

April 22, 2016

Ms. Kirsten Walli
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: EB-2015-0363 – Consultation to Develop a Regulatory Framework for Natural Gas Distributors' Cap and Trade Compliance Plans - Union Gas Limited Submission

As follow up to the April 5, 2016 meeting to provide input on topics to be included in the upcoming OEB Cap and Trade Discussion Paper, please find enclosed a summary of Union Gas Limited's positions and suggestions for consideration.

If you have any questions concerning this submission please contact me at 519-436-5334.

Yours truly,

[Original Signed by]

Vanessa Innis
Manager, Regulatory Initiatives

c.c.: Mark Kitchen, Union Gas
Crawford Smith, Torys
Andrew Mandyam, Enbridge
Brian Hewson, Board staff
EB-2015-0363 Participants

CAP AND TRADE FRAMEWORK FOR NATURAL GAS DISTRIBUTORS – UNION SUBMISSION

As follow up to the April 5, 2016 meeting to provide input on topics to be included in the upcoming OEB Cap and Trade Discussion Paper, please find below a summary of Union Gas Limited's ("Union") positions and suggestions for consideration.

Union is fully committed to implementing the Cap and Trade program and to ensuring its success. As a regulated natural gas distributor to over 1.4 million Ontarians across more than 400 communities, we have unique implementation considerations as we transition to the Cap and Trade program for January 1, 2017.

These include:

- The sector is regulated, and subject to the guidelines, regulations, and points of law within the Board's jurisdiction;
- Natural gas distributors have the obligation to continue to serve their customers. We have little direct control over consumption and emissions, although we do continue to encourage customers to use energy efficiently through programs such as Demand Side Management ("DSM");
- Natural gas consumption can vary greatly from season to season, and year to year, which adds complexity to the planning and execution of emission allowance purchase plans. As well, the appropriate recovery of costs for those customers who drive the requirement to purchase allowances can also vary seasonally and annually;
- Natural gas distributors will be competing for allowances in a market that includes other participants who are not regulated and are not subject to regulatory determination of cost prudence. Initially, the market for allowances in Ontario will be small and illiquid, thereby increasing the pressure on the price of allowances; and
- Union has a much larger compliance obligation than most other participants, and is projected to be the second largest acquirer of allowances in Ontario.

Summary Comments

In order to facilitate a smooth implementation of the Cap and Trade program for our customers, Union's primary recommendations to be included in the OEB Cap and Trade Discussion Paper are as follows:

- Through consultation, guiding principles must be established in concert with evaluation criteria/metrics. Both of these elements must incorporate the overarching requirement to comply with the Cap and Trade regulations.
- Union's requested interim rate order¹ must be approved by no later than July 1, 2016 in order to allow the required 6 month implementation time for billing system changes, and for adequate customer communications to be delivered.
- The costs need to be recovered from impacted customers via a separate volumetric line item on the bill, as it is in other Canadian jurisdictions (Quebec and British Columbia). This is consistent with

¹ Union's request was filed with the OEB on April 15, 2016.

the purpose of the Cap and Trade program, and supports the Board's objectives of transparency and energy literacy. It also facilitates the most efficient and practical method for ensuring that costs are recovered from the appropriate customers, and are tracked accurately from billing through to deferral account disposition. We believe a large number of intervenors also support a separate line item on the bill.

- To begin, compliance plans should be simple, recognizing the accelerated implementation timing of Cap and Trade in Ontario relative to other jurisdictions, and the associated learning curve as utilities work to balance their compliance obligations with cost prudence. This is the “walk before we run” philosophy discussed extensively on April 5th.
- The compliance plans should reflect that Union Gas will be a large purchaser of allowances in a very illiquid market. Union is concerned with the prominence of cost criteria and references in the April 5th discussion in terms of the utilities achieving “lowest cost” for allowances. More discussion and clarity is required in order to define what benchmark levels will be used to evaluate costs in a market that is not liquid or transparent. When purchasing natural gas, Union's obligations are to purchase supply prudently, while meeting market needs. The prudence related to gas supply purchases is tested against a very diverse and liquid natural gas market. Obligations to purchase emission allowances should be tested against a prudency measure (assuming a proper benchmark can be identified) rather than lowest cost.
- The initial compliance plan to be filed in 2016 by the natural gas distributors will focus on 2017. A second compliance plan will be filed in 2017 for 2018. At this time, Union does not believe that a long-term plan is either practical or valuable to create in either 2017 or 2018. With so much uncertainty in respect of the Cap and Trade program and inexperience in the market for emissions allowances, such an exercise would be time consuming, futile and would require information which is unavailable at present. For example, there is little indication of what the market for allowances will be for the compliance period, if available allowances will include those from Western Climate Initiative (“WCI”) linked jurisdictions, or if large final emitters will be buying allowances post 2020. Union notes some of this information, as well as other allowance market modelling assumptions, has been requested repeatedly of the Ministry of Environment and Climate Change (“MOECC”) by a number of stakeholders and has not been forthcoming.
- An approach to reporting and monitoring of the implementation of the compliance plans should be developed through the framework discussion process. Union believes reporting and monitoring of compliance plans should be implemented on a regularly scheduled, predictable basis and should support the principle of transparency while ensuring confidentiality to protect commercially sensitive information.
- Content of customer education and communication should continue to reside with the natural gas distributors, with Union and Enbridge working together where possible to achieve general consistency of message and timing across the province. This recognizes the ongoing accountability and obligation of utilities to manage customer's concerns.

