ONTARIO ENERGY BOARD

Staff Discussion Paper on Cap and Trade Regulatory Framework for Natural Gas Utilities

COMMENTS OF

INDUSTRIAL GAS USERS ASSOCIATION (IGUA)

Appropriate Role for the OEB

1. In the first paragraph of the introduction section of the May 25, 2016 *Staff Discussion Paper on a Cap and Trade Regulatory Framework for the Natural Gas Utilities* (Staff Discussion Paper) Staff identifies the purpose of the framework that is the subject of the Staff Discussion Paper as follows:

> *The framework will outline the OEB's approach for assessing the cost consequences of the natural gas utilities' plans for complying with the Cap and Trade program and establishing a mechanism for recovery of these costs in rates.*

2. IGUA agrees that this is an appropriate scope for the OEB's role in respect of the utilities' cap & trade compliance plans.

3. Further on in the Staff Discussion Paper, under the heading "Compliance Plans", Staff describes the purpose of the utilities' compliance plans as follows[1]:

> *To meet its obligations under Cap and Trade, the utility will need to develop Compliance Plans to be filed with the OEB for approval. The overall purpose*

[1] Staff Discussion Paper, page 9, middle.

of a Compliance Plan is to describe the utility's strategy for meeting its Cap and Trade obligations. The OEB will review the plans to determine whether to approve the associated cap and trade costs for recovery from ratepayers.
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The Compliance Plan 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.

4. The final sentence from the foregoing passages could be read to suggest that the Board's role in respect of cap and trade compliance by the utilities would extend beyond assessing the cost consequences of the natural gas utilities' plans for complying with the Cap and Trade program and establishing a mechanism for recovery of these costs in rates. That final sentence could be read to suggest that the Board would be acting to ensure that the utilities' plans fully support the government's GHG emission reduction policy.

5. A similar concern could arise from reading the following passage from the Board's May 25, 2016 covering letter for issuance of the Staff Discussion Paper:

> *The OEB is developing a framework to support the successful implementation of the provincial government Cap and Trade program.*

6. We are not suggesting that these passages necessarily intend to convey a broad role for the Board in actively furthering the government cap and trade policy. Indeed, we note that elsewhere in the discussion paper Staff has proposed that the OEB follow a "light-handed" regulatory approach, essentially deferring to the utility on decisions on management of its portfolio of cap & trade instruments, and reviewing that portfolio only to ensure reasonable cost effectiveness. Rather we are concerned that the passages could be interpreted that way.

7. It is important for the Board to retain a clear demarcation of its role and responsibilities in respect of gas distributor cap & trade compliance. That is, the OEB should not assume a role of broad oversight of the implementation by the government of its cap & trade policies, or actively promote those policies, beyond facilitating recovery by the distributors of appropriate costs of, and approving

engagement by the distributors in appropriate activities related to, the distributors' cap & trade/carbon management compliance obligations.

8. Facilitating government policy in this area is an appropriate role for the Board. Championing it is not.

9. ***The OEB's focus should remain on evaluation of the prudence and cost effectiveness of the utilities' cap & trade compliance plans, and should <u>not</u> adopt as a primary objective maximizing achievement of the government's policy objectives.***

10. IGUA does agree that evaluation of the cost effectiveness of the utilities' compliance approaches relative to alternative approaches is an appropriate input into determinations regarding the cost effectiveness of the utilities' cap and trade compliance plans. Subject to prudence considerations, however, the plans should be those of the utilities, not those of the Board.

GHG Abatement Programs for Natural Gas Customers (DSM Discontinuance)

11. The Staff Discussion Paper suggests that, in order to reflect the government's overall objective of reducing greenhouse gas (GHG) emissions in the province, the portfolio of cap and trade activities should include not only allowances and offset credits, but also customer implemented GHG abatement initiatives.[2] It makes sense that, where more cost effective than associated emission allowance costs, the distributors should incent gas consumption reduction by customers.

12. This is precisely what DSM has historically done, and continues to do, now with significantly increased budgets.

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[2] Staff Discussion Paper, page 11, top.

13. The direct and express carbon regulation now introduced by the government includes establishing, at first administratively and ultimately through the "market", a price for carbon emissions, and thus a value for carbon emission reduction.

14. Ratepayer funded DSM, which encourages emission reduction imprecisely by comparison, has now been supplanted by the province's comprehensive emission reduction/cap & trade policy, and should be discontinued.

15. To the extent that consumption reduction is more cost effective than facility expansion, the Board's conventional assessment of facility plans and capital investment budgets can better identify appropriate demand reduction initiatives.

