EB-2016-0296
EB-2016-0300

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, as amended (the "**Act**");

AND IN THE MATTER OF applications by Union Gas Limited and Enbridge Gas Distribution Inc. for approval of the cost consequences of cap and trade compliance plans.

WRITTEN SUBMISSIONS OF THE INDEPENDENT ELECTRICITY SYSTEM OPERATOR (IESO)

Introduction

1. On November 15, 2016, Union Gas Limited ("**Union**") and Enbridge Gas Distribution Inc. ("**Enbridge**") filed their 2017 Cap and Trade Compliance Plans (the "**Plans**") with the Ontario Energy Board (the "**Board**"), seeking approval of the cost consequences to them arising from each of their Plans. The Board determined that it would hear the applications in a combined proceeding.

2. On February 17, 2017, the Board issued its decision on the Issues List in this proceeding. The IESO's interest in this proceeding is restricted to the Board's determination of Issue 4 on the Issues List, which states:

> **4. Deferral and Variance Accounts** – Are the proposed deferral and variance accounts reasonable and appropriate? Is the disposition methodology appropriate?

3. With respect to the first part of Issue 4, the IESO has no concerns with the Union and Enbridge proposals to establish deferral and variance accounts ("**DVAs**") currently before the Board. More specifically, the IESO is supportive of:

(a) Union's proposal to establish two separate DVAs to track their customer-related compliance costs ("**Acct 179-154**") and their facility-related compliance costs ("**Acct 179-155**"), respectively; and,

(b) Enbridge's proposal to establish a single DVA (the "**GGECFCVA**") to track both costs, provided that Enbridge apportions the amounts collected between customer-related costs and facility-related costs.[1]

(collectively, Acct 179-154, Acct 179-155 and the GGECFCVA are referred to herein as the "**GHG DVA(s)**"; any reference to a generic deferral and variance account shall be referred to as a DVA)

4. With respect to the second part of Issue 4, the IESO is not supportive of the proposed methodologies to dispose of the GHG DVA balances as a one-time adjustment, based on actual historic usage. Clearing the GHG DVA balances in this manner would adversely impact the province's electricity markets, as explained in more detail below.

5. The IESO is also not supportive of delaying a determination on the appropriate GHG DVA disposition methodology until late 2018 (when the GHG DVAs would first come before the Board for disposition). Such a delay would create unnecessary cost uncertainty and adversely impact the province's electricity markets, as explained in more detail below. Such a delay would also adversely impact the IESO's current process to amend certain of its energy supply contracts ("**IESO Contracts**") with gas-fired generators, occasioned by the enactment of

[1] As confirmed in Enbridge's evidence at Exhibit F, Tab 1, Schedule 1, page 2.

the province's new cap-and-trade ("**C&T**") regime.[2] This, too, would adversely impact the province's electricity markets.

Enbridge's Position and Evidence

6. In its response to an interrogatory from Board Staff about Enbridge's proposed disposition of its GGECFCVA balance, Enbridge stated:

> [T]he 2017 GGECFCVA balance would be cleared as a **one-time credit or debit** and would be administered to customers as a one-time billing adjustment (note that the 2017 GGECFCVA balance would be apportioned between customer-related and facility-related obligations. The amount of credit or debit each customer would be allocated would be a function of the total 2017 GGECFCVA balance, each customer's responsibility for customer and facility-related costs, and **each customer's 2017 actual volumes**). The one-time adjustment would appear as a separate line item on customer's bills.[3] (emphasis added)

7. While Enbridge's current plan is to clear the GGECFCVA via a one-time adjustment, Enbridge is also seeking flexibility to depart from this approach, as noted in the same interrogatory response:

> [I]f the one-time billing adjustment is considered too large to be administered in a single installment, the Company would propose to clear the balance over multiple installments (i.e., over multiple months).

8. On cross-examination, the Enbridge witness panel confirmed that a one-time adjustment may not be the most appropriate methodology for disposing of the balance in the GGECFCVA.[4]

9. The Enbridge witness panel also confirmed the following:

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2 It is the IESO's position that certain of the IESO Contracts require amendments as a result of the enactment of C&T, while others do not.
3 Exhibit I.4.EGDI.STAFF.24, page 2.
4 Transcript, Vol. 1, p.79, line 21 to p.80, line 7.

(a) The balance in the GGECFCVA could be material. Because of the potential materiality, Enbridge is proposing an "early warning" trigger whereby a 25% variance in the price of emission allowances or gas volumes would require notification to the Board.[5]

(b) As noted in Undertaking J1.1, the $0.38 difference between Enbridge's assumed emission allowance price of $17.70 (in its Compliance Plan) and the settlement price at Ontario's first auction of $18.08 results in a variance of over $8 million to be recorded in the GGECFCVA. In other words, a mere 2.1% difference in the anticipated auction price resulted in an $8 million variance in the GGECFCVA for the first quarter of 2017.

