

Hydro's task force studying Full Cost Accounting **Mixed signals emerging on Full Cost Accounting**

by Rutherford

Toronto - Despite the support of a wide range of environmental and industrial organizations, as well as the expectations raised by Rio and by the recent amalgamation of the provincial ministries of Environment and Energy, the new "Superministry" has yet to commit firmly to the principle of Full Cost Accounting. Ontario Hydro however, appears to be moving more quickly in this direction. (See article on Hydro's sustainability task force, beginning on the front page of this issue). But without direction and co-ordination from the Ontario government, Hydro's initiative in this area will not be as significant or effective as it otherwise would be.

In a recent statement to IPPSO FACTO, Mr. Les Horswill, Assistant Deputy Minister for Policy Development affirms that, "The Ministry recognizes that a number of groups have discussed the issue and the Ministry recognizes the importance of the issue of Full Cost Accounting." This represents no substantial change from a previous NDP Minister's "general agreement with...the six pricing principles" summarized by IPPSO in a position paper on rate reform in December 1991. In his written response to an IPPSO report (dated 11 December, 1991), then-Energy Minister Will Ferguson emphasized the need to reach agreement on how to interpret and/or implement Full Cost Accounting principles and stressed the importance of the EAB hearings then ongoing as an opportunity to, "review...the methodology and assumptions used by Hydro in calculating its avoided costs", explaining that he preferred to "await the result of the EAB review before taking any major step in the area of purchase rates for electricity..."

Mr. Tony Rockingham, Manager of Electricity with the Ontario Ministry of Environment and Energy, believes that the government has nevertheless made it clear to Ontario Hydro that environmental costs and impacts are of major concern; a position which he says has been articulated on several occasions.

In November, 1992, as part of the Ministry's submission to the EAB Demand/Supply Plan hearings, Mr. Rockingham outlined the policy position of the Ministry. His statement read in part: "To the extent possible, all social and environmental costs/impacts and risks and benefits be considered in planning". The DSP hearings were

originally expected to provide the Ministry with practical advice on the social and environmental impact of electrical energy generation, its supply and use. But since Ontario Hydro withdrew its application to the EAB DSP hearings in January of this year (a move which precipitated the subsequent cancellation of those hearings) the Ministry has had to look to other sources for an analysis of viable methods for estimating and internalizing the environmental costs of pollution and degradation associated with the various technologies of electrical energy generation. One such source of advice, The Council On Renewable Energy (CORE), has recently filed its report with the Minister. Among its many recommendations: the establishment of a forum to discuss the methodology needed to address externalities in resource planning. It is encouraging to note that at Ontario Energy Board (OEB) natural gas hearings (Integrated Resource Planning, or IRP), a similar review was undertaken. In a negotiated settlement arrived

A definition of Full Cost Accounting

A process by which the social and environmental impacts of projects and technologies can be quantified and assessed for their comparative consequences on both the local community and society at large.

at in advance of the hearings, all three Ontario gas companies agreed in principle to very much the kind of externality review process repeatedly called for by several environmental groups. It is hoped that, in their final report, due out this summer, the OEB will ratify this important agreement.

Although the provincial government now has the power, under the revised Power Corporation Act, to give a directive to the Ontario Hydro Board, (allowing them to say, in effect, "You do this and the Government will take full responsibility for the consequences"), Mr. Rockingham explains that this power has never been used. The Act also allows Hydro to provide financial assistance for fuel substitution away from electricity - to natural gas, for example. Rather than using policy directives, the government opted for "a signed memorandum of

understanding" that the Ontario Hydro Board will operate within the policy framework of the Government. According to Mr. Rockingham, that framework is most clearly articulated in the policy document "New Energy Directions" issued by the Government in November, 1990, and which formed the basis for Mr. Rockingham's submission to the DSP hearings on behalf of the Ministry two years later - including its direct reference to social and environmental costs/impacts.

As a consequence of the public consultation preceding Bill 118 to amend the Power Corporation Act, the Ministry began to develop internally a set of Fuel Substitution Guidelines and incorporating some language on social and environmental impacts and costs. While not representing official Ministry policy, a draft of these guidelines has been sent to a number of organizations and environmental groups for their comments and input. According to Mr. Bunli Yang, Senior Manager of Conservation and Strategic Issues, this was "possibly the first time that the Ministry went public with...an appeal to the public or outside community to try...to set up some kind of process to deal with social and environmental impacts". However, no concrete action has been taken on fuel switching, a situation that would have been different under a system of Full Cost Accounting.

