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Our File No. 168193

May 18, 2017

VIA RESS, EMAIL AND COURIER

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1 E4

Attention: Kirsten Walli,
Board Secretary

Dear Ms. Walli:

Re: Cap and Trade Compliance Plans (Combined Proceeding): Enbridge Gas Distribution Inc. (EB-2016-0300), Union Gas Limited (EB-2016-0296) and Natural Resource Gas Limited (EB-2016-0330)

Please find enclosed BOMA's Written Submission with respect to Union Gas.

Yours truly,

FOGLER, RUBINOFF LLP

Thomas Brett
TB/dd
Encls.
cc: All Parties *(via email)*

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EB-2016-0296
EB-2016-0300
EB-2016-0330

ONTARIO ENERGY BOARD

Union Gas Limited
Enbridge Gas Distribution Inc.
Natural Resource Gas Limited

Applications for approval of the cost consequences of cap and trade compliance plans

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SUBMISSION OF

BUILDING OWNERS AND MANAGERS ASSOCIATION, GREATER TORONTO ("BOMA")

WITH RESPECT TO UNION GAS

May 18, 2017

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Submission on EB-2016-0296/0300/0330 with respect to Union Gas

Introduction

This proceeding deals with Union's 2017 Compliance Plan. 2017 is year one of a four-year compliance period, which will end on December 31, 2020.

The government has set an emission reduction target for the province's GHG emissions in section 6 of Climate Change Mitigation and Low-Carbon Economy Act, 2016 (the "Act"), as follows:

> **"6.** (1) The following targets are established for reducing the amount of greenhouse gas emissions from the amount of emissions in Ontario calculated for 1990:
>
> 1. A reduction of 15 per cent by the end of 2020.
> 2. A reduction of 37 per cent by the end of 2030.
> 3. A reduction of 80 per cent by the end of 2050."

As BOMA, and its counsel, has access to only that part of the evidence that the Board deemed to be public, which included a heavily redacted version of the Compliance Plan, its assumptions and conclusions can only be based on the truncated plans.

Issue 1

> *"Cost Consequences - Are the requested cost consequences of the Gas Utilities' Compliance Plans reasonable and appropriate?"*

In order to assess whether the requested cost consequences of Union's 2017 Compliance Plan are reasonable and appropriate, it is first necessary to assess whether the proposed Compliance Plan itself is reasonable and appropriate.

The Ontario Energy Board sets out the test on page one of its Report of the Board: Regulatory Framework for the Assessment of Costs of Natural Gas Utilities Cap and Trade Activities, EB-2015-0363 (the "Framework"), as follows:

> *"The OEB will assess the Utilities' Compliance Plans for cost-effectiveness, reasonableness and optimization, and ultimately to determine whether to approve the associated cap and trade costs for recovery from customers."*

The test is similar to the test the Board uses to set rates in a forward test year regime. Its ultimate objective, in both cases, is to establish just and reasonable rates. To do so, it judges, inter alia, the reasonableness of the forecast OM&A and capital expenditures. It requires utilities to evaluate alternative approaches, for example, additional maintenance versus asset replacement, and benchmark its proposals to those of similar entities. It requires utilities to optimize their capital expenditure portfolios. And, of course, after the year is over, before capital expenditures are allowed into rates, or if forecast funds remain unspent, in the course of clearing deferral and variance accounts, or otherwise, it tests for prudency.

Union's 2017 plan contemplates the purchase of allowances at the Ontario government's auctions, and perhaps through secondary market transactions as well. Union states that it may or may not utilize one or more derivative contracts to acquire allowances in the secondary market. However, Union's evidence is that it will not employ any consumer abatement activities (DSM program enhancements or new DSM programs) in 2017, other than the Ontario government's Green Fund home energy retrofit program. Union has included a forecast of emissions savings from that abatement program, incremental to DSM, in their 2017 Compliance Plan (Exhibit 1, p3 of 12). The 2017 forecast amount of compliance obligation provided by the program is forecast to be 7,000 tonnes out of a total compliance obligation of 15,500,000 tonnes (Exhibit 2, Schedule 1). Union has also stated they will not have any savings from long-term investments in 2017, as

they have not yet made any substantial analysis around such investments. It is also virtually certain that Union's 2017 plan will not include any savings from offset projects, given that the offset regulation has not yet been completed, and the offset protocols remain under development by a contractor to MOECC, with deliveries forecast over a series of months in the latter part of 2017. Moreover, offset projects are mostly larger, complex, physical projects, that take many months, if not years, to develop, construct, implement, and verify. Regulations for verified credits have not yet been enacted. Finally, the fact that Ontario Regulation 144/16 does not permit capped participants to purchase offset credits from other jurisdictions, eg. California and Quebec (Transcript, Volume 3, p11, lines 11-14) means that Union cannot purchase an off-the-shelf offset in 2017.

In other words, Union's 2017 Compliance Plan will consist almost entirely, if not entirely, of allowance purchases, at auction, from the government, and possibly, and to a much lesser extent, in the Ontario secondary market, to the extent that one develops in 2017. Auction purchase will be purchased at the auction clearing price. Purchases in the secondary market, including bilateral deals, will be by spot purchases, or purchases using one or more financial instruments, for example, forward contracts, futures, options, or swaps.

The plan does not include any extra funding for emission abatement measures from existing DSM programs, or funding for new DSM programs, even if either set of DSM measures had a lower cost per ton of emission reductions than the forecast 2017 allowance costs.

Union's evidence is that it did not request additional funding for existing DSM programs or new DSM programs for two reasons. First, because it did not have sufficient time to prepare the request, given that the Board published its Framework in September 2016, and Union was

required to file its Compliance Plan by November 15, 2016. However, Union was aware from the publication of the Ontario government's GHG Policy in mid-2015, from analyses it received from ICF in November 2015 (EB-2016-0004, Exhibit S3.EGDI.OGA.3, Attachment), the fact that the draft cap and trade regulations were introduced on February 24, 2016, and the Climate Change legislation and final regulations (Ontario Regulation 144/16) were given Royal Assent and approval respectively on May 18, 2016 and May 19, 2016, and the Climate Change Action Plan was released in June 2016, that additional DSM would need to be a significant part of any GHG emission reduction plan, as enhanced and/or additional DSM investments were the most cost-effective form of consumer/utility cost abatement activity. In short, BOMA believes that Union had time to explore, plan and optimize proposed new DSM programs, or enhancements or additional funding for existing DSM programs. Moreover, the likely short-term price trajectory of allowances in both California and Quebec was public knowledge in 2015. Union's second reason for not requesting additional DSM funds was that there were too many uncertainties around cap and trade, including the absence of the Marginal Abatement Cost ("MAC") curve, and the Board's ten year carbon price forecast, the absence of detail on the government's Cap and Trade Action Plan, and the comparative costs of various long-term emission abatement investment projects, such as Renewable Natural Gas.

Union's evidence is that it has not yet done the quantitative analysis necessary to compare the cost-effectiveness of DSM abatement measures relative to the actual and forecast Ontario allowance costs. It should have already done this analysis. Moreover, it was able to calculate the abatement unit cost for the Green Fund Home Retrofit Program.

While the MAC and prior forecast are not yet available, Union is well aware of the least cost to highest cost per m^3 of its array of existing DSM programs. In other words, it has enough

information to make cost comparisons between allowance purchases and DSM abatement measures. It is, or should be, well aware that DSM measures are the most cost-effective abatement measures available (and, unlike long-term investment projects, they do not require extensive analysis). Union has managed a successful DSM program for many years. So BOMA regards the "uncertainties" argument as spurious in this context, in that it clearly does not apply to DSM measures. Moreover, many of the other uncertainties alleged, such as whether linkage with California and Quebec will occur, apply not to 2017 in particular, but more generally. Finally, there will always be uncertainties going forward, as the government's overall GHG program is unveiled a step at a time over the next several years.

BOMA suggests that the principal reason Union has not commenced additional DSM programs is that the Board has not yet clarified the extent to which LRAM and DSM performance bonuses will be available for additional DSM projects beyond those in the existing 2015-2020 DSM framework.

If Union waits for the completion of the mid-term review, currently scheduled for June 2018 to expand its DSM programs, it will forego the use of additional DSM abatement measures for 2018 and probably 2019 as well. Union appears to be waiting to confirm whether it can earn additional profits via a higher bonus (DSM bonus), and have LRAM coverage if they increase their DSM spending, which yields additional savings commensurate with existing programs. The Board should clarify the regulatory status of additional DSM measures in its decision in this proceeding. The utilities have not provided any evidence that they lack the capacity to spend more money than budgeted in 2017 if they were to receive additional ratepayer funds. Ratepayers would be better off to the extent that enhanced DSM costs were less than the 2017 actual and forecasted allowance prices. It is not too late in the year to fund additional 2017 DSM

projects. There is also a clear need to fund more DSM abatement projects for the remaining three years of the first compliance period.

BOMA is of the view that, while simply purchasing the total value of allowances required to match forecast 2017 emissions may be the lowest risk option for the Union shareholders, it not demonstrably the best option for Union's ratepayers. Moreover, as the amount of allowance will decrease going forward by approximately four percent per year, and the program design mandates auction floor price increases each year, allowance prices will increase. It is important that Union gain early experience with an array of cost-effective, low risk options to continued auction purchases.

