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The AUC Rejects an Application for an Industrial System Designation

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Decision Commented On: [AUC Decision 25117-D01-2020](#), TA Kaybob 3 Generation Facility Inc. Generation Facilities Applications; SemCAMS Midstream ULC Industrial System Designation Application, Kaybob 3 Generation Facilities Project, September 25, 2020;

Discussion Paper Commented On: AUC, [Self-supply and export – Alberta Utilities Commission discussion paper](#), June 5, 2020 (published July 29, 2020, [AUC Bulletin 2020-28](#))

Under the terms of the *Hydro and Electric Energy Act*, [RSA 2000, c H-16 \(HEEA\)](#) and the *Electric Utilities Act*, [SA 2003, c E-5.1 \(EUA\)](#), the holder of an Industrial System Designation (ISD or IS designation) is entitled to meet its own electricity needs and export any surplus electricity to the grid. In other words, the holder of an ISD is exempt from the ‘must offer, must exchange’ rules of the *EUA* for any generation that it self-consumes (*EUA*, s117, and conditions included in ISD approvals). A principal advantage of the ISD for the holder is that the holder does not incur distribution and transmission tariffs for electricity that it consumes on site. As previously canvassed on ABlawg (see [here](#)), other exemptions from the power pool rules do exist, but these are smaller scale exemptions and recent decisions of the Alberta Utilities Commission (AUC or Commission) (see [AUC Decision 23418-D01-2019](#), EPCOR Water Services Inc., E.L. Smith Solar Power Plant, February 20, 2019 (EL Smith decision) and related decisions) have reduced the availability of one of these exemptions, thereby increasing interest in the ISD (see for example [AUC Decision 24979-D01-2020](#), International Paper Canada Pulp Holdings ULC, Industrial System Designation and Permanent Connection Order for the Grande Prairie Pulp Mill Complex, January 10, 2020; and for a more general discussion see AUC, [Self-supply and export – discussion paper](#)).

The IS designation was first set out in the *HEEA* in 1977. Twenty years later, the Department of Energy issued a [policy statement on industrial systems](#). The current rules for IS designations are found in section 4 of the *HEEA*. The AUC estimates that approved ISDs have a combined capacity of approximately 5,400 MW with approximately 4,200 MW in service (Discussion Paper at 13–14). This represents a significant proportion of the total installed capacity (about 16,000 MW) in the province. An IS designation is available for generation projects that are highly integrated with an industrial process. The most common type of qualifying project in Alberta is a cogeneration project associated with an oil sands development. The generation provides process steam for the oil sands (in situ or mine) as well as electricity. For a more general discussion see Nigel Bankes, Giorilyn Bruno and Cairns Price, “The Regulation of Cogeneration in Alberta” (2015) 53 *Alberta Law Review* 383.

This particular decision involved [applications](#) for the approval of generation facilities associated with the Kaybob 3 natural gas processing plant (K3 plant) near Fox Creek in Woodlands County. SemCAMs has a majority ownership interest in the plant (along with a number of other owners, some of whom process gas at the facility) and acts as the operator. The plant's processing operations require high pressure steam currently being provided by natural gas fired boilers that are nearing their end of life. The proposed generation facilities would consist of two 16.5 MW gas turbine generators and a heat recovery steam generator as well as one 9.75 MW RICE (reciprocating internal combustion engine) generator. The generation facilities would be built and owned by TA Kaybob 3 Generation Facility Inc (TAK3), a subsidiary of TransAlta, although an agreement between SemCAMs and TransAlta would allow SemCAMs to acquire a 50% interest in TAK3. The application for approval of the generation facilities was made by TAK3; SemCAMs made the IS designation application.

The applications for approval of the generation facilities and the IS designation were opposed by Paramount, XTOC and Cenovus, all of whom own an interest in the K3 plant. Their principal concern seems to have been that SemCAMs was proceeding with this proposal without their consent and in breach of the construction, ownership and operations agreement (CO&O) relating to the plant. They also had concerns about the economics of the project and considered that any benefits of self-generation would flow to SEMCams as operator rather than to them as interest owners in the facility. AltaLink, the transmission facility owner in the area, opposed the IS designation on the grounds that, if approved, it might allow market participants to unfairly avoid transmission system costs.