Meanwhile, the demand for concrete action on this front has grown unabated - and not only from environmental and conservation groups, (see IPPSO FACTO, page 5, Dec. '91), but from within the government itself. In February, 1992, a conference entitled "Housing and the Environment" was sponsored by the Ontario Ministry of Housing and concluded by unanimously adopting a position statement which included direct references to environmental cost accounting.

Of more significance still, is the report of the Sectoral Task Force on Energy of the Ontario Round Table on Environment and Economy (ORTEE). The Task Force received briefs from more than fifty organizations and individuals representing industrial users, non-governmental agencies, aboriginal groups, as well as governmental and educational authorities. Overcoming many (and even profound) differences in opinion, there existed "considerable agreement that shifting prices for resources towards (an accurate reflection of) their full costs offers significant long term

benefits to both our environment and economy". Their final recommendations, presented in September, 1992, included a strong endorsement of the principles of Full Cost Accounting (see IPPSO FACTO, Feb. '93). But to date, IPPSO is unaware of any formal response by the Ministry to the recommendations of the Round Table. As discussed below, Full Cost Accounting could have significant implications for Canada's position in international trade negotiations such as those surrounding NAFTA.

The Sierra Club of Canada recently gave the federal government a failing grade on progress toward environmental commitments it made in Rio. "Little progress was noted in meeting our promised greenhouse gas reductions, largely due to the intransigence of energy ministers, provincial and federal," according to Elizabeth May, Executive Director of the Sierra Club of Canada.

It is unfortunate that, having managed to produce consensus among such a diverse group of energy stakeholders, the Ontario Ministry of Environment and Energy appears unable (or unwilling) to take full advantage of this unique opportunity and follow up on the encouraging and very constructive recommendations outlined in this report. Instead of using this as the basis for establishing a new direction for provincial energy policy, we merely have a "recogni(tion of) the importance of...Full Cost Accounting".

Now in the second phase of its mandate, ORTEE is charged with the responsibility to facilitate implementation of its original recommendations and to catalyze, review, and monitor the development of a sustainable strategy.

As Chair of last year's Earth Summit in Rio de Janeiro, Maurice Strong was instrumental in - and is to be credited for - creating both a process and an atmosphere in which international recognition could be given to the concept of FCA. Now, as Chairman of Ontario Hydro, he will be expected to live up to some pretty high expectations. His first major initiative in the area of Full Cost Accounting has been to announce the formation of an "intense" 60-Day Task Force. Headed by Messrs David Runnals and Jim McNeil, the Task Force has been given the broad and ambitious mandate to help Ontario Hydro develop a sustainable energy policy and become a world leader in that area, to make the Ontario economy into the most energy efficient in the world, as well as to outline a plan to implement its recommendations.

Due at the end of July, the findings of this

Task Force are widely expected to result in "fundamental change to the organizational structure of Ontario Hydro".

David Runnals agrees, emphasizing that, "Both the Chairman and John Fox (are) very interested and very committed to the idea (and) I think that it's quite clear from...discussions around the table...that these will be pretty fundamental changes we're recommending...identifying the various externalities which will have to be included in the decision-making process and, (referring to the recently-announced organizational changes at Hydro), looking at how a sustainable decision-making framework will fit within that new structure.

Whatever system is adopted must ensure that the needs, interests, and concerns of all stakeholders are adequately - and fairly - considered

"We have a task group which is charged with looking at the whole question of Full Cost Accounting and we intend to devote an awful lot of time and effort and probably the lion's share of the resources of the group to looking into the question of how one implements a Full Cost Accounting system. FCA is perhaps the single most critical subject we have to deal with. (It's) not simple and straightforward, but I'm convinced, and I think that Jim would agree with this, that (FCA) is the key to...(the) whole question of integrating environment into economic decision-making."

One of the Working Groups formed under the Task Force will study and offer specific recommendations on how to bring Hydro's performance into line with the relevant sections of Agenda 21, signed at the Earth Summit in Rio de Janeiro, as well as with other international treaties and any impending legislation. Mr. Runnals explains that, going even farther, this group will investigate whether or not there are other areas in which the corporation should be taking initiatives that aren't in the existing legislation.

