

**EB-2015-0363**

## **Ontario Energy Board**

### **Consultation Process to Develop a Regulatory Framework for Natural Gas Distributors' Cap and Trade Compliance Plans**

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**SUBMISSIONS  
OF  
ENERGY PROBE RESEARCH FOUNDATION**

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**22 June 2016**

## **Executive Summary:**

The province's cap and trade market will involve significant regulatory intervention. While the Staff Discussion Paper is a well-reasoned approach by the Ontario Energy Board's (OEB) staff on how to implement and oversee the province's cap and trade policy for the incumbent utilities, it raises a significant number of regulatory and policy issues.

Many of the proposals put forward by the Board staff will result in the following:

- A significant amount of regulatory intervention, since the incumbent utilities may be asked to move into unfamiliar areas of business and investment strategies.
- A transfer of risk to ratepayers should the carbon investments undertaken by the utilities turn out to be poor or should a changing political environment undermine the investments.
- A transfer of risk to the Board (and subsequently ratepayers) who will be politically and financially responsible for the unintended consequences stemming from the cap and trade compliance plans tabled by the utilities and approved by the Board.
- Greater micro-management of the incumbent gas utilities, since the Board will increasingly have to monitor every aspect of their emissions-related activities and businesses.

Below you will find Energy Probe comments to particular sections of the discussion paper.

### **Section 4.1.1**

The discussion paper indicates that Board Staff would like the OEB to take a "light-handed approach" in regulating the utilities' compliance plans. But the paper then goes on to say that the Board would "assess the plans to ensure cost-effectiveness and reasonableness for the purpose of cost recovery", which would likely entail lengthy regulatory proceedings to determine what is "reasonable" and "cost-effective". As discussed later, part of Board Staff's paper calls for the utilities to potentially invest in new sectors and technologies, as well as present detailed financial plans and strategies with how they intend to operate in the cap and trade market. Both of those activities would, Energy Probe submits, require significant regulatory oversight to ensure that the interests of ratepayers are protected.

It's not clear how Board Staff defines cost-effectiveness, as later in the paper it is suggested that the utilities could embark on longer-term investments that may be more expensive in the short-term (than simply buying offsets or allowances), but will produce greater and continuous carbon reductions over a longer duration. Is Staff proposing that the utilities be "agnostic" in how they reduce emissions and simply pursue the cheapest option in the short term? Or is Staff proposing a different methodology for assessing "cost-effectiveness" that would allow for larger, riskier investments that may produce larger carbon reductions in the long-term?

## **Section 4.1.2**

Board Staff prefers “full compliance period” plans, meaning the utilities would submit plans that would span an entire compliance period (2017-2020). One argument in favour of this approach is that it would “reduce the utility’s regulatory risk with respect to plan implementation and recovery of prudently incurred costs.”

Energy Probe submits that the Board should consider annual compliance plans, if any at all. The cap and trade market in Ontario and elsewhere in North America is still in its infancy. The politics -- and long-term future -- of cap and trade systems are far from clear or certain. The utilities should proceed with the utmost caution in any of their plans or spending related to the province’s cap and trade system. Any long-term plans -- particularly if they receive approval from the Board -- transfer the political and economic risk of cap and trade from the utilities to ratepayers. The utilities will be allowed to recover the full cost of any of their carbon investments -- regardless of whether they turned out to economic -- since the Board will have previously approved them. The more long-term the plans, the greater the risk -- and cost -- will be for both ratepayers (who will likely be on the hook for any costs) and the utilities (who face the threat of disallowance).

## **Section 4.1.3**

The Staff Discussion paper argues for a long-term (10-year) carbon price forecast. Energy Probe questions the need for such a forecast given the ongoing uncertainty around cap and trade programs. In Europe, which has had a cap and trade system for over a decade, the price of carbon credits has repeatedly plunged well below any reasonable forecast<sup>1</sup>. In fact, Europe’s decade-long carbon market has suffered from a number of collapses in the price of carbon credits. Regulators in the EU have had to repeatedly revamp the cap and trade system to try and bring prices up to a level where they will encourage emitters to reduce their carbon output.

Ontario’s cap and trade system -- which will be connected to California’s and Quebec’s -- is likely to face just as significant political and economic uncertainty, rendering any long-term carbon price forecast irrelevant<sup>2</sup>. In order to mitigate that risk to the greatest extent possible, Energy Probe believes the Board should take a short-term approach.

### **Section 4.1.4.1**

Board Staff’s discussion paper argues for an “optimized” compliance plan that would be characterized by "strategic decision making and risk management". Is there any determination on what the right amount of optimization will be? Would the Board be the final decision maker on whether the utilities are using the most “optimal” approach? Would the different utilities be held to a different standard?