Based on Union's failure to compare enhanced DSM program spending with allowance purchases, BOMA does not see how the Board is able to conclude that the proposed Compliance Plan, taken as a whole is cost-effective, reasonable, and optimized.

However, given the fact that we are midway through 2017, and the fact that Union must now focus on its 2018 through 2020 plan, as a high priority, BOMA suggests that, on the terms and conditions suggested later in this submission, and subject to after-the-fact prudency review, the Board allow Union to recover its 2017 Compliance Plan-related expenditures from rates.

The Prudency Issue

BOMA notes that EGD has agreed that a prudency review of the 2017 Plan expenditures is necessary once the 2017 expenditures have been made (Exhibit I.1.EGDI.BOMA.12; Exhibit I.1.EGD.BOMA.35). Their counsel stated the Company's legal position very clearly, including the fact that the prudency test applies to the total Compliance Plan expenditures, not just any

additional funds required to clear a GGEIDA debit, based on a variance in emission volumes, allowance prices, or administrative costs, relative to forecasts (Volume 1, p116).

In BOMA's view, Union agreed in its evidence that a prudency review is required of the actual costs of implementing Union's 2017 compliance costs after the end of the Compliance Plan term. However, it is not clear from Union's evidence whether Union, particularly in its Argument-in-Chief, is asking that Board decide in advance, that is, in this proceeding, whether expenditures not yet made are prudent.

At one point, the Company states, when speaking about cost recovery:

> *"So our view is that this is a compliance obligation that we have, and all prudently incurred costs will be subject to cost pass-through."* (our emphasis) (Transcript, Volume 3, p18)

The Board will not know whether the costs were prudently incurred until they are examined after the end of 2017.

As an aside, the witness, Ms. Byng, also used the word "prudency" to mean "with care" in the context of describing Union's safeguards against improper disclosure of information. That is not the "prudency" that we are talking about here.

However, Ms. Byng also stated at Transcript, Volume 2, pp127-128:

> *"Quite simply, the framework identifies that cost recovery through prudency is one of the guiding principles. So when we bring our compliance plan forward and the cost consequences resulting, then it will be up to the Board to evaluate what methods we used or did not use, and whether they were prudent as a result."* (our emphasis)

In this sentence, Union appears to recognize that prudency can only be assessed after the plan has been implemented.

However, in its Argument-in-Chief, Union takes a more ambiguous position.

For example, at p2, Union states that:

> *"The purpose of Union's application was to present a prudent compliance plan for 2017 that complies with applicable regulations, and outlines how Union will meet its obligations..."* (our emphasis).

But, as stated earlier in this submission, the OEB has stated that it will assess Union's Compliance Plan for "cost-effectiveness, reasonableness, and optimization". Prudence is not a criteria used to evaluate the plan. Plans are not prudent. Expenditures made to implement the plan can be prudent or imprudent, and that decision can only be made after those expenditures have been made, and the plan year is over.

At p7 of its Argument-in-Chief, paragraph 14, Union states:

> *"The reasonability of the cost consequences associated with Union's 2017 Compliance Plan will be the subject of future proceedings (see Issues 1.4 and 4 below)."*

However, Issue 1.4 deals only with the reasonableness of the Compliance Plan and the forecast costs to implement the plan. It does not deal with a subsequent proceeding, as stated in paragraph 14.

Issue 4, on the other hand, deals with the structure of the proposed deferral accounts, and the costs captured by each of them.

Neither section provides any information about the "subsequent proceedings" that Union refers to, other than the proceedings to clear the deferral accounts.

Union repeats the statement in paragraph 40 that the focus of the Compliance Plan review is compliance and prudency. But it is not. The Board has clearly stated that compliance is only a

part of what it expects, and as stated earlier, prudency is not the criteria by which the Board assesses the plan. Rather, the criteria are "reasonableness, cost-effectiveness, and optimization". Another way of looking at it is to say that a plan could be reasonable, appropriate, and optimized, but could be implemented in an imprudent fashion. Some examples are provided below.

Finally, Union states, at paragraph 40:

> *"(...Compliance Plan review, deferral disposition), metrics and monitoring forms provide sufficient oversight to assess performance and overall prudency."*

They do not.

In BOMA's view, so long as the Board makes it clear that what Union calls "overall prudency" can be dealt with in the proceeding which deals with the clearance of deferral accounts, or at some other time, the extract above would be correct. Otherwise, the three items listed do not provide sufficient oversight because parties would not have the opportunity to raise the prudency issue and examine the utility with respect to the prudency of its expenditures incurred to implement the plan.

The Board's Framework makes this fundamental point clear, in its Guiding Principles, when it states:

> *"Cost Recovery: <u>prudently incurred costs</u> related to cap and trade activities are recovered from customers as a cost pass-through."* (p7) (our emphasis)

The Board can only determine whether costs were prudently incurred after they have been incurred.

At p23 of the Framework, the Board adds:

> *"The OEB must assess the cost effectiveness of the Utilities' compliance activities in meeting their emission reduction obligations for customers and their own facilities. That assessment will include a consideration of objective and independent analysis of Utilities' Compliance Plan implementation performance and costs."* (our emphasis)

The rationale for prudency review of cap and trade activity is further enhanced by the Board's decision, at p27, when discussing the treatment of longer term investments.

> *"The actual forecasts of planned capital expenditures related to any investments will, however, be dealt with in a Utility's regular rate application and/or any leave to construct cases".*

Prudency reviews are a component of rates cases and leave to construct cases.

Had the Board intended to depart from the long established regulatory principle that expenditures can be recovered in rates once made only if they are judged to be prudent, it would have said so explicitly in the Framework. It did not do that.

Prudency issues could arise in connection with expenditures to implement the Compliance Plan in several ways. For example, total purchased allowance costs may be higher than forecast due to improper or unwise use of a derivative(s). They could also result from the poor execution by Union of a Compliance Plan (see above), which, in itself, was found to be reasonable and cost-effective, for example, the execution was not sufficiently flexible to deal with changing circumstances. The need for flexibility is demonstrated by the example, posed by Mr. Pollock, in his cross-examination of the first EGD panel:

> *"Q: If you were to execute the approved plan in different circumstances, that would mean the difference between it being reasonable and unreasonable.*
>
> *A: I guess so, yes.*
>
> *Q: I'll give you an example, if helps. If I were to want to go and buy a vacuum cleaner for $100, that might be reasonable. But if I am going to the store and I see my neighbour who offers to sell me a brand new one, still in the package for*

$30, going out to the store and buying it for a hundred may no longer be reasonable. Is that fair as an example?

A: Yes." (Transcript, Volume 1, p73)

BOMA would only add that the example also shows how the expenditures resulting from the plan, if not modified to take into account the better opportunity, would be imprudent.

The Board should not allow the fact that the 2017 plan may necessarily be a "stripped-down" plan because of some of the compliance tools are not yet available, to diminish the importance of the prudency review.

Nor should the Board's determination of the reasonableness, cost-effectiveness, and optimization of the plan, let alone the prudency of the expenditures to implement the plan, be influenced by Union's contention that it has a statutory obligation to file a Compliance Plan in respect of its ratepayers' gas consumption and GHG emissions.

It is Union's ratepayers, not Union's shareholders, who are paying ninety-nine percent or more of the $274 million of allowances forecast to be purchased by Union at auctions, or in the secondary market in 2017. The MOECC recently reported that the March auction has raised $472 million. A substantial portion of that amount would have come from Union.

The Board recognized this fact in its Framework when it required that Union demonstrate that its plan was, inter alia, cost-effective, in addition to being compliant with the Act.

Moreover, Union also has a statutory mandate to have its proposals to increase rates approved by the OEB, and to implement only those capital expenditure projects that are found to be in the public interest, pursuant to leave to construct proceedings (both of which are subject to prudency

review). There is nothing special about the statutory obligation with respect to cap and trade programs cited by Union (and EGD).

Moreover, the fact that much of the evidence in this proceeding is characterized by the Board as strictly confidential, means that ratepayers' representatives and their counsel will not have, even after the end of 2017, all the information necessary to raise all appropriate prudency issues. In these circumstances, it will be up to the Board and Board staff to ensure that prudency issues are closely scrutinized, otherwise, the ratepayers will be disadvantaged. This can be avoided only if the Board staff and the Board act as vigorous advocates for the ratepayers in examining the Compliance Plan in general and the prudency issue, in particular.

This application is in essence an application to set final rates for 2017, effective January 1, 2017, which will recover the costs of implementing the utilities' cap and trade programs for 2017. It is, in effect, the finalization of interim rates for 2017 that were established in 2016.

Prudency review is an essential part of the ratemaking process.

Issue 1.7

> *"Has the gas utility reasonably and appropriately presented and conducted its Compliance Plan risk management processes and analysis?"*

The Framework states:

> *"At a minimum, the OEB believes that risk identification should address the following categories of risks inherent in Cap and Trade:*
>
> • *Volume variability;*
>
> • *Allowance price variability (including foreign exchange risk);*
>
> • *Emissions unit availability (i.e., allowances and offset credits);*

- *Market risk;*
- *Non-compliance; and,*
- *Any other risks identified by the Utilities"* (our emphasis).