16. ***Ratepayer funded DSM has now been supplanted by express and direct carbon regulation, and ratepayer funded DSM should be discontinued. Evaluation and execution of cost effective emission reduction programs should now be undertaken in the context of legislated and government managed carbon compliance costs.***

17. Through its cap & trade program the government has now determined the appropriate level of industrial emissions, and will actively manage the cost of achieving required emission reductions, including making funds available for salutary investments. Large Final Emitters (LFEs) directly subject to carbon emission compliance will be required to make their own evaluations of "cost effective" energy efficiency investments, relative to cap & trade compliance requirements.

18. Existing utility ratepayer funded DSM programs result in "leakage" of funds to cover utility administrative and shareholder incentive costs. Within the now formalized carbon regulation regime, these are funds that are better used by trade exposed LFEs to manage their carbon compliance obligations.

19. The comments in the Staff Discussion Paper on DSM/cap & trade overlap[3] are summarily focussed on the ability for the Board to ensure that costs and revenue losses associated with DSM vs. cap & trade customer abatement activities are kept distinct and separate. Staff does not address the redundancy of DSM and related administrative and incentive cost "leakage".

20. Staff does note, in passing, that the DSM framework is to be reviewed in June, 2018. A decision on this review will not be issued for implementation prior to 2019, which will be more than half way through first cap & trade compliance period. The Board should act on this matter sooner than 2019.

21. ***For LFEs in particular, who will now be subject to their own direct emission reduction obligations and associated costs, ratepayer funded DSM programs present a drain on available carbon compliance funds.***

22. Further, large emitters who are not designated by the cap & trade regulation as LFEs but who elect to opt in to direct carbon emission compliance obligations would incur redundant costs if still required to contribute to utility ratepayer funded DSM programs.

23. Operating duplicative (cap & trade/green bank funded demand reduction as well as ratepayer funded DSM) programs could lead to "stacking" of program incentives by some customers. As well as potentially being unfair, this would render implementation of both types of programs more complex and thus more expensive than necessary. These duplicative administrative expenses would unnecessarily divert funds that could, and should, be used to procure actual carbon reduction.

24. Continuing to pay utility shareholder incentives for carbon reduction initiatives that are now required as a matter of law is unnecessary, and would divert funds from achieving actual carbon emission reduction.

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[3] Staff Discussion Paper, page 49.

25. ***For all rate classes, carbon compliance costs could, and should, be offset by removal of ratepayer funded DSM costs from rates.***

26. At a minimum, and effective upon implementation of LFE carbon compliance obligations, parties subject to their own direct carbon emission compliance obligations should;

    (a) be permitted to opt out of ratepayer funded DSM programs: and

    (b) receive a bill credit which effectively refunds their ratepayer funded DSM program contributions.

27. The utilities are implementing billing and associated accounting system changes to be able to allocate appropriate carbon compliance costs to appropriate customers. These same billing and associated accounting system changes should be readily applicable to addressing DSM charges made redundant by implementation of direct carbon compliance obligations for LFEs and voluntary direct compliance participants.

Cost Recovery

28. There are three basic types of compliance costs identified in the Staff Discussion Paper:

    (a) "Customer related costs" refer to the costs of allowances or other instruments or initiatives (like efficiency programs) that relate to the gas consumed by distribution customers.

    (b) "Facility related costs" refer to costs of allowances or other instruments or initiatives associated with the gas consumed by the utilities' own facilities.

    (c) "Administrative costs" refer to the costs to manage the utilities' compliance obligations.

29. ***LFEs and voluntary direct carbon compliance participants who have their own direct compliance obligations should bear no portion of the customer***

related costs, and should only bear administrative costs associated with carbon compliance related to the utilities' own facilities.

Customer Related Costs

30. Staff has proposed that "customer related costs" be recovered, on a volumetric basis, from all distribution customers, except LFEs or customers who have voluntarily opted in to direct cap & trade compliance obligations. "Customer related costs" would include costs for allowances, credits or offsets, as well as costs of customer abatement programs.

31. IGUA endorses this proposal.

Facility Related Costs

32. Staff has proposed that "facility related costs" (i.e. compliance costs associated with the gas consumed by the utilities' own facilities) be recovered from all delivery customers.

33. Staff has proposed that costs of allowances, credits or offsets would be recovered on a volumetric basis.

34. IGUA agrees with this proposal.

35. Staff has further proposed that costs of carbon reduction investments would be recovered through standard utility capital planning and review processes.