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<sup>1</sup> The most recent collapse came in January. <https://euobserver.com/environment/132045>

<sup>2</sup> California’s cap and trade market faces an uncertain future, according to recent reports. <http://www.latimes.com/politics/la-pol-sac-climate-change-challenges-20160614-snap-story.html>

For example, suppose two utilities propose drastically different “optimal” approaches -- one relying on short-term investments such as the purchasing of offset or allowances in the carbon market, while the other pursued long-term investments that required greater up-front capital investment (but may produce more emissions at lower cost in future years). One of the options could very likely end up being drastically cheaper than the other, yet both of the plans would have been approved by the Board. Will the Board allow ratepayers from one utility to cover the much larger costs of the compliance plan, while the other ratepayers are spared that cost?

And is the most optimal approach to compliance the one that would involve the lowest cost for existing ratepayers or one that would produce the greater emission reductions over a longer-term horizon?

In the discussion paper, Staff makes the following comment:

*"Staff recognizes that although some longer term investments in GHG abatement may be more expensive than the price of allowances or offset credits in any given year, there may be strategic value in investments that decrease emissions over the longer term. Therefore, staff expects that the utility will include a range of compliance options in its Compliance Plans, including those that are more expensive per tonne of CO2 compared to the price of allowance."*

Does this mean that it's up to the Board to decide what uneconomic, long-term decisions the utilities will make regarding greenhouse gas reductions? Furthermore, Energy Probe would argue that there is a very large risk in pushing the gas utilities into businesses and sectors that may not be their area of expertise. Energy Probe would also caution that pushing the utilities into businesses outside of gas distribution and storage could create a major regulatory headache in that it will make it more difficult to separate and regulate those different businesses. It could also increase regulatory costs.

On page 22, the discussion paper once again indicates that Board Staff believes that “the price of emission units will increase over the medium and long term.” Energy Probe suggests that the Board take a more objective view of what the price of emission units will be over the long-term. In Europe -- currently the largest and longest-running cap and trade system -- the price of carbon credits has decreased over the last decade and is well below the level that many regulators were forecasting. The California system, according to recent reports, may already have a significant surplus of carbon credits, which would ensure that the cost of credits remain low for a long period of time. Pushing the incumbent gas utilities to pursue investments based on a significantly higher carbon price is a risky proposition for ratepayers who will have to pick up the tab if those higher prices don't come to fruition.

### **Section 4.1.4.3**

Board Staff's discussion paper lists an extensive number of risk management suggestions. The question for us is: will the Board be the sole judge on whether those risk management activities are adequate?

As part of the Staff's recommendations, it suggests that the utilities should identify their hedging strategies, trading strategies, and the market risks in purchasing or trading various financial instruments related to carbon credits, among others. Energy Probe thinks this runs the risk of imposing significant regulatory overreach. The idea of a carbon market is that businesses and consumers can best allocate resources to lower carbon emissions. But what the Staff paper is calling for is a detailed breakdown of nearly every decision the utility will make in regards to its carbon market activities. Energy Probe is concerned about both the cost of such regulatory oversight and whether it actually encourages the kind of market behaviour the province wants to occur in the cap and trade market.

### **Section 4.1.5**

The discussion paper encourages the incumbent utilities to invest in, potentially, "new technologies and new infrastructure." Again, the regulatory and financial risks of pushing the utilities to invest in sectors outside of their expertise will most likely fall on the shoulders of ratepayers, who will bear the cost of those investments if they turn sour. The Board should consider what types of investments it would like the utilities to consider and whether those investments will be able to earn a similar return on equity as regulated assets. The Board already has rules for non-utility businesses, but it's not clear whether these types of investments would fall into that category.

### **Section 4.2**

California appears to have a much more straightforward regulatory regime in terms of cap and trade. It's also the same for all utilities. Board Staff's discussion paper is asking Ontario utilities to potentially move into new technologies and sectors, which isn't the case in California. The discussion paper also asks the utilities to present much more detailed and ambitious compliance plans than what is required of utilities in California. Does Board Staff have a reason for implementing a much more aggressive regulatory regime for gas utilities in regards to cap and trade?

### **Section 5.1**

All cap and trade costs should be presented as their own line item on customer bills. The entire cap and trade program has little to do with the delivery of natural gas and much to do with provincial policy. In the interest of transparency, all costs related to an environmental policy should be separated as much as possible.

**Respectfully Submitted at Toronto, June 22, 2016**

**Energy Probe Research Foundation**