A summary of Union's position with respect to the interim rate order and the separate line item on the bill was provided in the April 8th submission to the MOECC in response to the Cap and Trade Regulatory Proposal. For ease of reference, this position has been attached in Appendix A.

The following details are provided by topic areas as discussed in the April 5th meeting.

Framework Objectives

The objectives presented by Board Staff at the meeting were: cost effectiveness, rate predictability, cost recovery, transparency, flexibility, and continuous improvement. While Union agrees with many of the principles articulated in the objectives, we do have significant concerns in the following areas:

- These objectives should be a point of input for natural gas distributors and stakeholders as part of the framework discussion to come. Union is concerned that it appears as though these objectives were finalized without consultation.
- The existing objectives do not acknowledge the unconditional requirement of natural gas utilities to meet their obligation to serve their customers while at the same time achieving compliance with the new Cap and Trade program regulations and legislation. The need for cost prudence must be balanced with compliance obligations.
- The references to “optimization” and “risk management” cause us concern. Union does not expect to take optimization positions with the emissions allowances portfolio. Union believes such action would compromise the objectives of compliance and cost prudence. Furthermore, Union believes that purchasing at a market price for emission allowances, rather than cost effectiveness, is both a more practical and consistent objective, as the utility should not be required to try to “beat the market”. Union notes that the Board considered risk management activities with respect to the gas supply portfolio in Union’s 2008-2012 Incentive Regulation Mechanism proceeding (EB-2007-0606). The Board found there was no material net benefit of risk management for customers and stated it would disallow the recovery of the associated costs. Given this context, Union questions why the utility would undertake risk management for carbon allowances when the OEB has ordered that it not undertake risk management for the purchase of the gas commodity. Gas supply is a highly liquid commodity traded with ease across North America. Ontario carbon allowances will not be liquid and not widely traded, making risk management activities incrementally more uncertain (and potentially costly) in nature. Union does not believe such activity to be prudent or responsible.
- The objective of transparency should include billing transparency and energy literacy for customers. The customer allowance costs need to be reflected as a new line item on applicable customer bills. The purpose is to provide a line of sight from costs, to their bill, to deferral account disposition in order to demonstrate appropriate treatment of costs. This will be critical to track the revenue received relative to the associated costs for the purchase of carbon allowances. More importantly, the single line item is necessary to influence customer behaviour. This exact philosophy underpins the Cap and Trade program as well as past directives from the OEB. Such directives include the unbundling of components on the natural gas bill (delivery, storage, transportation, and commodity), the implementation of time of use rates for electricity customers in order to change customer behaviour, and the disclosure of the Ontario Clean Energy Benefit and the Debt Retirement Charge.
- Transparency will need to be balanced with confidentiality in terms of specific details of utility’s emissions allowance acquisition plans in order to preserve commercially sensitive strategies.
- Existing capital planning processes (such as asset management plans and integrated supply plans) are sufficient for reviewing regulated projects when applicable, rather than establishing new and additional investment decision review processes for Cap and Trade.

Compliance Plans

Compliance Plan Governance

With respect to program governance, Union supports an approach that requires the utility to present plans to the Board (in advance of a given year) that would align with established guiding principles (yet to be defined), including compliance. Based on these plans, the utility then decides on how best to develop its portfolio and participate in the market.