BOMA would add to that list:

- Improper disclosure risk by Union or government employees;
- Program termination risk; and,
- The risk of pursuing too few cost-effective Ontario abatement opportunities and being required to purchase too many allowances in California, increasing the cost of the program, achieving less than optimum rate predictability, not to mention having reduced the economic and employment benefits to Ontario and Canada.

Risk Allocation

Union's position is that ratepayers bear all the risks noted above. Union has made it clear that all risks inherent in cap and trade activity that actually materialize and cause losses, are losses to be borne by the ratepayers, regardless of the cause of the loss. That would include cases where the loss was caused by the release by a Union employee of confidential information which resulted in ratepayer loss. Union did not answer that question. It did not state that it would be liable for any loss arising from such improper disclosure (Transcript, Volume 3, p19).

Other risks include program termination risk (a market risk) after money has been collected from ratepayers.

For example, this risk could materialize in the event that linkage with California proved impracticable for either California or Ontario. While the California Court of Appeal has recently

upheld the California cap and trade program, the Supreme Court of California might revise the Court of Appeal's decision or overturn it. In the event that the California Supreme Court decided the plan was illegal in 2017, the future of the Ontario Plan would be in serious doubt. Moreover, even if the Courts continued to sustain the current law, as described in a recent law review article in BOMA's Compendium #3 (State Constitutional Limitations on the Future of California's Carbon Market, Energy Law Journal, Vol. 37, No. 2, 2016), there is a substantial risk that the California Cap and Trade Legislation will not last in its present form beyond December 31, 2020 because the current law expires at that time.

Moreover, Bill SB 775, California Global Warming Solution Act of 2006: Market-Based Compliance Mechanism (the "Bill"), has just been introduced in California legislature. The Bill proposes a radical redesign of the 2006 legislation, to be effective January 1, 2021; it appears to have wide support among the various cap and trade constituencies in the state. The Bill would present a "fresh start" in 2021, which would eliminate the large pool of excess allowances from the current program, which have been depressing allowance prices in California (and Quebec) over the last few years. It would eliminate free allowances, and establish a price "collar" for allowances and offsets. It establishes a price "collar" which establishes a floor and a ceiling. The price floor is set at $20 in 2020, while the price ceiling starts at $30. The price floor rises at $5.00 per year plus inflation; the price ceiling rises at $10.00 per year plus inflation. The price ceiling would hit $100.00 (US) by 2030. The program would operate in perpetuity. There would be a border tax pursuant to an Economic Competitiveness Assurance Program to ensure the greenhouse gas emissions-intensive products, imported from jurisdictions that have no equivalent GHG charge, obtain no unfair advantage over products produced in state. The proceeds from allowance auctions will be divided into three pools; a dividend pool (a "dividend"

for each California resident), an infrastructure pool, and a clean energy R&D pool. On linkage, the Bill provides that starting in 2021, the new system will not link to any other jurisdiction (including Quebec) unless it has a minimum carbon price that is equal to or greater than California's, and meets other criteria. A copy of the Bill 775 is attached (Attachment 1).

Whatever the cause, in the event the Ontario Cap and Trade program were abandoned, utilities would be holding allowances in their CITISI account that might then be worthless. In such a case, ratepayers should not bear all of that loss, in the event the government were to refuse to return the amounts collected from previous allowance sales to the ratepayers. It is not clear that Union has thought through these issues; nor do they appear to have reached any agreements with the Ontario government on the need to return cash to ratepayers, in such an eventuality.

Without the ability to access "excess allowances and credits" from California, it is clear from analysis done by EnviroEconomics for the Ontario government that, without the pool of cheap California allowances to mitigate price impacts, allowance costs in Ontario would rise from four to nine times current levels (BOMA Compendium Item 1 – Impact Modelling and Analysis of Ontario Cap and Trade Program, May 5, 2016, EnviroEconomics/Navis Research/Dillon Consulting, pp2-6). Such an increase would clearly be unsustainable and would lead to termination or radical modification of the Ontario program.

A further risk, which if realized, could lead to large ratepayer losses, would be the improper or unwise use of various derivatives in connection with allowance purchases in the secondary markets. This is hedging risk, a form of execution risk.

The Framework states:

> *"While the OEB is not requiring a Utility to undertake hedging activities, Utilities will not be prevented from doing so. If a Utility decides that hedging is a cost-effective and optimal strategy to pursue in its Compliance Plan, the Utility should describe its hedging strategy, identify any potential risks and outline a plan that describes how these risks would be mitigated. The OEB will review the Utility's proposed hedging plans for cost-effectiveness, in accordance with the principles set out in the Regulatory Framework."* (p26)

The OEB states that it will "review the utility's proposed hedging plans for cost-effectiveness", but the issue may not be cost-effectiveness as much as the additional risks that the use of the particular instrument may create.

It is noteworthy that EGD and Union, in their respective submissions on the OEB Staff plan, stated they preferred not to use hedges. Moreover, BOMA is not convinced that Union has the expertise to utilize derivatives in the allowance and credit markets, in part, because Union has not used the instruments in the natural gas market since 2006, and, in part, because the cap and trade market is very new, and very different from the natural gas market (see below for a discussion of the differences in the two markets). BOMA would prefer that Union not use derivatives in 2017 to allow their personnel to gain a better understanding of the secondary market. In the event the use of derivatives causes a ratepayer to pay more for allowances than they would have paid without the derivatives, the responsibility for that loss should be with Union.

Finally, since compliance with the Cap and Trade statute, regulation, and Director's decisions are Union's responsibility, Union should be responsible for losses or penalties resulting from its failure to comply with the Act ("compliance risk"), including the leak of confidential information. It would be wrong to pass through to ratepayers the amount of any fees, penalties, fines, compliance agreements, increased allowance requirements (including those set out in section 14 of the Act), or other consequences, of Union's non-compliance.

Further Execution Risk

Another important risk is execution risk. In BOMA's view, the best way to minimize this risk is to have the right people and processes in place in Union to plan, design and execute the Compliance Plan properly over the Compliance Period.

Union established a steering committee to guide the development of its cap and trade program.

Union's cap and trade organization has a Cap and Trade group, which consists of three people (B.BOMA.20;B.SEC.3), including the Manager of the group. However, Union has asked for thirteen and a half FTEs (12.5 plus the Manager) to manage the program; only two of the 12.5 FTEs report to the Manager of Cap and Trade. None of the three team members have had direct experience in a cap and trade regime. The remaining FTEs, while dedicated entirely to cap and trade-related work, are members of other departments, and have no reporting relationship to the Manager of the Cap and Trade group. The Director of Gas Supply has 25% of her time devoted to cap and trade.

Union's evidence is that the accountability for the Cap and Trade program will reside in Union's Gas Supply Department (Exhibit 3, p4). Union has essentially trained a group of its gas supply department employees in the cap and trade market through training consultants, and sending the employees to conferences. It has not hired any personnel directly from the cap and trade industry. It has made liberal use of consultants in the development of its Compliance Plan.

Union has requested substantial additional personnel (about twice the number of EGD), which seems excessive. Many of the 13.5 roles, set out at B.SEC.3, must have existed for some time, well before the development of the cap and trade program. Examples include at least some of

the 3.0 roles identified in Environment Health and Safety, Technologies and Innovation (personnel already in those roles in DSM, people responsible for existing work on RNG and gas in transport, and in Distribution Business Development. For example, Union must have people working on RNG as there was an OEB hearing on this subject two years ago. The staffing for the program includes six to seven people, two in each of Health and Safety, Distribution System, and Technology. On the other hand, Union should probably acquire two people with specific cap and trade expertise. It is not clear why Union requires twice the FTE complement and nearly twice the budget of EGD to do the same job.

Unlike EGD's submission, there is no discussion of how the steering committee will operate, merely a reference to three other committees dealing with risk.

In BOMA's view, Union lacks depth in its cap and trade department; it will be dependent on cooperation from many other departments, including persons with expertise in DSM, the most cost-effective customer abatement option.

Union has stated that it will leverage its natural gas procurement, storage, and trading expertise to ensure successful implementation of the Company's Cap and Trade Compliance Plan.

However, BOMA believes, and Union agrees, as does EGD, that the carbon market and gas market are two different markets (Transcript, Volume 3, p32). The Ontario Cap and Trade market is brand new, has very few, if any, truly successful precedents, was created by government relies on detailed statutory and regulatory guidelines, and includes substantial administrative discretion, on the part of the government in the form of MOECC, especially by the Director, a senior official appointed by the Minister and responsible directly to the Minister. There is a large government enforcement staff (inspectors, agents, and a vast array of penalties,

fines, prison terms, compliance orders, etc. to deal with offenders. In fact, the Compliance and Enforcement provisions constitute much of the Act. None of this is present in the natural gas wholesale market. In addition, section 6(2) of the Act provides that emission reduction targets can be increased by the Lieutenant Governor in Council (the "Cabinet"). The cap and trade scheme relies not only on allowance purchases but abatement investments across a wide spectrum of sectors, does not yet have a liquid secondary market for allowances or offsets, and is not reliant on the gas supply infrastructure. In many respects, at least in the view of some experts, cap and trade, both in Ontario and in California, is not a market at all, but a policy construct to raise money to fund government green programs (EGD Evidence: Exhibit C, Schedule 1, Appendix A, p5 of 54). On the other hand, the gas market is a broad and deep market, has existed in Ontario since the late 1980s, operates with minimal government interference, does not rely on abatement capital expenditures, has a very liquid (Dawn) trading hub in Ontario, and other hubs throughout North America, and a deep and liquid gas futures market in New York, which supports extensive derivative trading.