(c) Enbridge has little control over the factors influencing the costs to be recorded in the GGECFCVA (i.e., emission allowance prices and gas volumes used), which makes it analogous to Enbridge's gas commodity costs for system gas customers (as opposed to other costs that are cleared via a one-time adjustment).[6]

(d) Enbridge disposes of variances in its gas commodity costs on a volumetric basis over a prospective 12-month period.[7]

Union's Position and Evidence

10. Union's proposed disposition of Acct 179-154 and Acct 179-155 is largely consistent with the Enbridge approach – at least for Union's larger customers.

11. For Union's larger (contract rate) customers, Union is proposing to dispose of the balances as a one-time adjustment, to be included as a separate line item on the bill.[8] However,

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5 Transcript, Vol. 1, p.38, line 13 to p.39, line 11.
6 Transcript, Vol. 1, p.82, lines 3 to 13.
7 Transcript, Vol. 1, p.85, lines 22 to 25.
8 See Exhibit B.Staff.17(b).

for all other customers, Union's proposal is to dispose of any balances on a volumetric basis over a prospective six-month period.[9]

12. However, under cross-examination, Union's witness panel indicated that it provides customers faced with large one-time adjustments with the ability to make alternative payment arrangements (on a case-by-case basis) by contacting their account managers.[10] It is not clear from the evidence whether that alternative payment arrangement would mean: (a) breaking up the one-time adjustment (still based on historic usage) into multiple installments; or (b) allowing contract class customers to elect to be treated like general service customers (i.e., payment of a disposition balance based on volumes over a prospective six-month period).

13. What is clear from the Union witness panel is that it is not seeking the Board's determination of an appropriate disposition methodology until it brings an application to the Board to dispose of the balances in Acct 179-154 and Acct 179-155.[11]

IESO Submissions

14. For reasons set out below, the IESO submits that:

(a) the Board should, in this proceeding, determine the basic parameters of how the GHG DVAs will be disposed of; and

(b) the GHG DVAs should be disposed of on a volumetric basis, over a prospective period of a number of months.

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9 Transcript, Vol. 2, p.97, line 22 to p.98, line 4.
10 Transcript, Vol. 2, p.114, line 22 to p.115, line 11.
11 Transcript, Vol. p.112, lines 19 to 23; and p.117, lines 4 to 12. It is proposed that the GHG DVAs would first come before the Board for disposition consideration in late 2018, with implementation of a disposition decision commencing in January 2019.

Argument

15. There are approximately 50 IESO Contracts with gas-fired generators. The provincial C&T regime has cost implications for the counterparties under the IESO Contracts, as of January 1, 2017. A number of months ago, the IESO began the process of negotiating amendments to many of the IESO Contracts to address the implications of the provincial C&T regime.

16. These negotiations are ongoing, in part because the details as to how the costs of the C&T regime will be imposed upon gas-fired generators have not yet been fully determined. One key unresolved cost element is how the GHG DVA balances will be disposed of. Consequently, the IESO requires resolution of this issue to finalize the IESO Contract amendment process for most generators under contract. Waiting until the GHG DVAs are brought forward for disposition (late 2018, for calendar year 2017) would unduly delay the IESO Contract amendment process, and leave all parties (the IESO and gas-fired generators) in contractual limbo. Both the IESO and generators would incur additional administrative and legal costs resulting from the extended delay.

17. Moreover, the IESO had anticipated, based on the wording in the Issues List, that the disposition methodology would be determined in this proceeding. As noted above, Issue 4 is explicit in its wording:

> **4. Deferral and Variance Accounts** – Are the proposed deferral and variance accounts reasonable and appropriate? **Is the disposition methodology appropriate?** (emphasis added)

18. By deciding on the basic parameters of the disposition methodology in this proceeding, as the Issues List suggests, the Board would avoid the additional period of uncertainty in the electricity market around this issue that would result from waiting until the GHG DVAs are first brought forward for disposition in late 2018.

19. There are only two main ways in which the GHG DVAs can be disposed of (based on the existing utility methodologies for clearing DVAs):

(a) via a one-time adjustment, based on historical gas usage during the period of time that variances were recorded in the DVA ("**One-Time Adjustment**"); or

(b) via a specific charge designed to recover the DVA balance, based on a forecast of prospective usage (i.e., a number of months forward) ("**Prospective Charge**").

20. As between the two, the One-Time Adjustment would adversely impact the electricity market in Ontario, whereas the Prospective Charge approach would not.

21. The Ontario electricity market and the Market Rules are premised on generators offering electricity competitively into the market reflective of their costs to generate. In the absence of a generator knowing what those true costs are, a generator could reasonably incorporate a contingency into its electricity offers to the market, which ultimately affects the market price and the overall cost to electricity ratepayers.

22. A One-Time Adjustment approach to clearing the GHG DVAs means that generators in 2017 will not know what their true C&T costs are at the time they make their offers because a lump sum amount will be levied at a much later date. As a result, if a generation facility is

unsure of its C&T costs (levied via natural gas rates) during 2017, its offer price may not reflect its cost to produce electricity, which would result in market clearing prices that do not properly value the production and consumption of electricity. This would result in a distortion of electricity market prices, and efficient decisions for production and consumption cannot be made. [12]

23. The Prospective Charge approach to clearance of the GHG DVAs would not negatively impact Ontario's electricity markets. For instance, the Prospective Charges at the beginning of 2019 (to clear the GHG DVA balances) could simply be built into a generator's 2019 offers into the electricity market. It would not require generators to make any allowance in 2017 for the clearance of the GHG DVAs because the 2019 GHG DVA charges would be a known cost to operating in 2019. This holds true regardless of the specifics of the Prospective Charge (i.e., whether a volume or demand-based, and regardless of the length of time over which the Prospective Charge is levied), so long as it is levied based on future operations.