Union recognizes that the OEB is striving to provide sufficient confidence to utilities such that they can execute plans with reasonable assurance of cost recovery, while at the same time providing comfort to stakeholders that adequate governance is in place to ensure prudence. Union believes these requirements can be achieved by establishing clear planning principles (similar to our gas supply planning principles), and evaluation criteria/metrics to measure performance for prudence. These should be established in consultation, and Union asks that a follow up discussion (either before the finalization of the discussion paper or at the beginning of the framework proceedings) with natural gas distributors be held to accomplish this.

Union notes the following concerns with the proposed metrics presented in the meeting on April 5th:

- The reference to a “balanced” portfolio implies that all compliance instruments discussed should be employed. This may not provide the prudent option for customers (they may not result in a reasonable cost and/or could be high risk) and their use should not be unilaterally mandated. Although Union appreciates that multiple options to buy allowance credits may ultimately exist, a “walk before you run” approach will be required.
- The only metrics defined are in relation to cost and do not reflect the compliance obligation that we have, nor various objectives and principles in the program. Union also questions how any meaningful cost benchmarks can be established in a market that is not liquid, not developed, and not transparent at this time.

Compliance Plan Scope

Union agrees that compliance plans should cover customer-related and facility-related obligations (allowances acquired on behalf of customers as well as its own operational requirements), noting that all elements of program complexity should be considered. For example, in addition to acknowledging the exclusion of large final emitters from the compliance plan, the plan should also reflect the exclusion of voluntary participants and customers with direct allocation of allowances.

With respect to provisions for Cap and Trade related investments (e.g. incremental DSM programs, investments in new technology, etc.) in the compliance plan, Union does not believe they should be included due to the confidential nature of these commercially sensitive projects. In addition, there are existing mechanisms (such as integrated supply plans, asset management plans, DSM reporting) in place for the purpose of reviewing regulated projects, when applicable.

As noted above, Union also has concerns with an approach that requires all the compliance instruments presented at the meeting being included in a “balanced portfolio” for allowance purchases. While Union may want access to all of the compliance instruments, this should not be mandated.

Compliance Plan Timing

Union believes the first year plan for the Ontario market should be simple, ensure proper and efficient cost recovery from customers, and be focused on compliance. Given the complexities of the program and the speed of implementation relative to other jurisdictions, a measured approach would best serve natural gas distributors and their customers. This is the “walk before we run” philosophy, similar to the approach when Ontario’s natural gas supply was deregulated in 1987.

Union proposes that in 2016, the utilities file compliance plans for 2017. Similarly, in 2017, the utilities can provide a plan for 2018. Without transparent information on allowance markets (supply and demand) and forward carbon prices, long term planning would be speculative and of little value. Union notes that allowance market modelling assumptions from the MOECC (e.g. assumed abatement by sector, level of free allowances, and impact of WCI linking) may assist in planning beyond 2017, however this information has not been shared to date. As acknowledged by Board Staff in the meeting, Union agrees the process for filing compliance plans will need to respect the confidentiality of market sensitive and competitive information.

Cost Allocation and Rate Design

As noted above with respect to the objective of transparency, Union believes a separate line item for the Cap and Trade program costs is imperative to drive changes in customer behaviour. This is entirely consistent with past OEB decisions, with the philosophy of the Cap and Trade program, and with practises in other Canadian jurisdictions (Quebec and British Columbia). From a practical perspective, the separate line item also provides the ability to bill customer allowance costs volumetrically to the appropriate customers, and to properly account for revenues. Carbon costs will be based on consumption and therefore must be volumetric.

In addition to a single line item on the bill, Union requires approval of its proposed interim rate order by no later than July 1, 2016 in order to implement necessary billing changes by January 1, 2017. This requirement is detailed in Appendix A.

Union recognizes there are several options for adjusting rates to reflect actual and forecasted Cap and Trade allowance acquisition costs. We believe these options should be evaluated and developed in consultation as part of the framework. It should consider factors such as the unique elements of the Cap and Trade program, customer consumption patterns, and the allowance market itself.

Union notes that in addition to allowance acquisition costs (for customers and Union’s own facilities), there will also be program costs, potential financing costs and customer outreach costs to be recovered. The mechanism for recovery of these costs may differ from those employed to recover allowance acquisition costs.

Customer Outreach and Education

Union believes that advanced and visible customer education and communication is key to ease transition and minimize customer concerns. In order for this communication to be effective, it must begin no later than four months in advance of January 1, 2017. Communication should include an explanation of what Cap and Trade is, what the impacts are (including the expected rate), and how customers can better manage their emissions /costs.