The AUC approved the applications to construct the generation facilities but denied the application for an IS designation. The part of the decision dealing with the approval of the generation is fairly straightforward, although the AUC (at paras 39 – 40) did rap TAK3 over the knuckles for being less than frank about the opposition to its application of some of the K3 plant interest owners. It is also noteworthy that the Commission observed that that it was not concerned with the distribution of benefits flowing from the project or any potential breach of the CO&O agreement; it was enough for the Commission to be satisfied that SemCAMs had an interest in land where the generators were to be located within the Kaybob 3 plant site and could grant a lease to TAK3:

42. The joint interest owners do not allege that SemCAMs is not an owner of the lands upon which the project is proposed to be located; rather, they assert that SemCAMs has leased the project lands to TAK3 in contravention of the terms and requirements of the CO&O. In other words, this is not a case in which TAK3 has not demonstrated *any* right to the land proposed for the facilities. Keeping in mind the purposes of its inquiry into the issue of ownership, the Commission is satisfied that SemCAMs has an ownership interest in the lands upon which the project is proposed to be built and operated. And in this regard, it reiterates its ruling of May 1, 2020 in which it stated that if the joint interest owners dispute that the grant of lease for the project lands was not made in accordance with the CO&O, they can pursue that issue in a civil action.

43. Similarly, the assertion made by the joint interest owners, that as customers of the K3 Plant they would be inappropriately paying for the proposed facilities, does not sway the Commission into denying the facilities application. As joint owners and customers of the

K3 Plant, their rights and obligations in relation to the plant are set out in the various agreements (including but not limited to the CO&O) they have made amongst them, and with the other joint interest owners and SemCAMS. Such agreements were freely entered into by commercially sophisticated parties who are assumed to accept the anticipated (and sometimes unanticipated) outcomes of those arrangements. It is not the Commission's role in this proceeding to resolve disputes that arise under the CO&O or a customer agreement.

The ISD part of the decision report is more complex. As noted above, section 4 of the *HEEA* establishes the rules for an IS designation. In particular, and in addition to some general purposive guidance in subsection (2), subsections (3) to (5) provide two alternative tracks for qualifying a project. Under track one a proponent may qualify a project if the proponent can convince the Commission that it has satisfied *all* of the requirements of subsection (3), to wit:

- (a) the electric system includes a generating unit located on the property of the one or more industrial operations it is intended to serve, there is a high degree of integration of the electric system with one or more industrial operations the electric system forms part of and serves, and there is a high degree of integration of the components of the industrial operations;
- (b) the industrial operations process a feedstock, produce a primary product or manufacture a product;
- (c) there is a common ownership of all of the components of the industrial operations;
- (d) the whole of the output of each component within the industrial operation is used by that operation and is necessary to constitute its final products;
- (e) there is a high degree of integration of the management of the components and processes of the industrial operations;
- (f) the application to the Commission for a designation under subsection (1) demonstrates significant investment in both the expansion or extension of the industrial operations processes and the development of the electricity supply;
- (g) where an industrial operation extends beyond contiguous property, the owner of the industrial operation satisfies the Commission that the overall cost of providing the owner's own distribution or transmission facilities to interconnect the integral parts of the industrial operation is equal to or less than the tariffs applicable for distribution or transmission in the service area where the industrial operation is located.

Under track two, the Commission may still approve an IS designation under one of two circumstances. First, even if either clause (c) or clause (d) have not been met, the Commission may still make a designation provided that it "is satisfied that all of the separately owned components and all of the industrial operations are components of an integrated industrial process." Second, and more generally, if not all of the conditions have been met, the Commission may still make a designation provided that it is satisfied that:

- (a) all of clauses (a) to (g) of subsection (3) and subsection (4) have been substantially met, and
- (b) there is a significant and sustained increase in efficiency in a process of the industrial operation or in the production and consumption of electric energy by the industrial

operation as a result of the integration of the electric system with the industrial operations the electric system forms part of and serves.

For a recent example of the application of the second branch of track two, see [AUC Decision 25184-D02-2020](#), Canadian Natural Resources Limited, Primrose East Power Plant and Industrial System Designation Amendment Project, April 6, 2020.

