based upon de minimis criteria.
6. The program shall include targets for the overall quantity of blue box waste to be diverted under the program, and per material targets for blue box waste to be captured under the program.
7. The proposed funding rules under the program will include:
 - (i) The method used to calculate the **total net costs** incurred by municipalities as a result of the program.
 - (ii) The funding formula to be used for determining payments to municipalities, including variations in costs dependent on north/south and urban/rural differences; and
 - (iii) A funding performance incentive to encourage program efficiency and effectiveness.
8. The program will include a plan, with funding provisions, outlining research and development activities to support and increase the effectiveness and efficiency of blue box waste diversion.

9. The proposed funding rules under the program will account for the voluntary contribution of the Liquor Control Board of Ontario (LCBO) of \$5 million annually for calendar years 2003 through 2006, to be used for direct funding to municipalities under the program to help cover the cost of recycling glass alcohol beverage containers in municipal blue box programs, any administrative expenses incurred by WDO and the designated IFO, and efforts to improve the effectiveness and efficiency of blue box waste diversion.

10. The proposed funding rules under the program will account for the voluntary contribution of the Canadian Newspaper Association (CNA) and Ontario Community Newspaper Association (OCNA) of newspaper advertising with a value of \$1.3 million annually and, in addition, annual funds for the purpose of implementing and monitoring the advertising program and any administrative expenses incurred by WDO and the designated IFO. The program will contain a plan on how the advertising will be allocated and administered. The funding rules will also contain a formula to determine when additional funding support from newspaper members will be required should the cost of recycling newspapers become a cost to municipal blue box programs.

11. The program will include a plan, with funding provisions, outlining activities to develop and promote products that result from the program.

12. The program will include a plan, with funding provisions, outlining educational and public awareness activities to support the program. [emphasis added]

33. As indicated by the emphasized portion of this excerpt, the Blue Box Program was required to include a method of calculating the eligible “total net costs” of municipalities for the purposes of determining the Stewards’ “total net cost” funding obligation to municipalities “as a result of the program.” The Blue Box Program was also required to include a funding performance incentive to “encourage program efficiency and effectiveness.” Accordingly, from the very beginning of the Blue Box Program, the Minister signalled that the Stewards’ funding obligation was to be calculated pursuant to rules approved by the Minister, and that efficiency was to be an important component.

34. Developed with the cooperation of Stewardship Ontario, WDO’s Blue Box Program was the result of extensive consultation among Ontario funding Stewards, municipalities, waste management, and the public.

35. The items specifically requested in the Addendum to the Minister’s 2002 Program Request Letter were addressed in the Blue Box Program. As explained in WDO’s February 28, 2003 cover letter to the Minister, the Blue Box Program:

- (a) includes support for all categories of waste that are designated as blue box waste in Schedule 1 of O. Reg. 101/94 under the *Environmental Protection Act* and that are managed by or on behalf of Ontario municipalities;

- (b) designates and defines as “Stewards” the brand owners and first importers in Ontario of products that result in blue box waste;
- (c) proposes program rules for calculating the total net cost incurred by municipalities as a result of the Blue Box Program, and Stewards’ 50 per cent share of those costs; and
- (d) includes the funding formula to be used for determining payments by industry to municipalities, and outlines funding provisions to support product and market research and development, public education and awareness, and incentives to encourage municipal program efficiency and effectiveness. [emphasis added]

36. The Blue Box Program itself lists all of the items from the Addendum to the Minister’s Program Request Letter and identifies where they are addressed.⁴ The method to be used to calculate the “total net costs” incurred by municipalities “as a result of the program” (Item 7 in the Addendum) is addressed in section 7 of the Blue Box Program.⁵ Section 7.1 of the Blue Box Program states as follows:

Funding of the net cost of municipal Blue Box waste program, under Section 25(5) of the *Waste Diversion Act*, and as directed in the Minister’s Program Request Letter to the WDO, is expected to commence in calendar year 2003. A large majority of Stewards’ fees will go toward the obligation to pay the 50% net cost calculation of municipal costs.⁶

37. The Blue Box Program thus expressly acknowledges that a calculation of municipal “net costs” is necessary. Section 7 of the Blue Box Program also signals the importance of “Cost Containment Strategies”:

Given the potential for Blue Box Program costs to double within five years it is in the interests of Stewards and municipalities to pursue all possible strategies for containing costs.⁷

38. Further, the approved Blue Box Program established a WDO committee known as the Municipal Industry Programs Committee (“MIPC”). As set out in section 5.4 of the Blue Box Program,⁸ MIPC was to be chaired (non-voting) by the Executive Director of WDO and include an equal number of representatives nominated by municipalities and by Stewardship Ontario, respectively. MIPC makes recommendations to WDO’s Board of Directors and, in the original approved Blue Box Program, was given responsibility with respect to certain functions as set out in the Blue Box Program: (i) collection and analysis of recycling program data; (ii) calculating

⁴ Blue Box Program, section 1, pp. 1-2.

⁵ Blue Box Program, section 7, p. 55.

⁶ Blue Box Program, section 7.1, p. 55.

⁷ Blue Box Program, section 7.4.2, p. 63.

⁸ Blue Box Program, section 5.4, p. 26.

and reporting on payments to individual municipalities; (iii) cash flow to municipalities; and (iv) reporting on progress toward targets.⁹

39. In addition, MIPC was given a role in the ongoing calculation of annual Steward payments to the municipal sector pursuant to subsection 25(5) of the *Waste Diversion Act*. A technical working committee of AMO and Stewardship Ontario was to report to MIPC in this regard.¹⁰ Of note the current working committee has adopted the name the “Best Practices Committee”, and its yearly mandate has been primarily focused on agreeing on appropriate inputs to the KPMG Best Practices Model for the purpose of determining the annual “total net costs” of the Municipalities in relation to ss. 25(5) of the *Waste Diversion Act* and the corresponding Steward 50 percent funding obligation.