BOMA believes that while some of the Company's activities necessary to operate the market are similar to those deployed in the gas market, such as cost benefit analysis, procurement, trading, contracting, the substance of the two markets in which these tools are used, are very different (our emphasis).

BOMA, therefore, believes that Union overstates the leverage available from its natural gas experience to successfully implement its Cap and Trade Compliance Plans.

Unlike EGD, where the manager of the cap and trade team was previously responsible for the Company's successful DSM program, the manager of Union's cap and trade team has no recent

background in either cap and trade or DSM. For example, the manager seemed unaware of the impact of Ontario securities legislation on the Cap and Trade market (Transcript, Volume 3, p16).

BOMA is concerned that Union's carbon team may not yet have sufficient expertise in Cap and Trade to successfully implement Cap and Trade over the medium to longer term. 2017 is a somewhat atypical year, due to the lack of compliance options; compliance for 2017 is pretty much a matter of buying an appropriate number of allowances.

Issue 2

> *"Monitoring and Reporting – Are the proposed monitoring and reporting processes reasonable and appropriate?"*

BOMA contends that, in order for its proposed monitoring and reporting processes to be judged reasonable and appropriate, Union needs to disclose in those reports sufficient information about the costs of its abatement activities and offsets to allow the Board and intervenors to compare the cost of abatement activities relative to that year's allowance auction prices, which will be publicly available from MOECC reports on quarterly auction results, to judge prudency and whether changes are necessary to support continued cost recovery.

In its reply to BOMA.22, EGD stated that:

> *"(a) Enbridge is of the view that the annual monitoring reports may be a mixture of confidential information and commercially sensitive information which may be available to intervenors that are not market participants, through the Board's Practice Direction and Rules in respect of Confidential filings. For example, the Transaction Logs should remain auction confidential as per the Climate Change Act. However, the average weighted cost per compliance instrument may be an item that could be produced subject to confidential treatment by the Board under its Rules and Practice Direction given the commercial sensitivity of such*

> *information. As experience in the market grows, what should and should not be confidential at varying levels, may be better understood."*

BOMA is encouraged by the above comment that some effort will be made to provide at least some useful information to intervenors. The fact that the reporting stage is occurring after the end of the year being reported upon should mitigate adverse market consequences of the release of the weighted average cost of the various compliance instruments. BOMA also notes that the fact that the costs of DSM expenditures, including incremental or enhanced DSM expenditures, are in the public domain, and with some adjustment and analysis, can be compared with same year allowance costs. Given that, at least for the first compliance period, it is likely that the bulk of Union's allowance purchases will be at auction, the average costs of the small amount of secondary market purchases could also be disclosed without material harm to ratepayers. Given the heavily redacted compliance plans, due to the Board's confidentiality policy, it is especially important to have some disclosure in the monitoring reports. It also would be helpful if the Ministry would release the reports for the Green Investment Fund, and other GHG emission reduction programs, each year 2017 and 2018, as soon as possible after the end of the year in which the projects were executed.

BOMA asked Union whether it agreed with the EGD approach, but did not get a positive answer. BOMA concluded that Union was reluctant to support EGD's approach. In general, BOMA's conclusion from reading the two companies' applications, IR Responses and answers to cross-examination questions was that Union was more inclined to use the Board's confidentiality regime to shield its cap and trade activities from ratepayers' scrutiny, while EGD appeared to make a more genuine effort to achieve at least a modicum of transparency. BOMA would request Union to be more forthcoming in its 2018 submission. An example of Union's approach is found at B.BOMA.39(a) and (b). In both questions, BOMA was seeking a high level generic

response to explain what Union meant by execution risk and liquidity risk. Union could have easily answered the questions without compromising its negotiating positions, but simply brushed them off, with boilerplate language that stated "Climate Change Act outlines prohibition on the disclosure of certain information". It does, but the Act's prohibitions did not include the information that was asked for in the two questions.

BOMA assumes that the MOECC will provide the reports it receives from the utilities on the Green Fund Home Retrofit Program results public.

Longer Term Investments

BOMA distinguishes long-term investments from enhanced DSM, which, given Union's successful experience with its DSM program, represent an abatement option which can be implemented very soon to produce almost immediate results, and should be viewed as short-term to medium-term customer abatement options, as well as a longer term option. Union's evidence is that longer term initiatives, including long-term investment projects, will not produce emission reductions in 2017.

BOMA also supports Union's recognition of the need for better coordination of existing DSM initiatives among gas utilities, electric utilities, and the IESO, and to integrate DSM and cap and trade abatement. This is required to facilitate the enhanced and additional DSM measures as a cost-effective emission reduction tool, and to accelerate the deployment of these DSM projects. Union should commence work on that integration immediately. Union should outline the regulatory treatment it expects for enhanced and additional DSM work in its 2018 submission.

The Company's evidence is that prior to committing to long-term investments, the Company will need to clarify the regulatory treatment of such investments, including how it will earn a return on its capital expenditures.

Union has raised the issue of the need to clarify the methodology for cost recovery of longer term projects (B.Staff.14). BOMA suggests that Union make proposals on this matter in its 2018 Compliance Plan submission, including the nature of the projects, the financing of such projects, whether by ratepayers or government funding under the Greenhouse Gas Action Plan, whether Union will manage and deliver these investments, and how the utility should be compensated for its efforts.

New Business Activities

This issue is closely related to the topic of proposed longer term investments. Union's evidence about the extent to which its Cap and Trade Compliance Plan may involve new business activities, was limited for much the same reasons its evidence on long-term projects were limited. It said there were too many uncertainties. Union's evidence states adding new business activities will require an amendment to Order in Council 1540-2009, which provides an exception to the government's earlier blanket undertaking, which restricted the scope of utility activities. That evidence differs from EGD's evidence on the same point. BOMA supports EGD's view that the regulation permits the OEB to make exception to the regulation one activity at a time.

Moreover, in the Framework, the OEB has stated that it is prepared to consider applications for approval to undertake new business activities on a case-by-case basis, which is consistent with EGD's position.

In BOMA's view, Union should make a concerted effort to accelerate the development of those new business activities, because, like enhanced or new DSM, they are vital to enhance Cap and Trade-driven economic activity in the province, as opposed to simply purchasing allowance from another jurisdiction and over the medium to longer term, may well be more cost-effective than allowance prices as they inexorably increase. Purchasers of large amounts of currently "excess" allowances from California will not produce economic activity in Ontario, nor diversify the Compliance Plan and reduce the risk of a substantial increase in allowance prices driven by, inter alia, new legislation in California, or the absence of linkage. The abatement/allowance issue has already been raised in a jointly-prepared report on Quebec's cap and trade program by the Quebec Sustainable Development Commissioner and the Auditor General of Quebec – Carbon Market: Description and Issues, Spring 2016. The report was tabled in the National Assembly. The Board should, as soon as possible, in future compliance plan proceedings, or otherwise, receive submissions and make decision about the cost recovery mechanisms, including funding through rates or government programs akin to the Green Fund Home Energy Program, and other programs funded under the GHG Action Plan, in respect of each new proposed new business activity. The conversation needs to occur sooner rather than later.

Unaccounted for Gas ("UFG"); Forecasts; Facilities Related Emissions

Union's evidence is that it currently has a study underway to identify opportunities for facilities-related abatement initiatives. It should file the study when it becomes available.

However, Union's evidence also states that Union's UFG and Compressor Fuel Volume taken together comprise virtually all its facility emissions (Exhibit 2, p8 of 10; Table 1). BOMA assumes that, like EGD, ninety percent of Union UFG (like EGD's) is driven by different meters

in use and variability in meter readings between Union and its gas suppliers and EGD (I.1.EGDI.FRPO.3). However, Union's UFG is almost always a positive number, which appears to be inconsistent with that conclusion. UFG is, of course, a part of rate base. Union provides no evidence for its assertions. It should do so.

Finally, EGD's evidence is that over the period 2010 to 2013, UFG as a percentage of gas send-out has been 0.7%, compared to an average of 0.8% among the American Gas Association's 172 North American gas distribution members (I.1.EGDI.FRPO.2).

Union should provide its percentage of UFG of throughput, as EGD did. BOMA urges the Board to require Union to investigate the practices utilized by those utilities that have the lowest ratios, with a view to driving its UFG ratio down to a lower percentage (the most recent detailed study of UFG in evidence is an AGA study done in 2004, over ten years ago [EB-2011-0354, D2, T6, Sch 1, p11]). As a leading world class gas utility, Union should not be satisfied with being slightly better than average performers. In addition, the Ontario utilities should attempt to standardize their future meter makes in future procurements, and persuade TCLP to do the same.