It is both Union's obligation and accountability to communicate with customers regarding the services they receive from Union. As their natural gas distributor, Union has the best understanding of our customers, their concerns and their unique characteristics. Therefore, we are in the best position to most effectively communicate with them. Union has a vested interest in not only responding to customer concerns, but understands the value of proactive communication on issues, particularly when it impacts their bills. The OEB recognized this obligation through the establishment of ongoing service level requirements in responding to customer calls. In addition, in the extreme winter conditions and gas prices of 2013/2014, the Board noted the duty of utilities to provide advance notice to customers of the resulting bill impacts.

As a result, Union proposes that the utilities develop their own respective communication plans and messages for each customer group, with a view to achieving consistency of messages and general coordination of timing, where possible.

APPENDIX A

EXCERPT FROM UNION'S SUBMISSION REGARDING CAP AND TRADE REGULATORY PROPOSAL (EBR Registry number 012-6837)

TIMING AND IMPLEMENTATION

Union Gas supports the government's GHG emissions reductions targets for the province established in the proposed legislation.² The government reflected the financial impact of implementing the Cap and Trade Regulatory Proposal as of January 1, 2017 in the provincial budget. As a regulated natural gas distributor, Union Gas requires regulatory approvals from the OEB and the time to ensure the necessary billing capability is in place to meet this implementation date. Specifically, to achieve the required regulatory rate approvals and billing system changes in time to implement and bill customers for the price of carbon allowances by January 1, 2017, Union Gas will require: 1) an interim rate order which provides regulatory authority to recover Cap and Trade customer emission allowance costs by no later than July 1, 2016; 2) six months to make the necessary changes to our billing systems, including adding a separate line item on the bill; and 3) six months to educate and communicate with customers in advance of the January 1, 2017 implementation date.

Regulatory Authority

Since Union Gas is regulated by the Ontario Energy Board ("OEB" or the "Board"), it is unable to levy any new charges to customers without a regulated rate and approval from the OEB. Therefore, Union proposes that the OEB approve interim rates to reflect the recovery of cap and trade costs by no later than July 1, 2016. This will provide six months to make the related billing system changes in time for January 1, 2017. This will still allow a thorough and comprehensive process to define the permanent OEB framework with input from all stakeholders. This proposal would require the following:

- the OEB to issue an interim rate order to bill customers for customer emissions allowance costs, effective January 1, 2017. For 2017, these costs account for an estimated \$250 million in costs per year (the vast majority of Union Gas' total estimated annual Cap and Trade program costs);
- use of Union's approved deferral account³ to capture price and quantity differences of customer emissions allowance costs. In addition, the deferral account would capture the remainder of Union Gas' Cap and Trade program costs. This would be comprised of Union's emissions allowance costs (related to operations of its own facilities such as compressors, fleet and buildings) and Cap and Trade program administration costs (such as incremental staffing costs, financing costs, system changes, and consulting costs, among others);

² Bill 172, Climate Change Mitigation and Low-carbon Economy Act, 2016, proposed February 24, 2016

³ Union Gas' Greenhouse Gas Emissions Deferral Account (EB-2015-0367) was approved by the OEB on April 7, 2016.

- an agreement between the OEB and regulated utilities on billing design details (such as including customer emission acquisition costs as a separate volumetric charge⁴ on the bill as described below, and treatment of HST).

The timing of the interim rate order of no later than July 1, 2016 is imperative to allow the Union Gas to properly prepare billing systems for implementation on January 1, 2017. Through the recent Hydro One experience, we also know that if billing system changes are not managed with care and precision, then the result is increased costs⁵, eroded consumer confidence, and frustration for all parties.

The requested timing allows billing of customers to align with the commencement of the program, and the utilities to begin recovering the costs of the program during the months where customer billing units are at their highest. Otherwise, Union Gas would be required to recover the same costs over a shorter duration in 2017, thereby increasing the per unit cost impact for customers.

It is Union Gas' expectation that the interim rate order would remain in place for the first year of the program (2017). By the time 2018 rates applications are submitted in the fall of 2017, the permanent OEB framework would be known and the utilities can implement rates reflective of that design by January 1, 2018. The treatment of the amounts accumulated in the deferral account described above would be determined as part of the 2017 deferral account disposition process, filed with the OEB in the spring of 2018.