40. Given that MIPC was established in the Blue Box Program that was approved by the Minister, it is inaccurate to assert, as the Municipalities do,¹¹ that MIPC “has no legal power or authority” solely because it is not referred to in the *Waste Diversion Act* itself. This assertion is inconsistent with the structure of the *Waste Diversion Act*. The Blue Box Program is approved by the Minister under the authority of the *Waste Diversion Act*. A committee that was expressly established in the Blue Box Program as approved by the Minister pursuant to his statutory authority cannot be described as having “no legal power or authority.”

41. Furthermore, as required by subsection 25(3) of the *Waste Diversion Act*, WDO and Stewardship Ontario entered into an agreement relating to the Blue Box Program. This agreement, which governs the exercise of Stewardship Ontario’s powers under the *Waste Diversion Act*, includes the following provision:

Stewardship Ontario:

(a) Will, following approval by the Minister, implement the Blue Box Program;

and

(b) Will comply with all of its obligations under the *Act* including the preparation of an annual report pursuant to Section 33 of the *Act*.¹²

⁹ Blue Box Program, section 5.4.1-5.4.4, pp. 26-28.

¹⁰ Blue Box Program, section 7.3, p. 58.

¹¹ Municipalities’ Claim, para. 41.

¹² Blue Box Program, section 10.4.2, p. 114.

42. Stewardship Ontario is thus obliged to comply with the Blue Box Program and any amendments thereto as requested and approved by the Minister. The issue for this Arbitration is to determine what calculation methodology for “total net costs” is required by the Ministerial-approved Blue Box Program, as amended. To the extent that the Municipalities wish to challenge the Minister’s statutory powers of decision, that is not before the Arbitrator.

43. It is noteworthy that the Municipalities’ Claim effectively ignores the Minister’s role in developing the Blue Box Program. The Municipalities, for example, purport to define the “Blue Box Program” as “a specific document by that name, written by WDO and SO”—with no mention of the Minister.¹³ This characterization overlooks the Minister’s supervisory jurisdiction under the *Waste Diversion Act* (through the Minister’s 2002 Program Request Letter and subsequent requests described below) in directing the development of and approving the Blue Box Program and the amendments thereto.

G. THE MINISTER’S JULY 2003 AND DECEMBER 2003 REQUESTS

44. In or around July 2003, the Minister requested that WDO develop and submit a cost containment strategy for the Blue Box Program (the “**Minister’s July 2003 Amendment Request**”). The Board of Directors of WDO established a Cost Containment Committee (subsequently renamed the Cost Effectiveness Committee) comprised of Board members representing Stewardship Ontario and AMO to address, among other things, cost containment.

45. WDO’s Cost Effectiveness Committee established a series of principles to guide their deliberations in responding to the Minister’s July 2003 Amendment Request. The Cost Effectiveness Committee also developed a cost containment strategy framework consisting of nine activity areas.

46. On or around December 22, 2003, following the Provincial election, the new Minister informed WDO that she had approved the Blue Box Program but also directed WDO to make further changes to the Blue Box Program including, but not limited to, a cost containment strategy that would ensure that municipal blue box program costs would be properly managed (the “**Minister’s December 2003 Amendment Request**”).

47. The Minister’s December 2003 Amendment Request specifically stated:

¹³ Municipalities’ Claim, para. 14.

The new 2004 [Steward] fees schedule should include 2 new actions. First, a cost-containment strategy that will ensure municipal blue box program costs are properly managed. ... [emphasis added]

48. The appendix to the Minister's 2003 Amendment Request listed seven "Detailed Program Requirements," including:

Specific cost containment principles for municipalities and stewards to follow.
Policies and practices that will ensure compliance with cost containment principles.

Policies and practices to encourage effectiveness and efficiency for municipal Blue Box systems.

H. THE INITIAL COST CONTAINMENT PLAN AND THE MINISTER'S REQUEST FOR REVISIONS

49. In response to the Minister's December 2003 Amendment Request, MIPC was tasked with the responsibility to develop, among other things, a cost-containment strategy that built upon, among other things, the earlier work that had been performed by the Cost Effectiveness Committee. The work completed by MIPC in this regard was, like the original Blue Box Program, the subject of consultations involving Ontario Stewards, municipalities, waste management, and the public.

50. The policies and practices developed by MIPC to support cost containment, efficiency and effectiveness were approved by WDO's Board of Directors on July 9, 2004 and submitted to the Minister on July 12, 2004 for approval.

51. On or around December 30, 2004, the Minister approved the Cost Containment Plan, while requesting some revisions. The Notice of Approval that accompanied the Minister's letter acknowledged that the Cost Containment Plan constituted a material change to the Blue Box Program under section 27 of the *Waste Diversion Act*.

Pursuant to Waste Diversion Act, 2002, section 27, the undersigned hereby approves changes to the waste diversion program for Blue Box Wastes.

52. Further, the Minister's December 30, 2004 letter stated in part:

I am also advising you of my approval of the cost-containment plan as submitted by WDO on July 12, 2004, with an accelerated timeframe. I am also asking the WDO to undertake three additional actions as outlined below. ...

...

... I want to ensure that municipalities and stewards remain vigilant in holding the line on Blue Box program costs. Municipalities must continuously implement measures to increase efficiency and contain costs. Industry stewards must continuously take steps to reduce costs through better design for recyclability of packaging and printed paper destined for the Blue Box system, and through support of markets for recycled materials.

...

That is why I am requesting that WDO undertake the following three initiatives:

1. Implement the cost-containment plan that WDO approved and submitted to me on July 12, 2004, but on an accelerated timetable. I would like to see the 'reasonable cost' bands implemented in 2006 rather than 2008 as proposed. Please resubmit the revised cost-containment plan to me by January 31, 2005.

...

I believe that with these measures, WDO, SO and municipalities will be in a good position to maintain control over Blue Box costs and to find efficiencies while promoting increased diversion and sending less waste to landfills. [emphasis added]

53. This letter signalled the Minister's understanding and intention (as set out in the Notice of Approval) that the "Cost Containment Plan" was an amendment to the Blue Box Program. The letter also signalled the Minister's desire to have cost containment implemented on an expedited schedule. The cost bands, which would be used to define the Stewards' total net cost funding obligation under subsection 25(5), would be based on "reasonable costs" as of 2006 and "best practices" costs as of 2008.