Other Working Groups will investigate: the possibility of using Hydro's procurement power as a way of stimulating a more sustainable provincial economy; how Hydro communicates about energy efficiency, demand management, NUGs and other power suppliers; the integration of Environment and Economics in decision-making; and the Labour/Employment structure - how to write performance contracts and how to write sustainability criteria into evaluation systems. While Mr. Runnals admits that some elements

of the new plan will take until the end of the century to implement, he emphasizes that, "we're also talking about some things that need to be done on the first of September". He explains that he also expects to maintain contact with IPPSO on these and related matters.

Critics of Ontario Hydro remain cautious and have yet to be convinced. Originally encouraged by the conclusions and recommendations of the ORTEE Energy Task Force, Mr. Kai Millyard, a spokesperson for the Coalition of Environmental Groups, is one of many environmentalists disappointed by the lack of accountability or by any apparent environmental consciousness at Ontario Hydro in the last six months - although he is hopeful that this new task force will now finally produce the same degree of substantive change in Hydro's environmental policies as the earlier Task Force On Change effected on Hydro's corporate and financial culture; "One can only hope that they are now getting around to it and...do a reasonable job at focusing on the environmental agenda and deciding how to run their affairs differently."

In its recent discussion paper "Hydro 21" outlining general options for the future, Hydro did little to reassure proponents of FCA. Referring to externalities as a "key question" in what amounted to a single mention in an otherwise detailed report, critics charged that Hydro clearly demonstrated that the subject had yet to be taken seriously.

Mr. Tom Adams, utility analyst for the non-profit research group Energy Probe, points to Hydro's recent announcement to offer a substantial discount to some of its largest industrial customers - at a cost as much as 85 per cent below typical household power rates. Although the deal will provide desperately needed additional revenue, some say that encouraging even greater use of power (to be generated through a surplus in Hydro's coal-fired capacity) at an even lower rate, simply flies in the face of any notion of FCA. While Energy Probe and IPPSO considered legal challenges to incentive rates in the hope of forcing Hydro to abide by existing EAB legislation, the provincial government ran an end-run around the problem by quietly approving an order-in-council to amend the Ontario Energy Board Act - granting Hydro an exemption which permitted the lower rates for increased energy consumption (for the eight companies who accepted the deal) "on an experimental basis...(until) 31 December, 1994."

It must be admitted however, that, even if

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such a public review had been undertaken, it is highly unlikely that externalities would have been factored into the process. Mr. Peter O'Dell of the Energy Board admits that he, "has no knowledge of FCA as a factor in assessing rate applications".

Not surprisingly, Mr. Adams is not impressed with Hydro's performance on the issue so far, believing that, "there's been no indication that FCA has produced any procedural or substantive changes at Ontario Hydro. (It appears that FCA is) a series of fuzzy concepts as he (Maurice Strong) espouses them". Another critic suggests, more cynically, that because lifecycle costs can be so difficult to define, it's actually been possible to use the request for a formal review as a means to successfully delay any meaningful change in corporate practices almost perpetually - like an administrative "Black Hole".

There have been some encouraging signs however: Mitchell Rothman of Ontario Hydro's Economics and Forecast Division was a member of the Environmental Costs Steering Committee which recommended that the proposed rehabilitation of the Bruce A Nuclear Generating Station should be accompanied by "an assessment of full environmental and private costs". Although the recommendation was ultimately adopted, the decision it was intended to inform (whether or not to rehabilitate Bruce A), was later postponed and accordingly, the agreed-upon analysis was abandoned. Mr. Rothman believes that it is important to note however, that a decision had been made to conduct such an analysis - at least in reference to this one specific decision.

British Columbia, by contrast, appears to be moving more aggressively towards bringing externalities into its formal review process. Less than a year after forming a government, BC Energy Minister Anne Edwards announced that all power projects will soon be evaluated according to their environmental - as well as their financial - impact. Called "Social Costing", the process seeks to arrive at an adjusted price for any proposed project and to ensure that the province's domestic electricity requirements are met at the lowest financial and environmental cost. To be included, for example, are the costs for the planting and maintenance of a sufficient number of trees to absorb the estimated CO2 emissions over

the life of a proposed project. Employment effects are also to be considered.

Taking part in the process will be three provincial agencies: the Ministry of Energy, Mines and Petroleum Resources, BC Hydro, and the Crown Corporation Secretariat (an agency attached to the Ministry of Finance).