36. Provided that such planning and review processes ensure that incremental investment in utility facility carbon abatement would only be made where it is more cost effective to make such investments than to acquire emission allowances, credits or offsets, then such investments would reduce carbon compliance costs

for all delivery customers. The costs of such investments are thus properly borne by all delivery customers.

37. However, treating costs of incremental utility investment to achieve carbon abatement in the same manner as all other facility investment costs could compromise the bill presentment transparency which IGUA (and others) advocate. Transparency of carbon compliance costs should not be lost, and incremental carbon compliance related investment in utility facilities might thus be more appropriately recovered in another fashion.

Administrative Costs

38. Staff has proposed that "administrative costs" should be recovered from all delivery customers on a volumetric basis.

39. Staff notes that administrative costs *"are not expected to be material"*, though little information on the basis for this expectation is provided. (Staff offers that its research has indicated that administrative and customer outreach costs combined ranged from 0.1% to 2.7% of total carbon compliance costs for utilities in California in 2015.)

40. Staff proposes that administrative costs driven by carbon compliance obligations not be segregated from other utility administrative costs, and be allocated in the same manner as other utility administrative costs of like nature (for example, incremental IT costs would simply be allocated together with other IT costs).

41. IGUA's view is that greater care should be taken to allocate administrative costs associated with carbon compliance, in order to avoid unnecessary duplication of costs for LFEs. There is no basis to conclude that the effort entailed in more careful tracking and allocation of carbon compliance administrative costs would outweigh the benefits of being fair to LFEs in this exercise.

42. In particular given the uncertainty of what compliance will look like moving forward, there is merit in trying to get this right at the outset.

43. ***Administrative costs for carbon compliance should first be directly allocated either to "customer related costs" or "facilities related costs".***

44. ***Where direct allocation of administrative costs is not possible, the remaining administrative costs for carbon compliance should be allocated pro-rata between customer and facility related costs (in proportion to the total directly allocated to each of these cost categories).***

45. Such an approach would be fair and cost reflective. There is no basis upon which to assume that material incremental expense would result from this approach to allocation.

46. Finally on this topic, no customer communication plan costs should be allocated to LFEs.

Rate Design and Bill Presentment

47. Staff has proposed that a volumetric (i.e. cents/m^3) carbon compliance cost recovery rate be separately identified on the utilities' approved tariff sheets. This would allow large volume customers that are not mandatory LFEs to obtain information to assist them in assessing whether to opt in to direct compliance obligations under the scheme.

48. IGUA endorses this proposal (though not in substitute for separate identification of carbon compliance costs on customer bills). The rate for LFEs and voluntary direct carbon compliance participants would have to be different from the rate for all other customers.

49. Staff proposes that the carbon compliance volumetric rate be included in the delivery charge on customer's bills, and not represented as a separate line item

on the bill. Staff justifies this position by asserting that; i) customer research indicates that consumers are concerned about the overall bill; and ii) an additional line on the bill could increase customer confusion and utility call centre activity.

50. These concerns seem specious. Staff summarily rejects a separate line item approach which would provide greater transparency to customers regarding the costs of carbon associated with natural gas use. Staff further acknowledges that LFEs and voluntary participants in various rate classes will need to have their delivery rates adjusted to remove these charges, which would lead to a lack of delivery rate uniformity in bill presentment.

51. ***IGUA supports billing transparency for carbon compliance costs, and opposes the suggestion that carbon compliance costs be incorporated within an aggregated delivery rate.***

Confidential Information

52. The cap & trade legislation prohibits disclosure of;

    (a) information related to participation in emission allowance auctions; and

    (b) information relating to carbon instrument transactions in the secondary or tertiary markets and not otherwise available.

53. In respect of auction related information, the legislative prohibition on disclosure appears to be absolute. While a legislative exception is provided for the OEB itself, such exception does not appear to extend to allow intervenor representatives to access such information under the Board's standard *Practice Direction on Confidential Filings*.

54. Staff has proposed that for auction related information, the OEB engage an audit type inspection function to validate the reasonableness of the auction related costs incurred by the utilities, and that a public report of such inspection be issued. Together with the legislated auction summary which the Minister is required to

publish within 45 days of each auction, Staff suggests that the publically filed inspection report will provide sufficient information to protect the public interest while adhering to the legislative requirement for non-disclosure of strategic auction behaviours.

55. ***This seems to IGUA to be reasonable as a starting point, subject to evolution of the market and auction protocols.***

56. In respect of secondary/tertiary market transactions, the legislative prohibition relates to market gaming or tipping, and expressly allows for public disclosure of information (as distinct from disclosure of information not otherwise available).

