## INTRODUCTION

The Federation of Rental-housing Providers of Ontario ("FRPO") welcomes the opportunity to contribute feedback for the Ontario Energy Board's (the "Board") consideration of a regulatory framework to oversee the activities of natural gas utilities in their role under the Ontario Carbon Cap & Trade Legislation. The following are FRPO's submissions in response to the Board's request of May 25, 2016. Prior to addressing the topic areas outlined in the Staff Discussion Paper, we firmly believe it is essential to consider the Role of Natural Gas Utilities to provide context for our more specific submissions.

## THE ROLE OF THE NATURAL GAS UTILITY IN CARBON CAP & TRADE

For decades, monopoly natural gas utilities have been regulated by the Ontario Energy Board to provide an appropriate economic environment to allow efficient distribution of natural gas while balancing the interests of shareholders and consumers. Natural gas utilities invest in infrastructure to deliver energy to consumers who choose their service over other alternatives for their energy. In that role, natural gas utilities deliver energy that, in its essence, is carbon based.

Under the government's new Carbon Cap & Trade ("CC&T) legislation[1], the government is establishing incentives to reduce carbon emissions. The stated objective is to change people's behaviour through their economic decisions to reduce greenhouse gas.

***"A key purpose of this Act is to establish a broad carbon price through a cap and trade program that will change the behaviour of everyone across the Province… In addition to the carbon price signal and to further support the reduction of greenhouse gas"*** , (Preanble).

[1] Bill 172

***"The cap and trade program is a market mechanism established under this Act that is intended to encourage Ontarians to change their behaviour by influencing their economic decisions that directly or indirectly contribute to the emission of greenhouse gas." (Section 2 Purpose (2))***

Our paramount concerns with the Discussion Paper in the context of the stated objectives of the legislation are:

> **If the government creates policy and ultimately legislation to allow consumers to understand the cost of carbon and adjust their behaviour accordingly, why should the natural gas utility be tasked with mitigating the cost impact to customers, potentially at shareholder risk, while burying the cost of the market mechanism in its cost of doing business.**

In our respectful submission, some aspects of the Discussion Paper seem to run counter to the original intent of the government's initiative to reduce carbon emissions. We would urge the Board to consider the role of the utility as more of a collection agency for this carbon cost not unlike a company collects sales taxes in the course of doing its business. Our specific comments on the Discussion Paper's topics are outlined below.

## GUIDING PRINCIPLES OF THE FRAMEWORK

We support that the Framework should be guided by the Board's objectives as described in the Ontario Energy Board Act, 1998. We also believe in the value of guiding principles. Yet, principles, at times, can be lacking in definition and/or targeted application that make their use for guidance less effective. Conversely, principles can be well defined and targeted but the underlying assumption about the behaviours to be guided can, potentially, be different than the original intent. We recommend that the Board first define the Role of the Natural Gas Utility and that the ultimate Board direction provide clarity in the definition and application of the principles in the Framework aligned with that Role.

For example, transparency is a sound principle in any system designed in the public interest. As used in the Discussion Paper application, the principle is directed at creating accountability of the utility in the development of its responsibilities under the Framework. This application is appropriate and, in our view, is very useful once the role of the utility is clarified. However, it is interesting the application of the powerful principle of transparency did not extend to the goal of influencing consumer behaviour explicitly stated in legislation. As we will submit below, without transparency in the cost of carbon, how can this game changing exercise of the government meet its stated intent of reducing carbon emissions.

Another example of the importance of definition and targeted application is “Cost Effectiveness”. The Board’s role of protecting the consumer interest with respect to price and the reliability and quality of service is explicit in its Statutory Objectives. Cost effectiveness is an underlying principle that would provide guidance from the Board to the utility as a standard for accountability. The element of economic efficiency is appropriately aligned. Risk management as it pertains to ensuring the reliability and quality of gas service is also appropriate in reviewing the core activities of the utility. However, risk management read in the context of the Discussion Paper takes on the characteristic of minimizing the commercial risk of nascent markets through potentially speculative behaviour. As described under Compliance Plans, we do not believe that this is appropriate for any business that is carrying out required duties that do not yield profit but whose actions could be subject to loss due to prudency reviews[2] should be responsible to devise strategies to reduce commercial risk.