Speaking from B.C., Mr. Lee Thiessen, Senior Economist and Project Analyst with the Power and Project Branch, explains that Social Costing is intended to be employed as a comparative tool between projects. Initially to be used to assess proposed projects within BC Hydro, it is expected that Social Costing will eventually be expanded to involve the entire electrical generation system. Now in its first application, the Ministry is currently receiving proposals for possible alternatives to refitting a diesel powered generator in the Queen Charlotte Islands. Environmental

"FCA is perhaps the single most critical subject we have to deal with." - David Runnals, Ontario Hydro Task Force on Sustainability

groups, power producers and others have welcomed these developments on numerous occasions.

If we accept the principle that the price of things should accurately reflect the true costs of their production, one of the ways in which this can be achieved is through taxation. One group which has been investigating the impact of FCA and Full Cost Pricing on the tax system is the Fair Tax Commission sponsored by Ontario Treasurer Floyd Laughren.

Of prime concern to the Commission is the impact of any proposed changes on industrial competitiveness. Struggling to find ways to ensure that the full environmental and social costs of goods and services are apparent, while at the same time not undermining an economic strategy, the Commission's Working Group on Environmental Taxation included representatives from industry, the labour movement, farmers, consumers, environmental groups and academia. Reporting directly to the Treasurer last December, they concluded that environmental tax instruments can help Ontario realize its environmental objectives.

Endorsing a broad environmental policy framework, the working group nevertheless emphasized that tax instruments need to be used in concert with other measures in order to find creative ways to offset the increases in costs and prices, provide for less total use and

less total payment, conserve resources and create jobs.

Under the right conditions, Full Cost Accounting can offer a distinct trade advantage to Ontario. In this era of globalizing trade, jurisdictions such as Ontario which have relatively high environmental standards only have more to gain from international trade agreements that pay heed to environmental costs.

In addition, there is also a social justice element to be considered in discussions about the generation and distribution of energy supplies. Mr. Joe MacLean of Energy Pathways (an independent consulting firm in Toronto), points out that small-scale, local power production, located at or near the demand source helps to encourage, not only environmentally-sensitive technologies, but local employment and regional economies - reminding us that we're all paying for current policies through the UI premiums paid out to those technicians and managers who could be running up to 140 generating substations across the province.

In its present form, critics argue that the standard inverted rate curve actively rewards higher consumption instead of discouraging it through constructive and effective conservation practices which are time-sensitive to production cycles.

With their continued reliance on an avoided cost model (without meaningful consideration of social and environmental impacts in energy generation), Ontario Hydro's previous reluctance to adopt (some might even say to consider seriously) a system of FCA is hardly surprising. Having spent a considerable amount of time in discussion with various Hydro officials and technicians in preparation for the many broadcasts produced by the popular television series "Waste Not" on the subject of energy generation and consumption, TV Ontario's David Stringer believes that Hydro has found it difficult to think beyond traditional approaches and consider seriously a network of local, small-scale projects which could help to reduce significantly our dependence on environmentally unsustainable energy sources, observing that, "there's a great irony in burning coal to meet the power demand created by air conditioners". Others say Hydro is burdened by historic commitments to nuclear and coal plants, which would have difficulty under FCA.

As explained by Mr. Matthew Akman of the Fair Tax Commission, "One of the biggest issues in ensuring that the actions of businesses

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reflect the full social cost (of production) is... (recognizing) that it's not necessarily the case that other (competing) jurisdictions... are not enforcing (FCA) guidelines". Forced by geography to rely heavily upon less-than-clean technologies, Ontario should recognize that it is in our own best interests to encourage - preferably by example - other jurisdictions to adopt FCA in energy pricing structures. While there are, of course, no shortage of suggestions about ways to reduce the demand on a centralized system of generation - particularly in the exploitation of less damaging and readily accessible alternative power sources, the main difficulty has always been arriving at a meaningful consensus on methodology. Whatever system is adopted must ensure that the needs, interests, and very real concerns of all stakeholders are adequately - and fairly - considered in any new system of assessing the relative costs of competing energy sources. Although the details and original proposals may be worked out by technical experts, it is up to the political leadership to produce a fair and consensual public process for reviewing (and possibly revising) the general methods and estimates prepared by those experts. Finding a methodology and public review process which more accurately reflects the full scale of environmental costs associated with different technologies has clearly become a matter of growing urgency.

If we can succeed in raising both the profile and credibility of Full Cost Accounting, we will ultimately find ourselves at much less of an economic disadvantage by ensuring that the playing field remains level - and sustainable - for future economic development. Failure to do so will not only threaten our ability to compete in an increasingly environmentally sensitive global marketplace, but will condemn us - and our children - to a future as bleak as it is absolute.

Rutherford is a communications consultant to non-profit organizations.