I. THE REVISED COST CONTAINMENT PLAN

54. Following the Minister's request for revisions, WDO submitted a revised Cost Containment Plan to the Minister on or around January 31, 2005.

55. The Cost Containment Plan contains eight principles that are expressly noted to have been recommended by MIPC, including:

Cost bands will be:

1. defined to reflect municipal diversity and 'reasonable costs' in 2006 and best practices by 2008;
2. utilized to analyze program costs to identify those that are higher than best practice costs; and

3. utilized to determine net program costs and funding.

Municipal Blue Box recycling programs will, where possible, work to operate at best practices to minimize gross and net Blue Box program costs.¹⁴ [emphasis added]

56. Importantly, the Cost Containment Plan also defines cost containment:

Containment of municipal operating costs is the reduction of the actual gross and net per tonne operating cost incurred by a municipality to collect, process and market Blue Box material, as a result of the implementation of cost containment policies and practices.¹⁵

57. In this vein, the Cost Containment Plan contains the following chart showing the impact of cost containment on the “total net costs” incurred by municipalities as a result of the approved Blue Box Program:¹⁶

Figure 3.1 Current BBPP Cost Components	Figure 3.2 After Implementation of Cost Containment Policies and Practices
Collection, Processing and Depot/transfer costs (including amortized capital) Promotion and education costs Direct and indirect admin costs Interest on capital costs less Revenue from the sale of recyclable materials (calculated on a three year rolling average), administrative fees, processing fees, grants from other agencies	Collection, Processing and Depot/transfer costs (including amortized capital) Promotion and education costs Direct and indirect admin costs Interest on capital costs less Revenue from the sale of recyclable materials (calculated on a three year rolling average), administrative fees, processing fees, grants from other agencies <u>Reduced by effects of cost containment policies and practices</u> [emphasis added]

58. This chart indicates that the cost containment policies and practices approved by the Minister as an amendment to the Blue Box Program were clearly and inarguably intended to reduce the “total net costs” of municipalities for the purposes of subsection 25(5). The Cost Containment Plan further provides:

The following policies and practices to support containment of municipal Blue Box system costs require action on the part of Stewardship Ontario and the

¹⁴ Cost Containment Plan, p. 17.

¹⁵ Cost Containment Plan, p. 7.

¹⁶ Cost Containment Plan, p. 8.

Association of Municipalities of Ontario, working co-operatively through Waste Diversion Ontario:

...

- Support the use of cost bands by various measures including but not limited to
 - Identifying 'reasonable costs' and the range of the cost bands for defined municipal groups ... to reduce the 2004 net system cost for the purpose of setting 2006 fees
 - Developing standards for 'reasonable costs' and procedures for appeals of decisions regarding reasonable costs by 2005 for application in 2006
 - Determining best practice costs for the purpose of setting the 2008 fees.¹⁷ [emphasis added]

59. As is evident from this excerpt, the use of "best practices" costs was expressly intended to inform the Stewards' "total net costs" funding obligation under subsection 25(5) of the *Waste Diversion Act*. This makes sense from a policy perspective. Municipalities have significant autonomy in operating their blue box waste management systems. The Cost Containment Plan itself re-affirms that the "[a]utonomy of municipal government decision-making remains intact."¹⁸ In the absence of a Best Practices limit on the obligation, Stewards would face a potentially unlimited financial liability over which they would have absolutely no control.

60. On or around August 11, 2005, the Minister wrote to WDO to approve the Revised Cost Containment Plan, stating in part:

I am pleased to advise you that I approve the proposal made by Waste Diversion Ontario on January 31, 2005 for changes to the cost containment measures under the Blue Box Program.

I am satisfied that the changes will shorten the implementation timeframe.

61. As with the December 30, 2004 letter, the Minister included a Notice of Approval with the August 11, 2005 letter, which confirmed that the Cost Containment Plan amounted to a material change to the Blue Box Program under section 27 of the *Waste Diversion Act*:

Pursuant to Waste Diversion Act, 2002, section 27, the undersigned hereby approves changes to the waste diversion program for Blue Box Wastes.

¹⁷ Cost Containment Plan, p. 22.

¹⁸ Cost Containment Plan, p. 19.

J. THE BEST PRACTICES MODEL

62. Following the Minister's approval of the revised Cost Containment Plan, MIPC agreed on an approach for setting the Stewards' obligation based on "reasonable costs" for 2006 and 2007. This was a transitional period before "best practices" were to be used to further define and limit the Stewards' funding obligations under subsection 25(5). MIPC then turned its attention to identifying how to determine "best practices" costs for setting the Stewards' obligation for 2008. MIPC initially undertook several initiatives to that end, including:

- (a) Engaging a third party to undertake a statistical analysis of the municipal data reported through the annual survey of municipalities administered by WDO (the "Datacall");
- (b) Engaging a third party to undertake a literature search of Best Practices; and
- (c) Undertaking a series of consultations with municipalities to define Best Practices and their impact.

63. Given that none of these initiatives provided the necessary data or a methodology for determining best practices costs, the Municipalities and Stewardship Ontario, through MIPC, engaged a KPMG-led consortium in the fall of 2006 to undertake a Best Practices Project to:

- (a) Review current practices across a number of Ontario municipal recycling programs, identify and document Best Practices, and formulate opportunities for implementing and diffusing Best Practices; and
- (b) Quantify the effects of a province-wide Best Practices adoption and define the Ontario net program Best Practices cost for determining the Stewards' contributions. [emphasis added]

64. The Best Practices Project was extensive. It lasted almost one year, resulted in a two-volume (268-page) report, and was completed at a cost of approximately \$2 million. Contrary to the Municipalities' assertion,¹⁹ this was anything but a "limited" exercise. The Project team included recycling system experts seconded from municipalities, representing large, small, and mid-sized recycling programs across the Province. As part of its information-gathering process, the Project team conducted a detailed review and site visits of some thirty-two municipal recycling programs that were carefully chosen based on a series of criteria.