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[2] Board Staff Discussion Paper, page 9 states: “The OEB will review the plans to determine whether to approve the associated cap and trade costs for recovery from ratepayers.”

Once again, we emphasize that we would urge the Board to define the Role of the Natural Gas Utility and ensure its guiding principles and their application are aligned with the objectives of the legislation.

COMPLIANCE PLANS

Our comments in this section will not be comprehensive as we take issue with the underlying premise of the role of the utility in the Staff Discussion Paper. As noted above, we view the role of the natural gas utility as the buyer of market priced credits and the collector of the resulting costs from non-LFE customers. In addition, as a business that has facility-related emissions costs, their role would be to seek their own reductions through appropriate investments for the benefit of reducing their costs and keeping their resulting prices competitive as a regulated deliverer of energy service. We will elaborate on compliance separately for the two roles and provide some specific comments on areas we believe would be helpful.

<u>LDC as a Collection Agency for Customer-related Emissions</u>

In the Discussion Paper, under the heading of the Purpose of Compliance Plans, reads the following:

*"The Compliance Plans should meet the government-defined legislative and regulatory obligations for the natural gas utilities, and support the government's effort to reduce GHG emissions in Ontario."*

At this point, beyond obliquely with their DSM plans, the Natural Gas Utilities have no regulatory obligation to support the government's efforts to reduce GHG emissions in Ontario. However, much of what follows in the compliance section sets out expectations for the Natural Gas Utilities to reduce the impact of Carbon Cap & Trade on all of its non-LFE customers. While traditionally it is a worthy goal of the utility to minimize the impact of cost on its customers, and certainly we would not advocate unduly increasing the cost, we ask the question: who should fund and accept the risk on strategies established to dampen the cost consequences of creating carbon emissions?

As alluded to above, why would a company put its shareholders at risk to employ strategies that can bear no profit but, if not effective, could be viewed as imprudent imposing cost consequences for the shareholder. The Discussion Paper's compliance recommendations are based upon the premise that the utility ought to invest in systems and the intellectual capital to dampen the unforeseen cost consequences of markets that are still forming. In our respectful submission, why would a Natural Gas Utility do this and is it in the public interest for them to do it?

At this time, the Natural Gas Utilities do not have expertise in the area of hedging strategies related to mitigating carbon allowances. However, given the shift in paradigm to carbon emission reduction, a reasonable person would conclude that there are many deep-pocketed, financial institutions and knowledgeable energy companies who would be investing in the opportunity to assist ready buyers in accessing insurance against the escalating costs of emitting carbon. That is their business and they would invest, at risk, to provide that insurance through many structured products that could be developed to assist Mandatory, Voluntary and Market Participants which may include LDC's. We respect the market works and that is the opportunity these entities will seize.

While we were not privy to the settlement discussions in California that led to the Settlement Agreement approved by the California, what is evident is the parties agreed to, and the California Public Utilities Commission approved an Agreement that precluded Utilities from procuring options, swaps, or other derivatives of compliance instruments[3].

[3] Board Staff Paper, page 26

We surmise that with the number of parties involved in the discussions, the role of the Natural Gas Utility was discussed and understood.

In our view, more important than our interpretation of the California decision, is a more applicable Ontario-centric decision on the Natural Gas Utility role in forward market involvement to manage price risk for customers. Up until about ten years ago, the Natural Gas Utilities routinely entered into longer term fixed price contracts and other structured products for price risk management on behalf of its customers[4]. After previous reviews of the respective risk management programs of Union and Enbridge, Union brought forth a proposal to, on a monthly basis, fix the cost of the commodity on a rolling 24-month basis. In spite of previous endorsements of the Natural Gas Utilities risk management activities, the Board did not provide pre-approval of the 24 month fixed price contracts. In its reasons, the Board stated:

> ***Insofar as the Board has approved the Risk Management program and the form of hedging instrument represented by the 24-month fixed price contracts, no further Board approval is needed. As is usual, the prudence of these arrangements may be tested when the consequences of them are sought to be included in rates[5].***

Since that decision, to our knowledge, neither Union Gas nor Enbridge enter into forward fixed price natural gas contracts extending more than one year. In our view, in spite of the reasonable assumption that Natural Gas Utilities have an informed view of market dynamics with respect to commodity price volatility risk, the Board did not approve a rolling fixing approach and put the utilities on notice that they were subject to prudency for these risk management activities.

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[4] EB-2005-0520 Decision with Reasons, dated June 29, 2006, page 8
[5] EB-2005-0520 Decision with Reasons, dated June 29, 2006, page 15

In our view, how then is it appropriate for this Board to charge the Natural Gas Utilities with the responsibility to be adequately informed and prospectively diligent to manage the vagaries of an emerging market to protect their non-LFE customer from price volatility and cost consequences? Even if they were successful in mitigating these cost consequences, would that be consistent with the government's legislative objective to create a price signal to influence consumer's economic decisions that effect the emission of greenhouse gases? These contradictions in incentives would be eliminated with the Board establishing the Natural Gas Utility as a collection agency for the costs of Carbon Cap & Trade.

Therefore, in this capacity as collection agent, the utilities could set up simple procurement strategies designed to be in the market at each auction buying forecasted allowances with strategies that aligned with getting the market price without risk mitigation.

Natural Gas Utility Delivery Energy – Facility-related Emissions

Clearly, above the utility's role in collecting the costs of carbon, they have their primary role as an energy delivery entity that uses carbon based fuel in its operations. In the case of compressors for the purposes of transmission and storage of gas and heat exchangers for reliable distribution operations, the utility operations would qualify as a large final emitter. As such, as a real cost of doing business, they will need to purchase allowances. It is in this role, in our respectful submission, that the utilities should be accountable for effective and prudent approaches to address the Marginal Abatement Cost Curve promoted by the discussion paper. As the utility, it can be proactive on its own and engage its customers in synergistic activities to find economically rational approaches to minimizing carbon emissions. The commercial opportunity of resulting offsets could be harvested by the utility in mitigating its facility-related emissions.

As an example, utilities could invest in emerging technologies to reduce their fugitive emissions. Since methane release has a much more significant effect on climate change, the utilities could invest in efforts to curb their fugitive emissions (as distinct from Unaccounted for Gas which is substantially effected by measurement differences). Given the opportunity, the utility would be incented to make economic investments in operational improvements.

In addition, to the extent that the utility would want to seek appropriate counter-parties to collaborate with for shared reduction or for the purchase of offsets or other forward contracts for allowances, in our view, the utility ought to be free to proactively manage its cost of doing business for the purposes of customer retention and business opportunity.

## COST RECOVERY

### LDC as Collection Agency

As outlined above, we recommend that the Board view the LDC as collection agent not cost manager for non-LFE customers. With the use of a single line on the bill customers would know the cost of carbon as expected in the legislation and the Board would be able to easily determine appropriate cost recovery as separate from other utility functions.

A separate Line item on the bill is a must to provide price of carbon to effect consumers' economic decisions aligned with legislation. If price of carbon is initially not influencing and targets are not met, the cost of carbon in the market will escalate. Without the transparency of a separate line, the escalating price of carbon will get hidden in the variable utility delivery charges and will not have the effect intended by the legislation.

In capturing the entire of cost of carbon, the utilities must also recover administrative charges. Administrative costs for the purchase of carbon credits, recovery of costs for bad debt on those costs and accounting should be separated out and borne in the separate line item for carbon costs. This approach would be equitable for LFE not to bear costs of utility when they have their own to pay. Staff acknowledges this would be inequitable but dismisses the application of the equity principle on the basis that the costs are small. We respectfully disagree.