57. Accordingly, any special, more stringent protocols for non-disclosure are warranted only in respect of secondary/tertiary market transaction information that is legitimately commercially or strategically sensitive and thus warranting confidential treatment. In that circumstance, disclosure even to intervenor representatives under the Board's standard confidentiality protocols seems to be precluded. Other secondary/tertiary market transaction information disclosure of which would <u>not</u> prejudice future utility carbon market activities would not require confidential treatment of any sort.

Recalibration and True-Up Process

58. Staff proposes that a separate, annual rate application be brought to set carbon compliance rate recovery amounts for the upcoming year, and true-up cost recovery for the preceding year.

59. Large volume customers (LVCs) have been surprised in the past by large annualized DSM cost true-ups. These present significant difficulty for LVC budgeting and business planning processes.

60. ***IGUA believes that, ideally, determination of carbon compliance costs for recovery should be treated like determination of gas costs for recovery. That***

is, ideally carbon compliance costs would be recalibrated and trued up quarterly.

Length of Compliance Plans

61. Staff has proposed that the utilities' compliance plans be 3 year plans, coinciding with the compliance periods set by the legislation. Detailed review and assessment by the OEB of each 3 year plan would be undertaken at the outset of each plan period, and annual updates would be limited to consideration of changes to the plan. (The first plan, however, would be for 2017 only, given the start-up phase of the scheme and the limited options expected to be available for compliance at the outset.)

62. Subject to our earlier submissions endorsing Board Staff's recommendation that the Board's approach to utility compliance plans should be a "light handed" one (focussed on prudence and cost recovery issues), IGUA agrees that multi-year plans coinciding with compliance periods are better than 1 year plans.

63. ***Some provision should, however, be made for evaluating post-compliance period continuity, particularly towards the end of the then current compliance period. This could be by way of longer term plans, or by way of filing requirements for discussion of post-plan compliance initiatives/directions. Further comment on this by the utilities would be helpful.***

Carbon Price Forecasts

64. Staff suggests the need for two carbon price forecasts; an annual forecast and a 10 year forecast.

65. The annual forecast proposed is the Intercontinental Exchange (ICE) one year forward carbon price forecast.

66. Staff proposes that for the 10 year forecast, the OEB publish a consensus forecast based on individual forecasts procured from various sources (in the way that the OEB currently addresses interest rate and cost of capital forecasts for use in rate applications).

67. IGUA has no concerns at this time with this approach.

Carbon Compliance Portfolio Optimization

68. The Staff Discussion Paper contemplates that the utilities will engage in "optimization" of their carbon compliance portfolios, and that such "optimization" would include consideration of longer term investment alternatives to reduce carbon emissions.

69. Such longer term investments may be more expensive initially, but could yield greater benefits in the long run than would only short term initiatives.

70. Staff's discussion assumes that the utilities will engage in "risk management" as a necessary element of participating in a carbon trading program.

71. ***IGUA agrees that a long term view should be taken of optimizing investments in carbon abatement.***

72. In respect of active risk management, there may be limited opportunity for such activity in the near term. To the extent that risk management opportunities arise as the market develops, prudence would dictate consideration of such opportunities by the utilities, and prudence review of utility decisions in that respect by the Board.

Consumer Messaging

73. Staff proposes that, in order to ensure consistency in consumer messaging regarding the new carbon compliance framework and associated costs, the OEB review the utilities' messaging and proposed customer communication activities.

74. IGUA has no concerns with Board review of utility consumer messaging. IGUA has already noted that no customer communication plan costs should be allocated to LFEs.

Additional Issue: Ownership of DSM Related GHG Reduction Credits

75. The utilities have, for some years, been carrying GHG reduction credit deferral accounts.

76. These accounts were first proposed, and approved, a number of years ago, in light of significant future uncertainty regarding the formation and possible dispositions of fungible carbon reduction instruments associated with utility DSM activities.

77. Our understanding is that no balances have been recorded in these accounts.

78. It is IGUA's understanding that at least some utility DSM contracts with customers contain clauses reserving to the utility all carbon reduction credits or value arising from utility funded DSM initiatives.

79. IGUA suggests that with the current clarity on Ontario's carbon cap and trade scheme, it would be appropriate for the Board to reconsider the function of, and need for, these deferral accounts and associated DSM customer arrangements.

80. ***IGUA suggests that the utilities provide further information clarifying the continued need for GHG deferral accounts, and the utilities' intentions in respect of potential customer generated carbon reduction credits to which the utilities did, or do, claim entitlement.***

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:

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