65. The KPMG "Project Charter" set-out the following "Key Objective" for the Project:

- To determine the Ontario net system best practice cost for determining Stewards' contribution²⁰

¹⁹ Municipalities' Claim, para. 77.

²⁰ KPMG Project Charter, October 24, 2006

66. “Key drivers” of the Project were summarized at the beginning of KPMG’s report:

The Minister of the Environment has determined that Stewards’ obligation will be confined to 50% of Best Practice system costs **by 2008**.

Stewards’ fees for 2008 are to be based on 2006 Net System Cost under Best Practices.

There is lack of understanding and consensus among stakeholders on what constitutes Best Practices in municipal recycling.

Municipalities are seeking guidance on how to employ Best Practices in order to increase diversion and lower program costs.²¹ [emphasis added]

67. The report also contains the following definition of Best Practices that was approved by MIPC:

Best Practices are defined as waste system practices that affect Blue Box recycling programs and that result in the attainment of provincial and municipal Blue Box material diversion goals in the most cost-effective way possible.²²

68. As noted above, KPMG developed a Best Practices Model. This Model uses groupings of Ontario municipalities. The municipal groupings, which were developed by MIPC and have been amended over time, are intended to account for differences in municipal size, density, geography, and collection type, which would influence the cost.

69. Currently, there are nine municipal groupings: groupings 1-5 consist of larger or more densely populated municipalities, and groupings 6-9 consist of smaller and more isolated municipalities, some with depot collection.

70. The Best Practices Model is, in essence, a peer-to-peer comparison of municipalities within each municipal grouping. With respect to municipal groupings 1-5, the current version of the Best Practices Model yields a gross cost that is based on the most efficient and effective 50 percent of municipalities within each municipal grouping as measured by three factors (net cost/tonne, recovery rate, and the responses to Best Practices questions in the Datacall). As such, the Best Practices Model reflects a compromise position, as it does not reduce the gross cost to account adequately for additional efficiencies that could be achieved across the system by taking greater advantage of economies of scale. Moreover, an optimized system would generate higher revenue than is currently realized. Therefore, an efficiently operating,

²¹ KPMG Report, Volume I, p. 4.

²² KPMG Report, Volume I, p. 15.

integrated Blue Box Program would cost less than the net cost calculation that uses the gross cost generated by the Best Practices Model and actual revenue.

71. The Municipalities' Claim disingenuously asserts that the Best Practices Project was intended for use only in 2008. Further, they assert the Best Practices Model is "now out-dated."²³ The Project was undertaken to identify a Best Practices Model for use by 2008, not only in 2008. Indeed, MIPC would not have spent almost one year and approximately \$2 million on the Project if the intention were to use its results for only one year. As a peer-to-peer comparison tool, the Best Practices Model accounts for, and incorporates, cost increases that are common to all municipalities. Further, KPMG's report expressly contemplated that the Best Practices Model could be updated and used in subsequent years:

The current version of the cost model allows for changes to be made in subsequent years. Capital costs have been accounted for and Net System Cost under Best Practices is unlikely to experience dramatic fluctuations over the next several years. In fact, over the next two to three years minor adjustments for inflation and population growth may sufficiently capture the escalation of Best Practices costs.

However, as Best Practices are temporal in nature, eventual review of Net System Cost under Best Practices may be necessary. For this purpose, the team has developed a process for updating the cost model, including gathering data, normalizing and aggregating costs, and testing the validity of results.²⁴ [emphasis added]

72. As contemplated by KPMG, the input parameter values of Best Practices Model have in fact been updated by the mutual agreement of the Municipalities and Stewardship Ontario through the "Best Practices Committee", a subcommittee of MIPC, in subsequent years.

73. In a Memorandum of Agreement, dated October 17, 2007, among WDO, Stewardship Ontario, the AMO, and the City of Toronto, agreed to the use of the KPMG Best Practices Model as the basis for setting 2008 Stewards' fees under subsection 25(5) of the *Waste Diversion Act*. These parties further agreed to:

Review the methodology utilized to determine the best practice net system cost for setting fees and the methodology utilized for the wine and spirits deposit system adjustment for 2009 and beyond through the MIPC.²⁵ [emphasis added]

²³ Municipalities' Claim, para. 77.

²⁴ KPMG Report, Volume II, p. 24.

²⁵ Memorandum of Agreement, section 4.1(d), p. 6.

74. In every subsequent year through to and including the calculation of the 2012 Stewards' obligation, MIPC has used the Best Practices Model developed by KPMG, with input parameter values adjusted as agreed, to inform the determination of a Best Practices gross cost.

75. In their Claim, the Municipalities assert that, if they cannot simply bill for 50% of their actual costs to run their individual systems, and a model is to be used, it should be a new model that would, among other things, eliminate from consideration the top 25% most efficient municipal programs and instead focus on those programs that fall within 25% to 75% of the total range within each municipal grouping.²⁶ This would result in abandonment of KPMG's Best Practices Model, which was developed with extensive municipal consultation and at great expense, in favour of an arbitrary, untested model that does not even consider effectiveness and efficiency and instead considers only gross cost per tonne.