In our view, this Board has stood on the principles of cost causation in the past even if those costs are small. In the late 1990's, as direct purchase was becoming more prevalent, direct purchase customers and their agents advocated for the separation of the gas supply administration fee to separate and recover these costs from the system gas pool and not from direct purchase customers who bore their own costs for this service. Union Gas agreed with that approach and the Board approved this separation in EBRO 493/494[6]. At the time, these costs were approximately $1.5M with most being allocated as bad debt collection for the commodity. The result was an additional allocation of cost which was less than one tenth of a cent per cubic metre yet the Board approved this allocation. It is our expectation that the incremental administrative costs for outreach and education of customers in addition to collecting, accounting and remitting the carbon costs including bad debt[7] will be greater than 0.1 cents per cubic metre and the California experience supports that.

## LDC as Energy Delivery Agent

As separated above, in its role as an energy delivery agent, the utility should have more choice and opportunity to manage its facility-related carbon costs. As such, we support the inclusion of these costs as a separate line item in its variable costs ie., included in the variable delivery rates of the utility bill. In our view, from an Incentive Ratemaking

[6] Decision, EBRO 493/494 dated March 20. 1997, page 233
[7] It is our view that the utility and its shareholders will not and should not be held accountable for bad debt on carbon cost recovery.

Perspective, this is a Z-factor which was not reasonably foreseen and the utility need not await rebasing to initiated recovery for these facility-related carbon costs. We believe the utilities would be in the best position to propose the appropriate ratemaking and accounting for these responsibilities in their next rate case application for 2017. However, we believe appropriate deferral account treatment would be a component of their respective approaches.

## MONITORING AND REPORTING

### LDC as Collection Agent

With the use of a separate line item, there would be reduced cost associated with the process of reporting and oversight associated with the recovery of carbon costs from non-LFE customers. Respecting confidentiality, some discrete review of the utilities volume forecasting and bid strategies related to ensuring sufficient allowances over time would be warranted. However, oversight related to value at risk or other paradigms would be unnecessary.

### LDC as Energy Delivery Company

Reporting and monitoring would occur as part of the utilities deferral account disposition in the year following their fiscal period. At that time, the Board and other stakeholders could have insight into the actual costs of the utility in managing this cost using tools from the Marginal Abatement Cost Curve but not its bid strategies for facility-related allowance. This insight and data would assist the Board in reviewing and approving the go-forward approaches for the utility to get on-going cost recovery for rebased rates and the following incentive periods.

One element of reporting that will be difficult is the separation of carbon costs associated with Unaccounted for Gas ("UFG"). In its primary role as an energy delivery company, these UFG costs have been managed with shared responsibility between utilities and ratepayers for volume and price risks. Following that approach may be efficient to a point. However, the real challenge would be separating fugitive emissions from UFG associated with metering differences. Proposing solutions to that challenge is beyond the scope of this review but we believe that, to the extent that these costs will be ultimately visited upon customers and shareholders, it will be incumbent on both utilities and ratepayers to assist the Board with equitable approaches in this area and we remain available to serve collaboratively with the utilities.

## CUSTOMER OUTREACH AND EDUCATION

We agree that the utilities should have a lead role in communication focused on outreach and education. In fact, they have an opportunity to lead by example in communicating some its own initiatives for mitigating facility-related emissions as the energy delivery company. As noted above, we support full cost recovery as a pass through for this function in its role as the Collection Agency.

## CONFIDENTIALITY OF CAP AND TRADE INFORMATION

As has been stated several times above, we do not support the utilities being required to adopt hedging strategies to mitigate the costs of carbon for non-LFE. This separation of role will reduce the amount of information that would fall under this category. Beyond this point, we do not have further comment in this area.

## CONCLUSION

We respectfully submit that the Board identify and define the role of the natural gas utility in this new capacity mindful of its well established principles and aligned with the original intent of the legislation. By defining the role(s), clarity can be brought to the respective components of its responsibility as an energy delivery company mandated to facilitate a new carbon cost regime in the public interest.

All of which is Respectfully Submitted on Behalf of FRPO,

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