Union has not proposed any measure to reduce its compressor fuel use. BOMA assumes compressor fuel efficiency will be covered in Union's study, and reported on in its 2018 filing.

Cost Recovery

> *"5.2 Are the tariffs just and reasonable and have the customer-related and facility-related charges been presented separately in the tariffs?"*

BOMA suggests the Board not make a finding as to whether Union's tariffs are just and reasonable, for several reasons. The Ontario Energy Board Act (the "Act") requires the Board to determine whether rates, not tariffs, are just and reasonable. Tariff is not a defined term in the

Ontario Energy Board Act and exactly what it includes is not entirely clear. For example, TransCanada has a Tariff Book, which includes a number of items other than the rates themselves, for example, pro forma contracts for each type of service.

EGD's evidence was that it likely referred to EGD's Rate Handbook, but was not definitive. EGD had requested the wording related to the reasonableness of tariffs be added to the draft issues list (Procedural Order No. 2). EGD's witness was not sure why the issue had been requested by EGD.

If EGD's reason for this section were to ensure that the level of the Cap and Trade "adder" is determined to be a just and reasonable rate, the Board already does that if and when it finds the delivery rates that include the "adder" to be just and reasonable.

BOMA did not examine Union witnesses on this matter.

Finally, a determination that the tariffs are just and reasonable is likely to cause confusion in the future.

Issue 4; Issue 5.1

> *"Deferral and Variance Accounts – Are the proposed deferral and variance accounts reasonable and appropriate? Is the disposition methodology appropriate?"*
>
> *"Is the proposed manner to recover costs reasonable and appropriate?"*

Union's proposals for its cap and trade deferral accounts are set out at Exhibit 6, pp1-2. Subject to Union's amendment of its evidence, provided at Transcript, Volume 2, p109, BOMA supports the timing of the clearance of the three new and existing cap and trade-related deferral variance accounts.

However, BOMA does not agree with the Union proposal to clear all contract rate customers through a one-time charge, regardless of the amount in the two deferral accounts, in particular, the customer-driven emissions unit deferral account. The Board should direct Union to wait until the 2017 yearend balance in the account is known before deciding whether to clear the account through a one-time charge or over a six month period. Commercial landlords have difficulty dealing with billing large billing adjustments with a retrospective affect, and prefer that any outstanding balance owed the utility be collected in a series of more modest future installments.

As noted above, the cost amounts to be charged to ratepayers will be subject to a prudency review, along with, and as part of the broader prudency review of 2017 Compliance Plan-related costs.

Issue 6 (see also Issue 5.1 – Cost Recovery)

> *"Implementation – What is the implementation date of the final rates and how will the final rates be implemented?"*

The Board-approved interim cap and trade charges effective January 1, 2017 (Early Determination EB-2015-0363).

In the Early Determination, the Board also directed that "charges related to the recovery of Cap and Trade program costs will be included in the Delivery Charge on the bill".

For rate-making purposes, Union did not include any administration or financing costs in the derivation of the Cap and Trade rates, and stated that such costs will be recovered through Union's new deferral accounts.

As noted above, the costs to be charged to ratepayers will be subject to a prudency review, along with and as part of the broader prudency review of 2017 Compliance Plan costs.

Board Directives

While BOMA appreciates the Board's efforts to focus the proceeding on the 2017 plan, given the fact that the 2017 Cap and Trade program is already underway, and the utilities did not have the time to address parts of the Framework in any depth, BOMA suggests the Board include in its decision in this proceeding, whatever guidance it can for the utilities' August 2018 filings, including specific matters that it would like the utilities to address. There are still three months remaining before the 2018 filing is due, and doubtless Union has been working on their 2018 plan over the previous few months. Such guidance could include:

- their proposed regulatory treatment of enhanced DSM as an abatement measure in 2018, 2019, and 2020, and the amount of their enhancements for 2018;
- the need for the utilities to produce analysis of DSM abatement costs relative to forecast allowance costs;
- the utilities' analysis of the impact of the linkage with California and Quebec on January 1, 2018, and the impact of a decision not to link, or delay linkage, for the Compliance Plan, for the remainder of the first compliance period, including the likely impact of no linkage on allowance prices;
- have the utilities spell out the regulatory treatment they require to advance other abatement projects, in particular the increased use of heat pumps;
- have Union and EGD propose and provide a detailed rationale for their preferred regulatory treatment of the long-term investments and OM&A activities to reduce GHG

emissions that they have been considering, including whether such activities (long-term investments, OM&A, or new business activities) should be part of the regulated utility, in a separate legal entity, or in the unregulated part of the utility, and how Union should be involved in the government's GHG reduction programs.

All of which is respectfully submitted, this 18th day of May, 2017.

Tom Brett,
Counsel for BOMA

ATTACHMENT 1

AMENDED IN SENATE MAY 1, 2017

SENATE BILL **No. 775**

Introduced by Senator Wieckowski

February 17, 2017

~~An act to amend Section 38564 of the Health and Safety Code, relating to greenhouse gases.~~ *An act to amend Section 12894 of, and to add Section 16428.87 to, the Government Code, and to amend Section 38505 of, to add Section 38574.5 to, and to add Part 5.5 (commencing with Section 38575) and Part 5.6 (commencing with Section 38577) to Division 25.5 of, the Health and Safety Code, relating to greenhouse gases, and declaring the urgency thereof, to take effect immediately.*

LEGISLATIVE COUNSEL'S DIGEST

SB 775, as amended, Wieckowski. ~~California Global Warming Solutions Act of 2006: greenhouse gas emissions reduction.~~ *California Global Warming Solutions Act of 2006: market-based compliance mechanisms.*

(1) The California Global Warming Solutions Act of 2006 designates the State Air Resources Board as the state agency charged with monitoring and regulating sources of emissions of greenhouse gases. The act authorizes the state board to include use of market-based compliance mechanisms. Existing law prohibits a state agency from linking a market-based compliance mechanism with any other state, province, or country unless the state agency notifies the Governor. Existing law requires the Governor to issue specified findings within 45 days of receiving that notice from a state agency and to provide those findings to the Legislature.

This bill would add to the findings required to be issued by the Governor and provided to the Legislature in those circumstances.

(2) The California Global Warming Solutions Act of 2006 requires the state board to approve a statewide greenhouse gas emissions limit equivalent to the statewide greenhouse gas emissions level in 1990 to be achieved by 2020 and to ensure that statewide greenhouse gas emissions are reduced to at least 40% below the 1990 level by 2030.

This bill would require the state board to adopt a regulation establishing as a market-based compliance mechanism a market-based program of emissions limits, applicable on and after January 1, 2021, for covered entities, as defined. The bill would require the program to set an initial minimum reserve price of $20 per allowance, as defined, and an initial auction offer price of $30 per allowance when auctioning allowances. The bill would require the program to increase the minimum reserve price each quarter by $1.25 plus any increase in the Consumer Price Index, and the auction offer price each quarter by $2.50 plus any increase in the Consumer Price Index, as specified. The bill would authorize the state board to revise the definition of a covered entity, as specified.

The bill would establish the Economic Competitive Assurance Program, to be administered by the state board, to ensure that importers that sell, supply, or offer for sale in the state a greenhouse gas emission intensive product have economically fair and competitive conditions and to maintain economic parity between producers that are subject to the market-based program of emissions limits and those who sell like goods instate that are not subject to that program, as specified.

This bill would establish the California Climate Infrastructure Fund, the California Climate Dividend Fund, and the California Climate and Clean Energy Research Fund in the State Treasury. The bill would require the Franchise Tax Board, in consultation with the Climate Dividend Access Board, which the bill would establish, to develop and implement a program to deliver quarterly per capita dividends to all residents of the state that would maximize the ease with which residents of the state may enroll in the program, as specified.

(3) This bill would declare that it is to take effect immediately as an urgency statute.

~~The California Global Warming Solutions Act of 2006 designates the State Air Resources Board as the state agency charged with monitoring and regulating sources of emissions of greenhouse gases. The act requires the state board to consult with other states, the federal government, and other nations to identify the most effective strategies and methods to reduce greenhouse gases, manage greenhouse gas control~~

~~programs, and facilitate the development of integrated and cost-effective regional, national, and international greenhouse gas reduction programs.~~

~~This bill would require the state board also to consult with local agencies for these purposes.~~

Vote: ~~majority~~ $^2/_3$. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 12894 of the Government Code is amended to read:

12894. (a) (1) The Legislature finds and declares that the establishment of nongovernmental entities, such as the Western Climate Initiative, Incorporated, and linkages with other states and countries by the State Air Resources Board or other state agencies for the purposes of implementing ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code,~~ *Code)* should be done transparently and should be independently reviewed by the Attorney General for consistency with all applicable laws.

(2) The purpose of this section is to establish new oversight and transparency over any such linkages and related activities undertaken in relation to ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code~~ *Code)* by the executive agencies ~~in order~~ to ensure consistency with applicable laws.