K. THE MUNICIPALITIES' COLLATERAL ATTACK ON MINISTERIAL DECISION-MAKING

76. At its core, the Municipalities' position is a challenge to Ministerial decision-making. The Municipalities suggest that the Minister acted *ultra vires* in approving the amendment of the Blue Box Program through the Cost of Containment Plan. For example, the Municipalities state that:

- (a) the *Waste Diversion Act* does not authorize the Minister or the Blue Box Program "to limit or alter the payment obligation" in subsection 25(5);²⁷
- (b) since 2003, the Minister has "purported to amend" the Blue Box Program. The Minister's "only possible jurisdiction" to amend the Blue Box Program is under section 26(3) or section 27 of the *Waste Diversion Act*, "neither of which authorizes her to amend or limit the municipal right to compensation" under subsection 25(5);²⁸
- (c) the Cost Containment Plan "would have been *ultra vires* if it had attempted to derogate" from subsection 25(5);²⁹ and
- (d) the *Waste Diversion Act* "contains no legal authority for payment containment. 'Payment containment' could not be and is not part" of the Blue Box Program or the Cost Containment Plan.³⁰

77. These assertions amount to collateral attacks on the Minister's decisions. The Municipalities are, in effect, attempting to convert this arbitration into a judicial review whose object would be the variation or even nullification of the Minister's decisions. This arbitration, however, is not a judicial review, and nor is the Minister a party. The Municipalities are pursuing

²⁶ Municipalities' Claim, para. 122.

²⁷ Municipalities' Claim, para. 32.

²⁸ Municipalities' Claim, para. 38.

²⁹ Municipalities' Claim, para. 71.

³⁰ Municipalities' Claim, para. 81.

what is, in essence, an administrative law *vires* review in the context of an arbitral proceeding by challenging the Minister's decisions (many years after they were made) in this forum.

L. THE MINISTER WAS AUTHORIZED TO REQUIRE COST CONTAINMENT

78. Moreover, the Municipalities would not have been successful even if they had commenced a judicial review at the time the Minister approved the Cost Containment Plan. This is because the Minister has significant discretion under the *Waste Diversion Act*. As noted above, it is the Minister, not WDO or Stewardship Ontario, who decides whether to require the development of a waste diversion program and who must then approve the program as well as any material changes to it. Pursuant to subsection 26(2), the program that is submitted for the Minister's approval must contain specific information, including "[s]uch other information as the Minister may require." The *Waste Diversion Act* thus expressly authorizes the Minister to shape a waste diversion program such as the Blue Box Program. It is the Blue Box Program, developed pursuant to the Minister's direction and subsequently approved and amended by the Minister, that defines the Stewards' funding obligation under subsection 25(5).

79. The *Waste Diversion Act* nowhere prohibits the adoption of a cost containment regime as part of the Blue Box Program. Indeed, as already mentioned, the only restriction on the contents of a waste diversion program is provided by subsection 25(2), which prohibits a program from promoting the burning or landfilling of the designated waste, the application of the designated waste to land, and any activity prescribed by the regulations. Apart from this restriction, the contents of a program are governed entirely by the Minister's discretion.

80. The Municipalities' purported distinction between "payment containment" and "cost containment" is tortured and unsupportable. The Stewards' funding obligation in subsection 25(5) is tied to the total net costs "as a result of the program." Payment and costs are two sides of the same coin under subsection 25(5). The purpose of reducing costs is to contain payments.

81. In this regard, the Municipalities assert that the Cost Containment Plan "could not, and the Minister did not purport to, amend or alter" the Stewards' funding obligation under subsection 25(5).³¹ The Municipalities further assert that the Cost Containment Plan is

³¹ Municipalities' Claim, para. 73.

“aspirational” and that its “ongoing relevance” is uncertain, “since it states that it applies to 2008.”³²

82. These assertions are also unfounded. As the Municipalities acknowledge,³³ the Cost Containment Plan states that “[c]ost bands will be ... utilized to determine net program costs and funding.”³⁴ Even more precisely, the Cost Containment Plan states that costs bands are to be used for “[d]etermining best practice costs for the purpose of setting the 2008 fees.”³⁵

83. Moreover, as noted above, there is no support in the Cost Containment Plan for the proposition that it is limited to 2008. Like the Best Practices Model itself, the Cost Containment Plan was the product of significant work by many stakeholders and was not intended for a single year. The Cost Containment Plan states that MIPC’s recommendation with respect to Best Practices costs was to be implemented “by 2008”³⁶—signalling that Best Practices costs were intended to be used going forward. This is consistent with the Minister’s letters (excerpted above), which indicate that cost containment is a fundamental, enduring aspect of the Blue Box Program.

M. INCENTIVES FOR EFFICIENCY

84. The Addendum to the Minister’s original 2002 Program Request Letter required, in Item 7, that the proposed funding rules under the Blue Box Program include a “funding performance incentive to encourage program efficiency and effectiveness.” It has thus been recognized, since the inception of the Blue Box Program, that incentives for efficiency are necessary. If there were no such incentives that served as a control on the Stewards’ funding obligation under subsection 25(5), this obligation could be unlimited.

85. In their Claim, the Municipalities seek to downplay the need for the Cost Containment Plan, on the basis that they have other incentives to operate efficiently.³⁷ It was, however, the Minister, not WDO or Stewardship Ontario, who decided that the Cost Containment Plan and an amendment to the Blue Box Program was necessary. This is, in any event, not an argument for this Arbitration, but for another forum.

³² Municipalities’ Claim, paras. 73-74.

³³ Municipalities’ Claim, para. 74.

³⁴ Cost Containment Plan, p. v (emphasis added).

³⁵ Cost Containment Plan, p. 22.

³⁶ Cost Containment Plan, p. 17.

³⁷ Municipalities’ Claim, paras. 63-64.

86. The Municipalities now effectively seek to challenge the Minister's decision to amend the Blue Box Program in 2004/2005 in this Arbitration, rather than judicially review it at the time, after years of acquiescing to the tenets of the Cost Containment Plan.

87. Moreover, while it is acknowledged that the Municipalities are accountable to their taxpayers, the Municipalities do not acknowledge that they also have disincentives to operate their blue box systems efficiently. For example, a desire to preserve local jobs, infrastructure, and independence may serve as a disincentive to joining with other municipalities to provide blue box systems on a larger scale so as to take greater advantage of economies of scale.

88. The Municipalities suggest that the development of benchmarks can help to identify less efficient municipalities and thereby contain costs.³⁸ Given, however, that municipalities have significant autonomy with respect to the provision of blue box services, benchmarks by themselves are insufficient, unless they are tied to the Stewards' funding obligation. Stewards, which have no operational control over the delivery of blue box services, are not and should not be required to bear those costs that are in excess of Best Practices costs, the benchmark set by the Minister.