Billing Capability and Presentment

To support the Cap and Trade program implementation for January, 2017, Union Gas requires a separate line item on the bill for three reasons. First, it is necessary in order to appropriately recover the Cap and Trade program customer emission allowance costs (on a volumetric basis) from the appropriate customers. Second, it is fundamental to the principle of transparency and necessary to meet the emissions reduction objectives of the Cap and Trade program. Third, it is the only efficient way to manage the regulatory accounting requirements of a cost that is purchased on behalf of customers and subsequently billed to them.

The billing requirement for a separate line item is driven by the design and complexity of the Cap and Trade program. The exclusion of certain customers from Union's customer compliance obligation (eg. those customers that register themselves as capped participants, including large final emitters, customers with direct allocations, and voluntary participants) means that some customers in a rate class should be charged for emissions allowances acquired on their behalf, while others should not. However, without a separate line item on the bill all customers in a given rate class, even large final emitters or voluntary participants who have acquired their own allowances, would be levied the same delivery rate. This issue would result in participants that the government intended to receive free allowances (such as trade exposed industry or large hospitals like London Health Sciences Center) being charged for costs they should not be. A separate line item on the bill for the Cap and Trade customer emissions allowance costs will solve this issue, since the rate would only be charged to customers on behalf of which Union has an obligation to

⁴ The volumetric charge should be the same for all applicable customers irrespective of the rate class they are in.

⁵ The cost for Hydro One to address their billing issue was \$88.3 million.

acquire emissions allowances. Union estimates there are approximately 150⁶ customers across 7 different rate classes that will initially be acquiring their own allowances, will be receiving free allowances, or are eligible to opt-in as voluntary participants.

Aside from the practical and operational requirements for a separate line item, Union Gas believes that transparency of the Cap and Trade program is an essential component of driving changes in customer behaviour, which is fundamental to achieving the government's emissions reductions objectives. All natural gas customers need to see the cost of carbon allowances clearly identified on their bills to make informed decisions in respect of that price signal. Indeed, the entire premise of a Cap and Trade program is to place a price on carbon in order to motivate customers to take action and change behaviour (as stated in the preamble to Bill 172)⁷. This could be achieved through various programs to reduce consumption and associated emissions. To remove this line of sight from customers would make it far more difficult to achieve GHG emissions reductions, and would likely result in increased costs for consumers as the price of carbon increases over time. This is not consistent with the philosophy of the program, and is certainly not in the public interest.

Further, if the cost of the customer emissions allowances was built into existing delivery rates, Union Gas would be unable to practically isolate a specific revenue stream attributable to the Cap and Trade program without significant manual processes outside its billing and financial tracking systems. The clear identification of this revenue is necessary to properly account for the program and related deferral account balances to ensure that all costs and revenues are appropriately tracked, reported and recovered from customers.

Once regulatory authority is granted as described above, Union requires six months to implement the changes required to be able to bill customers appropriately for the new charges.

Customer Education and Communication

In parallel with the development of billing capability, there is also the need to ensure sufficient time to educate customers on the Cap and Trade program. A recent independent study illustrates that 80%⁸ of customers know little or nothing about the Cap and Trade system. A survey completed by Union in January, 2016 yielded a similar result of 76%. In order to assist customers with the transition to the Cap and Trade program, Union Gas will develop a communication plan for residential and business customers and educate them on actions they can take to manage their GHG emissions and energy costs. In addition to educating customers on the components of the program, communication will include what cost impacts to expect and how to identify these cost impacts on their bill. Union recommends that customer communication take place over the six month period July to December, 2016.

⁶Based on natural gas consumption only; more customers could be eligible to opt-in due to emissions from other fuels,

⁷ The Preamble to Bill 172 (Climate Change Mitigation and Low-carbon Economy Act, 2016) states "A key purpose of this Act is to establish a broad carbon price..that will change the behaviour of everyone across the Province".

⁸ http://www.polymtl.ca/iet/doc/Feeling-the-Heat_eng_20151203.pdf, Published December 2015.

In conclusion, this proposed solution addressing regulatory approvals, billing system changes and customer communication allows the natural gas utilities to achieve the government's goal of implementing the Cap and Trade program by January 1, 2017. It allows the OEB to complete its framework discussions through the balance of 2016 as planned, while providing a regulatory solution for the utilities which allows systems to be put in place in an orderly fashion. It also provides sufficient time for the utilities to communicate these changes to their customers in advance of implementation as a means of easing the transition and minimizing potential customer concerns and issues. Union Gas believes this solution provides the best alternative for government, utilities, customers, and the Cap and Trade program.