(b) (1) The California membership of the board of directors of the Western Climate Initiative, Incorporated, shall be modified as follows:

(A) One appointee or his or her designee who shall serve as an ex officio nonvoting member shall be appointed by the Senate Committee on Rules.

(B) One appointee or his or her designee who shall serve as an ex officio nonvoting member shall be appointed by the Speaker of the Assembly.

(C) The ~~Chairperson~~ *Chair* of the State Air Resources Board or her or his designee.

(D) The Secretary for Environmental Protection or his or her designee.

(2) ~~Sections 11120 through 11132 do~~ *The Bagley-Keene Open Meeting Act (Article 9 (commencing with Section 11120) of Chapter 1 of Part 1) does* not apply to the Western Climate Initiative, Incorporated, or to appointees specified in subparagraphs (C) and (D) of paragraph (1) when performing their duties under this section.

(c) The State Air Resources Board shall provide notice to the Joint Legislative Budget Committee, consistent with that required for Department of Finance augmentation or reduction authorizations pursuant to subdivision (e) of Section 28.00 of the annual Budget Act, of any funds over one hundred fifty thousand dollars ($150,000) provided to the Western Climate Initiative, Incorporated, or its derivatives or subcontractors no later than 30 days prior to transfer or expenditure of these funds.

(d) The ~~Chairperson~~ *Chair* of the State Air Resources Board and the Secretary for Environmental Protection, as the California voting representatives on the Western Climate Initiative, Incorporated, shall report every six months to the Joint Legislative Budget Committee on any actions proposed by the Western Climate Initiative, Incorporated, that affect California state government or entities located within the state.

(e) For purposes of this section, "link," "linkage," or "linking" means an action taken by the State Air Resources Board or any other state agency that will result in acceptance by the State of California of compliance instruments issued by any other governmental agency, including any state, province, or country, for purposes of demonstrating compliance with the market-based compliance mechanism established pursuant to ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code~~ *Code)* and specified in Sections 95801 to 96022, inclusive, of Title 17 of the California Code of Regulations.

(f) A state agency, including, but not limited to, the State Air Resources Board, shall not link a market-based compliance mechanism established pursuant to ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code~~ *Code)* and specified in Sections 95801 to 96022, inclusive, of Title 17 of the California Code of Regulations with any other state, province, or country unless the state agency notifies the Governor that the agency

intends to take such action and the Governor, acting in his or her independent capacity, makes all of the following findings:

(1) The jurisdiction with which the state agency proposes to link has adopted program requirements for greenhouse gas reductions, including, but not limited to, requirements for offsets, that are equivalent to or stricter than those required by ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code.~~ *Code).*

(2) Under the proposed linkage, the State of California is able to enforce ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code~~ *Code)* and related statutes, against any entity subject to regulation under those statutes, and against any entity located within the linking jurisdiction to the maximum extent permitted under the United States and California Constitutions.

(3) The proposed linkage provides for enforcement of applicable laws by the state agency or by the linking jurisdiction of program requirements that are equivalent to or stricter than those required by ~~Division~~ *the California Global Warming Solutions Act of 2006 (Division* 25.5 (commencing with Section 38500) of the Health and Safety ~~Code.~~ *Code).*

(4) The proposed linkage and any related participation of the State of California in Western Climate Initiative, Incorporated, shall not impose any significant liability on the state or any state agency for any failure associated with the linkage.

(5) The jurisdiction with which the state agency proposes to link has adopted legally binding program requirements for greenhouse gases that include minimum carbon prices, including auction reserve prices, that are equivalent to or greater than those required by the California Global Warming Solutions Act of 2006 (Division 25.5 (commencing with Section 38500) of the Health and Safety Code).

(6) The prospective link does not threaten the uninterrupted performance and purpose of the California Climate Dividend Program, established by Part 5.6 (commencing with Section 38577) of Division 25.5 of the Health and Safety Code, with a finding made in consultation with the Franchise Tax Board.

(g) The Governor shall issue findings pursuant to subdivision (f) within 45 days of receiving a notice from a state agency, and

shall provide those findings to the Legislature. The findings shall consider the advice of the Attorney General. The findings to be submitted to the Legislature shall not be unreasonably withheld. The findings shall not be subject to judicial review.

SEC. 2. Section 16428.87 is added to the Government Code, to read:

16428.87. (a) The California Climate Infrastructure Fund is hereby created in the State Treasury.

(b) The California Climate Dividend Fund is hereby created in the State Treasury. Moneys in the fund shall be allocated, upon appropriation, pursuant to Part 5.6 (commencing with Section 38577) of Division 25.5 of the Health and Safety Code.

(c) The California Climate and Clean Energy Research Fund is hereby created in the State Treasury.

SEC. 3. Section 38505 of the Health and Safety Code is amended to read:

38505. For ~~the~~ purposes of this division, the following terms have the following meanings:

(a) "Allowance" means an authorization to emit, during a specified year, up to one ton of carbon dioxide equivalent.

(b) "Alternative compliance mechanism" means an action undertaken by a greenhouse gas emission source that achieves the equivalent reduction of greenhouse gas emissions over the same time period as a direct emission reduction, and that is approved by the state board. "Alternative compliance mechanism" includes, but is not limited to, a flexible compliance schedule, alternative control technology, a process change, or a product substitution.

(c) *(1)* "Carbon dioxide equivalent" means the amount of carbon dioxide by ~~weight~~ *mass* that would produce the same global warming impact as a given ~~weight~~ *mass* of another greenhouse ~~gas, based on the best available science, including from the Intergovernmental Panel on Climate Change.~~ *gas over a specified time horizon.*

(2) In calculating the carbon dioxide equivalent of any greenhouse gas emission pursuant to this subdivision, the state board shall use the best available scientific information, including the most recent findings from the Intergovernmental Panel on Climate Change. Where other jurisdictions use different methods for calculating the carbon dioxide equivalent of any greenhouse gas emissions, the state board may in parallel report carbon

dioxide equivalents using these alternative methods, but the state board shall not use the existence of alternative methods in other jurisdictions as a basis for selecting methods other than the best available scientific information, including the most recent findings from the Intergovernmental Panel on Climate Change, for regulations developed pursuant to this division. The state board shall select consistent methods in calculating carbon dioxide equivalents across all regulations developed pursuant to this division.

(d) "Cost-effective" or "cost-effectiveness" means the cost per unit of reduced emissions of greenhouse gases adjusted for its global warming potential.

(e) "Direct emission reduction" means a greenhouse gas emission reduction action made by a greenhouse gas emission source at that source.

(f) "Emissions reduction measure" means programs, measures, standards, and alternative compliance mechanisms authorized pursuant to this division, applicable to sources or categories of sources, that are designed to reduce emissions of greenhouse gases.

(g) "Greenhouse gas" or "greenhouse gases" includes all of the following gases:

(1) Carbon dioxide.

(2) Methane.

(3) Nitrous oxide.

(4) Hydrofluorocarbons.

(5) Perfluorocarbons.

(6) Sulfur hexafluoride.

(7) Nitrogen trifluoride.

(h) "Greenhouse gas emissions limit" means an authorization, during a specified year, to emit up to a level of greenhouse gases specified by the state board, expressed in tons of carbon dioxide equivalents.

(i) "Greenhouse gas emission source" or "source" means any source, or category of sources, of greenhouse gas emissions whose emissions are at a level of significance, as determined by the state board, that its participation in the program established under this division will enable the state board to effectively reduce greenhouse gas emissions and monitor compliance with the statewide greenhouse gas emissions limit.

(j) "Leakage" means a reduction in emissions of greenhouse gases within the state that is offset by an increase in emissions of greenhouse gases outside the state.

(k) "Market-based compliance mechanism" means either of the following:

(1) A system of market-based declining annual aggregate emissions limitations for sources or categories of sources that emit greenhouse gases.

(2) Greenhouse gas emissions exchanges, banking, credits, and other transactions, governed by rules and protocols established by the state board, that result in the same greenhouse gas emission reduction, over the same time period, as direct compliance with a greenhouse gas emission limit or ~~emission~~ *emissions* reduction measure adopted by the state board pursuant to this division.

(*l*) "State board" means the State Air Resources Board.

(m) "Statewide greenhouse gas emissions" means the total annual emissions of greenhouse gases in the state, including all emissions of greenhouse gases from the generation of electricity delivered to and consumed in California, accounting for transmission and distribution line losses, whether the electricity is generated in state or imported. Statewide emissions shall be expressed in tons of carbon dioxide equivalents.

(n) "Statewide greenhouse gas emissions limit" or "statewide emissions limit" means the maximum allowable level of statewide greenhouse gas emissions in 2020, as determined by the state board pursuant to Part 3 (commencing with Section 38550).

SEC. 4. Section 38574.5 is added to the Health and Safety Code, to read:

38574.5. (a) For purposes of this section, the following terms have the following meanings:

(1) "Allowance" means a tradeable compliance instrument that is equal to one metric ton of carbon dioxide equivalent and is issued by the state board as part of the regulation adopted pursuant to this section or is issued by the appropriate governing body of an external market-based compliance mechanism to which the program established pursuant to this section has been linked pursuant to Section 12894 of the Government Code.