89. A further indication of the need for incentives is the over-reporting of municipal costs through the Datacall. Each year, as part of the Blue Box Program,³⁹ municipalities are required to complete the Datacall in order to be eligible for funding under the Blue Box Program. WDO then selects a number of municipalities to be audited, with a view to determining whether they have over-reported their costs.

90. The Municipalities' Claim asserts that the Datacall process provides a "high degree of assurance" that the costs being reported are accurate,⁴⁰ and that the audits with respect to the 2012 Datacall resulted in an increase to municipal net costs. 2012, however, was an anomaly. In numerous prior years, the audits revealed significant over-reporting of municipal costs.

91. For example, with respect to the 2011 Datacall, twenty municipal programs were selected for an audit, representing approximately 18% of the total reported net cost for the Blue Box Program. These audits resulted in a decrease to submitted net costs of \$1,122,356, or 3%. 60% of the audited programs had their reported net costs reduced as a result of the audits, 35% were increased, and 5% had no change.

³⁸ Municipalities' Claim, para. 68.

³⁹ Blue Box Program, section 5.4.1, pp. 26-27.

⁴⁰ Municipalities' Claim, para. 93.

N. THE MUNICIPALITIES' FLAWED INTERPRETATION OF SUBSECTION 25(5)

92. The Municipalities' position in this Arbitration is, effectively, that subsection 25(5) of the *Waste Diversion Act* creates a blank cheque: 50 percent of the Municipalities' net actual costs to run their blue box systems must be borne by Stewards, regardless of how high those costs are. This position is fundamentally inconsistent with the *Waste Diversion Act* and with the approved Blue Box Program and the amendments thereto (as described above).

93. The Municipalities purport to define the "Blue Box Program" as either a municipal undertaking pursuant to O. Reg. 101/94 under the *Environmental Protection Act*, or a waste diversion program under the *Waste Diversion Act*.⁴¹ The Municipalities then argue that the phrase "as a result of the program" in subsection 25(5) refers to municipal blue box programs (plural).⁴² Thus, the Municipalities contend that the Minister's directions with respect to cost containment can be entirely ignored when it comes to calculating the Stewards' funding obligation under subsection 25(5). According to the Municipalities, the only limit on the Stewards' obligation is that the costs must have been incurred by municipalities "to divert Blue Box wastes from landfill, as opposed to other municipal expenses such as landfills, roads and sewers."⁴³

94. This argument cannot withstand any degree of scrutiny. As mentioned above, the singular term "program" (English) and "programme" (French) is consistently used throughout the *Waste Diversion Act* to mean a waste diversion program that has been developed and approved by the Minister under the *Waste Diversion Act*. In the absence of such a program for blue box waste, Stewards would have no funding obligation. It is the approved and amended Blue Box Program, under the *Waste Diversion Act*, that triggers and defines the Steward's funding obligation under subsection 25(5).

95. The *Waste Diversion Act* imposes no obligation on municipalities to provide blue box services. To the extent that municipalities have an obligation to do so, this obligation arises pursuant to O. Reg. 101/94 under the *Environmental Protection Act*, which does not use the term "program," but instead contains a series of provisions under the heading "blue box waste management systems." Section 7(1) of O. Reg. 101/94, which is the central provision in this regard, sets out the requirement as follows:

⁴¹ Municipalities' Claim, para. 13.

⁴² Municipalities' Claim, paras. 53-56.

⁴³ Municipalities' Claim, para. 56.

A local municipality that has a population of at least 5,000 shall establish, operate and maintain a blue box waste management system if the municipality is served by a waste management system owned by or operated by or for the municipality that collects municipal waste or accepts such waste from the public at a waste disposal site. [emphasis added]

96. Blue box waste management systems under O. Reg. 101/94 are structurally very different from the Blue Box Program under the *Waste Diversion Act*. Section 7 of O. Reg. 101/94 imposes a mandatory obligation on certain local municipalities to operate blue box waste management systems as part of the systems required in those municipalities.⁴⁴ The blue box waste management systems must be adequate to deal with the anticipated blue box waste,⁴⁵ and municipalities have annual reporting requirements.⁴⁶ By contrast, the approved Blue Box Program is directed to WDO and Stewardship Ontario and was intended to enhance diversion efforts and to provide defined funding support for the blue box materials described in the approved Blue Box Program.

97. The Blue Box Program is an opt-in program. Municipalities need not participate and are not obliged to participate. They are entitled to operate their blue box waste management systems, to collect whatever materials they see fit beyond the required list under the *Municipal Waste Regulation*, and to fund those systems entirely out of their municipal tax base. If, however, municipalities wish to access funding from Stewards, it is subject to the terms and conditions of the Minister's approved Blue Box Program, which governs the Stewards' funding obligation.

O. THE QUANTUM OF THE 2014 ANNUAL STEWARD OBLIGATION

98. In their Claim, the Municipalities ask the Arbitrator to rule on the quantum of the 2014 Annual Steward Obligation in the first phase of the Arbitration.⁴⁷ Such a determination, however, is entirely dependent on the prior determination of what principles govern the calculation and, in particular, whether or not the Steward Obligation pursuant to subsection 25(5) of the *Waste Diversion Act* is to be determined pursuant to the Blue Box Program and in particular the amendments thereto as approved by the Minister, specifically the Cost Containment Plan. Accordingly, we suggest that this is an issue for the second phase of the Arbitration, if required.

⁴⁴ O. Reg. 101/94, Part II.

⁴⁵ O. Reg. 101/94, Part II, section 7(6).

⁴⁶ O. Reg. 101/94, Part II, section 10(2).

⁴⁷ Municipalities' Claim, paras. 86-100.

99. For the reasons expressed above, it is Stewardship Ontario's position that, pursuant to the Blue Box Program as amended by the Cost Containment Plan, KPMG's Best Practices Model should be used to calculate the 2014 Annual Steward Obligation. Using the Best Practices Model, Stewardship Ontario calculates \$95,679,612 as the 2014 Annual Steward Obligation.