24. By taking the Prospective Charge approach, the provincial C&T regime would not undermine the generator's ability to determine its cost of production, and so the cost of C&T compliance could be properly included in each of the generator's offers, thus avoiding introducing inefficiencies in the operation of the electricity market.

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[12] If a generator incorporated a contingency into its electricity offers (to account of an unknown subsequent One-Time Adjustment), there are two potential outcomes: (i) the allowance would have been too conservative, meaning that its offers would have been too high in 2017 resulting in the generator offering in at more than its marginal cost, thereby unnecessarily driving up the price of electricity; or (ii) the allowance would have been insufficient, potentially resulting in the generator running at a loss instead of other resources with a lower cost being dispatched to operate.

25. In the Board's *Regulatory Framework for the Assessment of Costs of Natural Gas Utilities' Cap and Trade Activities* (the "**Regulatory Framework**"), the Board indicated that the disposition of any GHG DVA balances should avoid market distortions and, in order to do so, should be administered on a prospective basis:

> The OEB also believes that deferral account balances should be apportioned between customer-related and facility-related obligations and, **to avoid any market distortions, the balances should be administered on a prospective basis**, not a retroactive basis. (emphasis added)

26. Therefore, the IESO submits that only the Prospective Charge approach to clearing the GHG DVAs is consistent with the Regulatory Framework. A One-Time Adjustment approach would be inconsistent with the Regulatory Framework.

27. Under cross-examination, both Enbridge and Union acknowledged that they did not consider market distortions in proposing their respective methodologies for disposition of the GHG DVA balances.[13]

28. In addition, there are other reasons that have been highlighted in the evidence to suggest that the Prospective Charge approach is the preferred methodology for disposition of GHG DVA balances.

29. The magnitude of the balances in the GHG DVAs has the potential to be significantly higher than those in the DVAs typically cleared by a One-Time Adjustment, and the larger the balance, the larger a distortion to the market would result from clearing the GHG DVAs by a

[13] For Enbridge, see Transcript, Vol. 1, p.85, line 26 to p.86, line 1. For Union, see Transcript, Vol. 2, p.118, lines 13 to 17.

One-Time Adjustment. As Enbridge noted in cross-examination, the magnitude of the DVA balances cleared in 2016 via One-Time Adjustment was larger than it had ever been ($60 million), and nearly double that cleared in the year with the second greatest DVA balance ($33 million):

> MR. KACICNIK [for Enbridge]: For example, historically, when we cleared our deferral [and] variance accounts, those could be refunds or those could be charges.
>
> Historically, they could **range from a refund of 10 or 20 million [dollars] to charges from zero to 30 million [dollars]**. Last year we had the largest balance to be cleared, and there is a charge of **60 million [dollars]**. So that was the largest ever.
>
> I think the second largest was about **33 million [dollars]** and the rest were lower. (emphasis added)

30. Yet as mentioned above, a settlement price for emission allowances at the first quarterly auction that exceeded Enbridge's forecast by only 38 cents resulted in an $8 million variance in the GGECFCVA.

31. The two utilities seem to recognize the risk around the potential magnitude of the GHG DVAs, because although they are proposing an annual One-Time Adjustment, they have both indicated that if the balance gets too large another approach may be more appropriate.

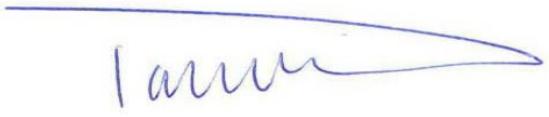
32. The IESO submits that there is no need to wait – either approach can be implemented by the two utilities, and the utilities should be indifferent between the two approaches. If both options are feasible, and there is concern and potential for the GHG DVA balances to be significant, the disposition methodology can be resolved now, with the details (type of charge and duration of charge) to be determined more precisely at the time of disposition. As noted above it also avoids the market distortions that would result from a One-Time Adjustment.

33. In addition, as noted above, the types of costs to be recorded in the GHG DVAs are more akin to those that the utility incurs as a result of its gas commodity supply – i.e., a significant pass-through cost, the inputs of which are driven by customer volumes and commodity markets over with the utilities have no control. The utilities true-up their gas commodity cost variances using a Prospective Charge approach.

34. Many of the other DVAs cleared by the utilities via a One-Time Adjustment do not have the same risk to become material, and many of them have an ability for the utility to at least partially control costs (i.e., are tied to operating costs). On this basis, too, the Prospective Charge approach seems more suited to the disposition of the GHG DVAs than a One-Time Adjustment.

ALL OF WHICH IS RESPECTFULLY SUBMITTED,

May 19, 2017



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