(2) "Annual compliance event" means an annual process to demonstrate compliance with the program established pursuant to this section in which covered entities submit allowances to the

state board equal to a minimum specified proportion of their verified emissions of greenhouse gases for the prior year, as reported to the state board pursuant to Section 38530.

(3) "Carbon offset credits" means credits awarded to projects or programs for voluntary greenhouse gas emissions reductions that occur outside of the scope of covered entities' greenhouse gas emissions, including all credits issued by the state board pursuant to Section 38562.

(4) "Consumer Price Index" means the California Consumer Price Index, All Urban Consumers, published by the Department of Industrial Relations.

(5) "Covered entity" means a source of emissions of greenhouse gases that is within a source category that is subject to compliance obligations pursuant to subdivision (c) of Section 38562 as of January 1, 2017. For a new source of emissions of greenhouse gases commencing operation after January 1, 2017, "covered entity" means a source that would have been within a source category subject to compliance obligations under subdivision (c) of Section 38562 if it had began emitting greenhouse gases on or before January 1, 2017. If, after January 1, 2018, the state board determines that a future adjustment to the definition of "covered entity" is warranted, the adjustment shall result in at least an equal percentage of statewide greenhouse gas emissions remaining subject to the program established pursuant to this section as if the initial definition of "covered entity" developed under this subdivision were to apply.

(6) "Covered imported product" has the some meaning as in Section 38575.

(b) The state board shall adopt a regulation establishing as a compliance mechanism program of market-based emissions limits, applicable on and after January 1, 2021, to covered entities. The regulation shall do all of the following:

(1) Set annual aggregate emissions limits for greenhouse gas emissions from covered entities that the state board determines in conjunction with other policies applicable to statewide greenhouse gas emissions are sufficient to ensure the emissions target specified in Section 38566.

(2) Require, beginning January 1, 2021, the state board to conduct quarterly allowance auctions that are open to participation from covered entities, importers or sellers of covered imported

products, and any other participants who register with the state board for the purposes of participating in quarterly allowance auctions.

(3) Offer at each auction a number of allowances equal to the auction's quarterly share of the annual aggregate emissions limit established in paragraph (1).

(4) Require a covered entity to submit allowances equal to at least 90 percent of its annual carbon dioxide equivalent emissions at each annual compliance event, with the option to submit additional allowances without penalty to account for the remainder of its annual emissions, if any, at the subsequent year's annual compliance event. The state board shall determine the timing of the annual compliance event taking into account the availability of covered entities' verified emissions data as reported to the state board pursuant to Section 38530.

(5) Require that all allowances created pursuant to this section be offered for sale at auction and not allocated to covered entities either for free or for consignment sale, unless subsequent events trigger the creation of a free allowance allocation program pursuant to Section 38575.

(6) Require an initial minimum auction reserve price equal to twenty dollars ($20) per allowance. The state board shall not auction allowances to bidders at a price less than the currently applicable auction reserve price.

(7) Require an initial auction offer price equal to thirty dollars ($30) per allowance. At each auction, the state board shall make an unlimited number of allowances available at the currently applicable auction offer price.

(8) Require, beginning April 1, 2022, a quarterly increase in the auction reserve price on April 1, July 1, October 1, and January 1 of each year equal to one dollar and twenty-five cents ($1.25) plus a quarterly share of the percentage, if any, by which the Consumer Price Index increased for the preceding calendar year.

(9) Require, beginning April 1, 2021, a quarterly increase in the auction offer price on April 1, July 1, October 1, and January 1 of each year equal to two dollars and fifty cents ($2.50) plus a quarterly share of the percentage, if any, by which the Consumer Price Index increased for the preceding calendar year.

(10) Require allowances to be valid for compliance purposes only in the calendar year in which they are introduced into

circulation by the state board or for covering any remaining compliance obligations from the prior year pursuant to paragraph (4).

(11) Prohibit carbon offset credits from being used to meet a covered entity's compliance obligation required pursuant to paragraph (4).

(12) Prohibit an allowance or any other compliance instrument issued pursuant to a regulation adopted pursuant to Section 38562 from being used to meet a covered entity's compliance obligation required pursuant to paragraph (4).

(13) Prohibit compliance instruments issued by external market-based compliance mechanisms that have been linked pursuant to Section 12894 of the Government Code to a regulation adopted pursuant to Section 38562 from being used to meet a covered entity's compliance obligation required pursuant to paragraph (4).

(14) Allow for the use of compliance instruments issued by external market-based compliance mechanisms that have been linked pursuant to Section 12894 of the Government Code to the program established pursuant to this section to satisfy a covered entity's compliance obligation required pursuant to paragraph (4).

(c) All moneys collected pursuant to this section shall be deposited in the California Climate Dividend Fund, the California Climate and Clean Energy Research Fund, and the California Climate Infrastructure Fund, which are all created pursuant to Section 16428.87 of the Government Code, as follows:

(1) The first ____ per year shall be deposited into the California Climate and Clean Energy Research Fund.

(2) The next ____ per year shall be deposited into the California Climate Dividend Fund.

(3) All other remaining moneys shall be deposited into the California Climate Infrastructure Fund.

(d) On a quarterly and annual basis, the state board shall determine the net amount of moneys collected from covered entities pursuant to this section and Part 5.5 (commencing with Section 38575).

(e) (1) The state board, in consultation with the Franchise Tax Board, shall prepare an annual report summarizing the collection and disposition of all moneys collected pursuant to this section

and Part 5.5 (commencing with Section 38575). The state board shall make the report publicly available by posting the report on its Internet Web site.

(2) In addition to any other reporting requested by the Joint Legislative Committee on Climate Change Policies, the state board shall provide quarterly summary statistics of the moneys collected pursuant to this section and Part 5.5 (commencing with Section 38575) and make that summary publicly available by posting the summary on its Internet Web site.

(f) The state board, in consultation with the Franchise Tax Board, shall project and analyze the expected emissions of greenhouse gases and future revenue collection, taking into account uncertainty over future economic growth, energy consumption, and other relevant factors that affect the emissions of greenhouse gases. The projections shall include at least one-year and five-year emissions of greenhouse gases and revenue outlooks and shall be included in the annual report required pursuant to paragraph (1) of subdivision (e).

(g) In administering the collection and disposition of the moneys collected pursuant to this section and Part 5.5 (commencing with Section 38575), the state board and the Franchise Tax Board shall use conservative accounting management practices to maintain sufficient reserves in each of the funds established pursuant to Section 16428.87 of the Government Code. The appropriate accounting management practices may include reasonable projections determined on an annual basis of expected revenue collection to achieve the money collection and disposition requirements of this section, Part 5.5 (commencing with Section 38575), and Part 5.6 (commencing with Section 38577).

SEC. 5. Part 5.5 (commencing with Section 38575) is added to Division 25.5 of the Health and Safety Code, to read:

PART 5.5. ECONOMIC COMPETITIVENESS ASSURANCE PROGRAM

38575. (a) For purposes of this part, the following terms have the following meanings:

(1) "Allowance" has the same meaning as set forth in Section 38574.5.

(2) "Annual compliance event" has the same meaning as set forth in Section 38574.5.

(3) "Covered entity" has the same meaning as set forth in Section 38574.5.

(4) "Covered imported product" means a product or category of imported product that the state board has determined, after an evaluation of relevant market prices and associated lifecycle greenhouse gas emissions to exhibit a material price difference.

(5) (A) "Material price difference" means a substantial difference in the price of a covered imported product or prospective covered imported product that arises solely as a result of whether or not a substantial component of the product's lifecycle greenhouse gas emissions is not subject to the program established pursuant to Section 38574.5.

(B) In determining whether a material price difference exists, the state board shall consider only the economic consequences of the program established pursuant to Section 38574.5 and not other factors that are merely coincident with the program. The state board, at its discretion and based upon the availability of sufficient data, may evaluate whether a material price difference exists with respect to the retail or wholesale prices of the product.

(b) The Economic Competitiveness Assurance Program is hereby established, to be administered by the state board to ensure that importers that sell, supply, or offer for sale in the state a greenhouse gas emission intensive product have economically fair and competitive conditions. The purpose of the Economic Competitiveness Assurance Program is to maintain economic parity between producers, the prices of whose goods are materially impacted by the implementation of the program established pursuant to Section 38574.5, and those who sell like goods instate that are not subject to the program established pursuant to Section 38574.5. The state board shall adopt a regulation implementing this part that does all of the following:

(1) Applies to all covered imported products.

(2) Establishes a process for evaluating the prices and greenhouse gas emission intensities of major categories of products manufactured, sold, or consumed in the state. The state board shall use its expert discretion, emissions inventory data, state economic and trade data, and any other supplemental data sources necessary

to conduct a thorough analysis of the flow of greenhouse gas emission intensive products through the state economy.

(3) Establishes, and periodically updates, a list, based on analysis conducted pursuant to paragraph (2), of covered imported products and their associated greenhouse gas emissions intensities. The list shall include estimates of the lifecycle greenhouse gas emissions of covered imported products that the state board calculates by product type, production process, or any other aggregated category that the state board deems relevant, with lifecycle greenhouse gas emissions reported on a per product unit basis at the aggregated category level for each covered imported product.