100. The Municipalities assert that the Cost Containment Plan does not apply to the calculation and that the 2014 Annual Steward Obligation should be \$114,072,322.⁴⁸ Should the Arbitrator determine that the Cost Containment Plan is inapplicable, the Municipalities' calculation does not appear to meet the requirements of the Blue Box Program in this regard.

101. Should the Arbitrator determine that the Cost Containment Plan is inapplicable to the "total net costs" determination, the calculation of the 2014 Annual Steward Obligation would still have to be based on the balance of the Blue Box Program itself. As submitted above, that is clear from the wording of subsection 25(5) of the *Waste Diversion Act*. In this regard, section 7.3.1 of the Blue Box Program (without regard to the Cost Containment Plan) establishes the following Guiding Principles with respect to the calculation:

The AMO/Stewardship Ontario Task Group has agreed to establish a technical working committee that will report to MIPC (made up of AMO and Stewardship Ontario representatives and/or their technical designates) to determine the methodology and procedures for calculating the total net cost of municipal Blue Box programs in subsequent years.

The net cost calculations for Ontario's Blue Box programs will be developed using the following six principles as a guideline:

(1) Accuracy

Best estimates of actual expenditures and revenues using best available information. Protocol for data collection and reporting must be agreed by AMO and Stewardship Ontario.

(2) Transparency

All parties must know the source of the data and be able to understand how the numbers were derived.

(3) Verifiability

Industry and municipalities must be able to verify how the estimate was derived. This may involve third party verification of data. Stewardship

⁴⁸ Municipalities' Claim, para. 99.

Ontario and WDO technical and/or financial auditors must also be able to verify the data.

(4) Acceptability

The fee calculation methodology reflects a reasonable fee for services provided under the Blue Box Program Plan.

(5) Consistency of Reporting

Consistency in the submission of agreed upon data, in an agreed upon format, in a timely manner.

(6) Ability to Identify Costs

The information gathered and submitted must be in sufficient detail to identify cost drivers.⁴⁹ [emphasis added]

102. Thus, even if the Cost Containment Plan is inapplicable, the Blue Box Program would still require that the Municipalities' reported costs be assessed against a reasonableness standard. The Municipalities' proposed calculation, however, appears to simply use the municipal costs as reported, without any consideration as to how those reported costs should be adjusted based on reasonableness, as required.

103. In addition, the Municipalities' Claim asserts that "[a]ctual cost information is known and reliable."⁵⁰ However, the audits undertaken as part of the Datacall have revealed significant inaccuracies in the reporting of municipal costs, as noted above. Indeed, it is inappropriate to speak of "actual" costs in this context. The information provided in the Datacall is the Municipalities' reported costs, which, as demonstrated by the audits, are often unreliable. Further, for some municipalities, only net costs are reported, such that Stewardship Ontario has no visibility with respect to those municipalities' gross costs or revenues associated with the Blue Box Program.

104. The Municipalities purport to explain some of the audit variances as arising from "differences of opinion" as to how much of the municipal costs are related to residential blue box waste, as opposed to blue box waste from non-residential sources. The Municipalities contend that the application of subsection 25(5) is not limited to residential blue box waste.⁵¹

⁴⁹ Blue Box Program, section 7.3.1, pp. 58-59.

⁵⁰ Municipalities' Claim, para. 87.

⁵¹ Municipalities' Claim, para. 95.

105. As already discussed, however, the Stewards' "total net costs" funding obligation under subsection 25(5) is expressly tied to the costs incurred "as a result of the program." The Blue Box Program is specifically restricted to certain types of residential recyclables. Section 2.1 of the Blue Box Program states:

This definition [in O. Reg. 273/02 under the *Waste Diversion Act*] is broad in scope and encompasses packaging and printed materials and a wide range of consumer products. However, given that municipal Blue Box programs collect primarily packaging and printed materials and do not generally collect consumer products, the Blue Box Program Plan addresses only consumer packaging material and printed papers commonly found in the residential waste stream.⁵² [emphasis added]

106. Likewise, section 7.3.2 of the Blue Box Program states:

It should be noted that the costs presented by municipalities will be reflective of the cost to manage residential recyclables only. All costs associated with handling IC&I [Industrial, Commercial, and Institutional] sourced tonnes of materials (e.g., from schools), even if delivered through the municipal program, will be removed and the tonnes reported as recovered not included in the information provided by municipalities.⁵³ [emphasis added]

107. Accordingly, the Stewards' funding obligation under subsection 25(5) does not extend to costs associated with:

- (a) residential recyclables collected by the Municipalities that are not covered by the Blue Box Program, and
- (b) any non-residential (IC&I) materials collected by the Municipalities,

both of which fall outside of the scope of the Blue Box Program for the purposes of subsection 25(5).

108. Stewardship Ontario is not telling the Municipalities what materials should be collected in their individual blue box waste management systems. Individual municipalities may have many reasons, political or otherwise, to expand the scope of their systems. However, Stewards are not responsible for paying a share of the costs of materials not covered by the approved Blue Box Program under subsection 25(5).

⁵² Blue Box Program, section 2.1, p. 3.

⁵³ Blue Box Program, section 7.3.2, p. 59.

P. NEWSPAPER ADVERTISING

109. The Municipalities have also raised the issue of whether the Stewards' obligation under subsection 25(5) may be paid partly through in-kind newspaper advertising services.⁵⁴ This, we suggest, is an issue for the second phase of this Arbitration, if required, as set out below.