In its Kaybob 3 decision, the Commission focused on clauses (c) (common ownership) and (d) (use of the output of each component), two of the requirements for track one.

In the Commission’s view there was neither common ownership nor was the test even “substantially met” (at paras 63–64). The K3 plant was owned by nine interest owners, but the generation facilities would be owned by TAK3 (TransAlta) with nothing more than the stated intention of SemCAMS to acquire an interest up to 50%. The minority interest owners in the K3 plant would have no ownership interest in the generating facilities. Absent common ownership the applicants (at para 66) “may bear a greater burden to demonstrate that the assets are, in fact, components of an integrated industrial process.” And in this context the Commission placed particular emphasis on clause (d) (use of output) and the RICE generator. The evidence before the Commission was (at para 68) “that the RICE generator’s only output is electric energy, that under normal operating conditions all of that energy will be exported to the AIES, and that none of it will be needed or used by the industrial operation to constitute the K3 Plant’s final products.” Accordingly, the Commission was of the view (at para 68) that the application did not satisfy clause (d) if the RICE generator were to be included.

The proposal also failed to meet the test set by either the first branch of track two (demonstration of an integrated industrial process) or the second branch (tests substantially met and demonstrated efficiency gains), largely for the same reasons that the project failed track one, and specifically so in relation to the RICE generator. Indeed, the Commission indicated that it would have been prepared to grant an IS designation for only the two cogeneration units. It declined to do so only because the applicant had indicated that these units would need to be “dramatically re-designed” (at para 93) if the RICE generator were not an integrated component of the application.

Commentary

This decision needs to be seen in the context of the broader discussion of the appropriate rules for self-supply and export in Alberta’s electricity market. The current rules (of which the ISD rules are a part) have evolved in a very *ad hoc* way over the last 40 years and they lack coherence. The Commission’s EL Smith decision of February 2019 began the discussion as to the appropriateness of the existing rules and the AUC has continued that discussion (at the behest of the Department of Energy) through two rounds of consultations, as discussed in previous posts [here](#) and [here](#). The AUC’s work on this topic culminated with the release of its Discussion Paper on Self supply and export in July 2020. That paper has clarified the issues for all concerned, but it is now up to the Department of Energy to make some policy decisions. As the Discussion Paper notes (at 29):

To move forward on this issue, the Department of Energy must balance the competing interests of fair and open competition in the energy market and economic development,

which may be enhanced by allowing unlimited self-supply and export, with maintaining or preserving the ongoing viability of the transmission system. These opposing interests were identified and addressed at length in the round two submissions of the parties.

Some stakeholders considered the ISD to be a legitimate mechanism to foster efficient increments of cogeneration that have benefits to all users of the interconnected system. To others, the ISD is a means to reduce power costs for their industrial processes. Still others view the ISD under the current tariff scheme as a form of cross-subsidization from electricity consumers to industrial system operators

The Commission further observed that even if the rules of self-supply and export were to be relaxed it would still be important to consider the tariff treatment issue to ensure the just and reasonable allocation of transmission costs. This could be addressed by the AUC in the ongoing distribution system inquiry (now wrapped up with the Commission’s report pending) or future AESO tariff proceedings, but the Commission added that: (at 29)

... before the Commission can effectively turn its mind to the tariff issue, the Department of Energy must decide, from a policy perspective, whether to allow self-supplying generators that do not qualify as ISDs to self-supply and export. In making this policy decision, the Department of Energy may want to take into account the system and societal benefits associated with such operations.

In sum, this decision, like the EL Smith line of decisions, underlines the importance of clarifying or reformulating the existing rules on self-supply. For reasons previously stated in the conclusions to my post on the EL Smith decision ([Opening a Can of Worms](#), at 12) this is no longer a job for the AUC. It is now (and has been for some time) the Department’s responsibility.

This post may be cited as: Nigel Bankes, “The AUC Rejects an Application for an Industrial System Designation” (September 30, 2020), online: ABlawg, http://ablawg.ca/wp-content/uploads/2020/09/Blog_NB_K3_ISD.pdf

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