(4) Creates a process for private parties involved in the sale of greenhouse gas emission intensive products manufactured instate to petition the state board to have a product listed as a covered imported product as a result of a material price difference. The state board shall evaluate private party petitions using consistent criteria for establishing the presence of a material price difference. The state board may prioritize the order in which it addresses the petitions according to reasonable factors, including the relative quantity of potentially affected greenhouse gas emissions and the relative impact of any economic disparities petitioners claim are created by the program established pursuant to Section 38574.5. To the maximum extent practicable, the state board shall be consistent across the evaluation of private party petitions and between the evaluation of private petitions and the state board's own determinations of covered imported products pursuant to paragraph (3).

(5) Creates a process for removing a covered imported product from the list of covered imported products created pursuant to paragraph (3) if at any time the state board concludes the program adopted pursuant to Section 38574.5 does not result in a material price difference for a listed product or covered imported product.

(6) Imposes an obligation on any person who sells, supplies, or offers for sale instate a covered imported product to surrender allowances equal to the lifecycle greenhouse gas emissions associated with each covered imported product sold or supplied for consumption in the state and that would have been subject to the program established pursuant to Section 38574.5 if the product had been manufactured instate. The person shall submit to the

state board allowances equal to at least 70 percent of the annual lifecycle greenhouse gas emissions obligated under this paragraph at the time of the annual compliance event established pursuant to Section 38574.5, with an option to submit additional allowances without penalty to account for the remainder, if any, at the subsequent year's annual compliance event. The obligation to surrender allowances established by this paragraph does not apply to individual products for which covered entities face compliance obligations for all substantial components of the covered imported product's lifecycle greenhouse gas emissions. If one or more covered entities are subject to compliance obligations for one or more substantial components, but not all substantial components, of the covered imported product's lifecycle greenhouse gas emissions, the state board, to the maximum extent practicable, shall reduce the obligation imposed by this paragraph on importers of those covered imported products to account only for the proportion of total lifecycle greenhouse gas emissions for which covered entities do not already face compliance obligations.

(7) Develops, to the maximum extent practicable, a process to exempt covered entities from the obligation to surrender allowances pursuant to Section 38574.5 for the production of covered imported products for which a covered entity faces a compliance obligation for a substantial component of the lifecycle greenhouse gas emissions of a covered imported product that is exported for final sale outside of the state or, at the state board's discretion, to instead develop a process for returning or issuing to covered entities the same number of valid allowances that the covered entity submitted to the state board to account for a substantial component of the lifecycle greenhouse gas emissions from covered imported products that are exported for final sale outside the state.

(8) Reduces, to the maximum extent practicable, the obligation to surrender allowances at the annual compliance event pursuant to paragraph (6) to account for any legally binding carbon pricing policies that apply in the place of origin of a covered imported product. For the purposes of this paragraph, carbon pricing policies may include carbon fees, carbon taxes, emissions limits programs, and other market-based compliance mechanisms that impose an explicit cost on greenhouse gas emissions. If a carbon pricing policy exists in the place or places of origin of a covered

imported product, but that policy does not impose carbon prices that are equivalent to those resulting from the program established pursuant to Section 38574.5, the state board shall use reasonable methods to account for the adjustments specified in this paragraph on a partial basis that reflect the difference between carbon pricing policies across applicable jurisdictions to the lifecycle greenhouse gas emissions of the covered imported product.

(9) Creates a process for a manufacturer or importer of a covered imported product to petition for an entity-specific lifecycle greenhouse gas emissions factor if it can provide credible documentation supporting the claim.

(10) Creates, if at any time a judicial opinion, settlement, or other legally binding decision reduces or eliminates the state board's authority to implement the Economic Competitiveness Assurance Program, a system that freely allocates allowances to the manufacturers subject to Section 38574.5 whose products the state board is no longer able to include as covered imported products in the Economic Competitiveness Assurance Program. The free allowance program is subject to all of the following:

(A) The purpose of a free allowance allocation pursuant to this paragraph is to maintain economic parity between producers of greenhouse gas intensive goods that are subject to Section 38574.5 and those who produce or sell similar products that are not.

(B) The state board shall design, to the extent feasible and subject to other conditions in this paragraph, a free allowance allocation program to treat manufacturers of greenhouse gas intensive goods that are subject to Section 38574.5 on an equal basis with respect to producers and sellers of similar goods that are not.

(C) The state board shall allocate any free allowances to covered entities according to a formula that accounts for the volumetric output of greenhouse gas intensive products produced, the greenhouse gas intensity of the product, the lifecycle greenhouse gas emissions of the average and best performing manufacturers instate, the impact of free allocation on the dividend distributed pursuant to subdivision (c) of Section 38577.2, and any other factors the state board finds appropriate.

(D) The state board, subject to the limited authority to allocate free allowances pursuant to this paragraph, shall require that the process for considering and prioritizing the eligibility of product

categories to receive free allowances be governed by the decisionmaking criteria and process provisions of this section.

(c) All moneys collected pursuant to this part shall be deposited in the California Climate Dividend Fund, created pursuant to Section 16428.87 of the Government Code.

SEC. 6. Part 5.6 (commencing with Section 38577) is added to Division 25.5 of the Health and Safety Code, to read:

PART 5.6. FUNDS

38577. For purposes of this part, "covered entity" has the same meaning as set forth in Section 38574.5.

38577.2. (a) The California Climate Dividend Program is hereby established to be administered by the Franchise Tax Board for allocation of the moneys in the California Climate Dividend Fund, created pursuant to Section 16428.87 of the Government Code, in the form dividends to all residents of the state on a per capita basis pursuant to subdivision (c) for the public purpose of mitigating the costs of transitioning to a low-carbon economy.

(b) (1) The Climate Dividend Access Board is hereby established and shall consist of six representatives with at least one member from each of the following groups:

(A) Nonprofit organizations working in the area of environmental justice.

(B) Nonprofit organizations working in the area of immigration reform.

(C) Nonprofit or government organizations providing direct social services to low-income or homeless communities.

(D) Organizations providing financial services and assistance to unbanked and underbanked communities.

(2) (A) The Senate Committee on Rules shall appoint two members.

(B) The Speaker of the Assembly shall appoint two members.

(C) The Governor shall appoint two members.

(3) The Climate Dividend Access Board shall conduct periodic public workshops and make recommendations to the Franchise Tax Board on how to effectively and safely distribute climate dividends to residents of communities in the state that are difficult to reach, including, but not limited to, homeless, unbanked, underbanked, and undocumented residents.

(4) The Climate Dividend Access Board, in making recommendations to the Franchise Tax Board pursuant to paragraph (3), shall consider methods to minimize the cost both to the state and to residents of alternative climate dividend distribution methods, with the goal of maximizing the degree to which climate dividend moneys benefit residents.

(c) (1) The Franchise Tax Board, in consultation with the Climate Dividend Access Board convened pursuant to subdivision (b), shall develop and implement a program to deliver quarterly per capita dividends to all residents and shall maximize the ease with which residents may enroll in the program. The program may include the automatic enrollment of residents who have filed a state income tax return in the prior year. The program shall provide per capita dividends on a quarterly basis unless the Franchise Tax Board, in consultation with the Climate Dividend Access Board, makes a finding that a quarterly dividend is impracticable for any particular category of residents. The Franchise Tax Board may determine an appropriate frequency of dividends provided to a category of residents of not less than at least once per year.

(2) If the Franchise Tax Board determines, after consultation with the Climate Dividend Access Board, that it cannot create a workable mechanism to distribute dividends to categories of residents, the Franchise Tax Board, in consultation with the Climate Access Dividend Board, may allocate dividends for those residents to nonprofit organizations providing direct services to those residents.

(3) In determining the per capita refund amount, the Franchise Tax Board shall employ reasonable estimates of expected carbon revenue collection and the projected number of residents, setting aside reasonable reserve margins from period to period to ensure that the per capita refund does not deplete available moneys in the California Climate Dividend Fund.

38577.4. All revenues generated pursuant to Section 38574.5 and Part 5.5 (commencing with Section 38575) constitute state funds for the purposes of the False Claims Act (Article 9 (commencing with Section 12650) of Chapter 6 of Part 2 of Division 3 of Title 2 of the Government Code).

38577.6. This part does not affect the implementation of any other requirements of this division, including regulations developed pursuant to Part 5 (commencing with Section 38570).

SEC. 7. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the California Constitution and shall go into immediate effect. The facts constituting the necessity are:

It is necessary to provide for the reauthorization, extension, and reform of the state's cap and trade program implemented pursuant to Part 5 (commencing with Section 38570) of Division 25.5 of the Health and Safety Code to provide certainty in the marketplace and to reduce the emissions of greenhouse gases in furtherance of achieving the statewide greenhouse gas emission target specified in Section 38566 of the Health and Safety Code at the earliest possible date.

~~SECTION 1. Section 38564 of the Health and Safety Code is amended to read:~~

~~38564. The state board shall consult with local agencies, other states, the federal government, and other nations to identify the most effective strategies and methods to reduce greenhouse gases, manage greenhouse gas control programs, and facilitate the development of integrated and cost-effective regional, national, and international greenhouse gas reduction programs.~~

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