110. The Municipalities have mischaracterized this issue. The Municipalities' Claim suggests that Stewardship Ontario has unilaterally decided to reduce the monetary payments to municipalities by having the Canadian Newspaper Association ("CNA") and the Ontario Community Newspaper Association ("OCNA") provide in-kind advertising space.⁵⁵

111. In fact, this was not Stewardship Ontario's decision. It was, instead, the Minister's decision, which Stewardship Ontario is obliged to follow. Item 10 in the Addendum to the Minister's Program Request Letter stated:

10. The proposed funding rules under the program will account for the voluntary contribution of the Canadian Newspaper Association (CNA) and Ontario Community Newspaper Association (OCNA) of newspaper advertising with a value of \$1.3 million annually and, in addition, annual funds for the purpose of implementing and monitoring the advertising program and any administrative expenses incurred by WDO and the designated IFO. The program will contain a plan on how the advertising will be allocated and administered. The funding rules will also contain a formula to determine when additional funding support from newspaper members will be required should the cost of recycling newspapers become a cost to municipal blue box programs. [emphasis added]

112. The Blue Box Program implemented this direction as described in section 6.5.3, clearly referring to the involvement of the Ministry of the Environment:

The CNA and the OCNA have negotiated with the MOE that their first \$1.3 million in obligations as calculated by the pay in model will be in the form of newspaper advertising (with no carry forward to subsequent program years where obligations calculated for the industry sector do not reach \$1.3 million). In addition, annual funds will be included for the purpose of implementing and monitoring the advertising program and any administrative expenses incurred by WDO.⁵⁶

113. In 2005, this aspect of the Blue Box Program was amended at the Minister's direction so as to allow the CNA/OCNA's in-kind contribution to exceed \$1.3 million. In an Addendum to the December 30, 2004 letter to WDO, the Minister stated:

⁵⁴ Municipalities' Claim, paras. 101-117.

⁵⁵ Municipalities' Claim, para. 101.

⁵⁶ Blue Box Program, section 6.5.3, p. 46.

Pursuant to section 7 of the *Waste Diversion Act, 2002*, the Minister requests that Waste Diversion Ontario (WDO) prepare and submit for the Minister's approval an amendment to the blue box program plan, which would expand upon the existing in-kind contribution of members of the Canadian Newspaper Association and the Ontario Community Newspaper Association ... [emphasis added]

114. Subsequently, in a letter dated April 19, 2005, the Minister clarified this direction:

To clarify, CNA/OCNA's entire financial obligation to municipalities may now be met exclusively through in-kind contributions from participating newspapers. The only exception to this rule would be in adverse market conditions ...

115. Pursuant to this direction, sections 6.5.3 and 9.14.3 of the Blue Box Program were amended. The amended section 6.5.3 states in part:

Following approval of the proposed amendment to the BBPP in 2005 and in future years under the BBPP, the CNA and OCNA portion of stewards fees representing payments to municipalities, as calculated by the pay in model, will be in the form of in-kind newspaper advertising under normal old newspaper (ONP) market conditions.

116. The Municipalities' Claim asserts that "this purported amendment was ultra vires and without effect."⁵⁷ Any such challenge should have been by way of a judicial review at the time.

117. In any event, the Minister's direction with respect to in-kind payments is not inconsistent with subsection 25(5). Subsection 25(5) does not qualify the term "payments" in any way. The fact that section 31 of the *Waste Diversion Act* provides for in-kind payments to Stewardship Ontario does not mean that in-kind payments to municipalities are therefore excluded from the ambit of subsection 25(5) in these specific circumstances.

118. In the event the Arbitrator finds that in-kind payments are permissible under subsection 25(5), the Municipalities' Claim asserts that the advertising space provided is of limited value. Stewardship Ontario, however, does not determine the value of the advertising space. Instead, the value is determined pursuant to the amended section 6.5.3 of the Blue Box Program, which was approved by the Minister and which states that lineage in CNA/OCNA member papers is to be calculated using published CARD rates. Stewardship Ontario is obliged to follow the Blue Box Program in this and all other regards. To the extent that Municipalities object to the use of CARD rates, this is an issue to be taken up with the Minister.

⁵⁷ Municipalities' Claim, para. 103.

Q. THE DIVISION OF ISSUES

119. The Municipalities have proposed a bifurcated hearing. Stewardship Ontario would be willing to consider bifurcation, provided that the issues to be considered in each phase of the hearing are appropriately defined.

120. As is now evident from the Municipalities' Claim and Stewardship Ontario's Defence, the fundamental issue in this Arbitration is whether the Stewards' "total net costs" funding obligation under subsection 25(5) is to be defined pursuant to the Blue Box Program and the amendments thereto as approved by the Minister, specifically the Cost Containment Plan. The Municipalities assert that the Stewards' obligation is not so defined and instead amounts to a blank cheque. For the above reasons, Stewardship Ontario responds that its funding obligation under subsection 25(5) does not amount to a blank cheque. The principles of cost containment are an integral part of the approved Blue Box Program, as amended, and must be taken into account in determining the Stewards' "total net costs" funding obligation under subsection 25(5).

121. In Stewardship Ontario's view, it would be most efficient to devote the first phase of the hearing to this fundamental issue. It is absolutely necessary to consider the role of cost containment in determining the Stewards' "total net cost" funding obligations in and as the first phase of the hearing. Once this fundamental issue has been decided, the second phase of the hearing could, if necessary, consider any remaining issues.

Date: February 20, 2014

McCarthy Tétrault LLP
Suite 5300, Toronto Dominion Bank Tower
Toronto, Ontario M5K 1E6

Thomas N.T. Sutton LSUC#: 40683A
Tel: (416) 601-8082
Fax: (416) 868-0673

Brendan O. Brammall LSUC#: 54544M
Tel: (416) 601-7518
Fax: (416) 868-0673

Dina Awad LSUC#: 62684J
Tel: (416) 601-7776
Fax: (416) 868-0673

Lawyers for Stewardship Ontario

TO: **Saxe Law Office**
248 Russell Hill Road
Toronto, Ontario M4V 2T2

Dianne Saxe
Tel: (416) 962 5882
Fax: (416) 962 8817

Lawyers for the
Association of Municipalities of Ontario

AND TO: **City of Toronto Legal Services Division**
Metro Hall
55 John Street, 23rd Floor
Station 1260
Toronto, Ontario M5V 3C6

Glenn K.L. Chu
Tel: (416) 397-5407
Fax: (416) 397-1765

Lawyers for the City of Toronto