

Hydro One Networks Inc.

8th Floor, South Tower
483 Bay Street
Toronto, Ontario M5G 2P5
www.HydroOne.com

Tel: (416) 345-5700
Fax: (416) 345-5870
Cell: (416) 258-9383
Susan.E.Frank@HydroOne.com

Susan Frank

Vice President and Chief Regulatory Officer
Regulatory Affairs



BY COURIER

October 26, 2007

Ms. Kirsten Walli
Secretary, Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli:

EB-2007-0662- Comments Respecting Notice of Proposal to Amend a Code: Proposed Amendments to Affiliate Relationships Code for Electricity Distributors and Transmitters

This memo is in response to the Ontario Energy Board's (the Board) request for comments respecting the Board's Notice of Proposal to Amend a Code entitled Proposed Amendments to Affiliate Relationships Code for Electricity Distributors and Transmitters.

Thank you for the opportunity to review the Notice of Proposal to Amend a Code (Proposal) proposing changes to the Affiliate Relationships Code. Please find attached our Comments on the Proposal.

I am enclosing three hard copies of Hydro One Networks' comments. An electronic version of the comments in searchable Adobe Acrobat (PDF) and Word is being provided to you via email to Boardsec@oeb.gov.on.ca, as requested.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank
Attach.

EB-2007-0662- Comments Respecting Notice of Proposal to Amend a Code: Proposed Amendments to Affiliate Relationships Code for Electricity Distributors and Transmitters (Proposal)

General

On the whole, Hydro One Networks Inc (“Hydro One”) accepts the tone and direction that is being set in the proposed amendments to the Affiliate Relationships Code (ARC). Hydro One accepts and respects that the ARC is an integral component of the regulatory scheme in the Province, and indeed in any regulated environment. As such, we are offering our comments in the spirit of clarifying certain items where we feel that there may be confusion that creates interpretive ‘bottlenecks’ or potential compliance issues.

We do, however, have two more notable comments:

The code sections on transfer pricing refer to materiality limits on either an absolute dollar value or a percentage of utility revenue. Hydro One believes that it is preferable to have a uniform percentage of utility revenue as the sole materiality factor, as this better reflects the primary concern for all utilities – namely, impact on customer rates.

Also, in regards to transfer pricing, we find that the Board’s suggestion of the dual requirement of having a competitive bidding process, as well as obtaining the opinion of an independent evaluator to determine market price in certain situations, to be excessive and redundant. We feel that a competitive bidding process with appropriate bid evaluation controls (eg selection criteria) are adequate for the purposes of ensuring that market price is reflected in transfer pricing. The introduction of an evaluator would only add costs and delays to the procurement processes, which would be especially problematic when utilities face high growth and investment requirements.

Specific Comments

A. Section 1.1 - Purpose of the Code

The Board is proposing to amend section 1.1 of the Electricity ARC to more clearly articulate its objectives. An objective has been added which serves to protect “ratepayers from harm that may arise as a result of dealings between a utility and its affiliate”. While we agree with the intent of the objective, we suggest that the code reference to “harm” in section 1.1(a) should be qualified. Otherwise, it is too broad and subject to interpretation. The discussion leading up to the proposed change in the code suggests that potential ‘harms’ are primarily related to customer confusion and cross subsidization. We suggest that the “harm” in the revised code be modified to make specific reference to customer confusion and cross subsidization.

B Section 1.2 - Definitions

A number of new and revised definitions have been included in the revised Code which are useful and welcome. To avoid confusion we would suggest:

- The proposed 'Shared Corporate Services' definition is very precise; Hydro One recommends a broader definition. The activities defined in the OEB's definition are as follows:

"shared corporate services are business functions that provide shared strategic management and policy support to the corporate group of which the utility is a member, relating to legal, finance, tax, treasury, pensions, risk management, audit services, corporate planning, human resources, health and safety, communications, investor relations, trustee or public affairs",

This definition, as it stands, is too narrow and will exclude other cost streams that are currently reflected in Affiliate Agreements as shared services. Examples include "Real Estate Support Services": and "Information Management/ Information Technology". At a minimum, these should be added to the definition, or the definition should change so that it allows additional business transaction streams as appropriate in the circumstances.

C. Section 2.1 - Degree of Separation

Hydro One accepts the Board's proposal to amend section 2.1 by eliminating the requirement in section 2.1.2 that a utility be physically separated from any affiliate that is an energy service provider.

D. Section 2.2 – Sharing of Services and Resources

The heading of Section 2.2 should read: "Providing or Receiving Services and Resources" to be consistent with the body of the section; section 2.2.1 should refer to "service or resource"

Section 2.2.4 should read as follows: "In the event of an emergency situation a utility may **provide services and resources** to, or **receive services and resources** from, an affiliate that is also a utility, without a Services Agreement". The first sentence of section 2.2.5 should read: "The transfer pricing rules set out in section 2.3 do not apply when a utility **provides services to, or receives services from,** an affiliate in an emergency situation". We feel that it is clearer to refer to the 'provision and receipt' of services and resources as opposed to 'sharing' which is a less precise terminology.

E. Section 2.3 – Transfer Pricing

2.3.3 Where a Market Exists

The proposed Section 2.3.3 requires a competitive bidding process to determine market price (where annual contract value < \$100,000 or 0.1% of utility revenue) and the use of an independent evaluator (where a contract over its terms exceeds \$500,000 or 0.5% of utility revenue). As noted in our General section above, we support using only the percentage of utility revenue and not a fixed dollar amount. In addition, the requirement for an independent evaluator is not supported by Hydro One. The need for an independent evaluator is in our opinion redundant and adds cost and delays procurement activities particularly in times of high growth. We believe that it is preferable to have documented bid selection criteria which in turn are subject to audit by the OEB. In conclusion, the proposed requirement for a bidding process should be sufficient to ensure the market price is reached. In any case, the Board would have the right to audit Hydro One's bidding process.

F. Restriction on Provision of Strategic Business Information

2.6 Confidentiality of Confidential Information and Restriction on Provision of Business Strategic Business Information

The Electricity ARC currently contains provisions that restrict a utility from sharing with an affiliate any employees that collect or have access to confidential information. We welcome the Board's proposal to retain that restriction but to limit its application to energy service provider affiliates.

However, we find the Board's proposal to amend section 2.6 of the Electricity ARC by adding a new section 2.6.4 that specifically prohibits a utility from providing strategic business information to an affiliate that is an energy service provider to be a very subjective and potentially cumbersome. Generally, such information is already contemplated in the current definition of 'confidential information' and, therefore, to highlight a subset is redundant and may open up a variety of interpretations. Accordingly we suggest the elimination of this specific reference and the removal of its definition within Section 1.2.

Clause 2.6.2: Hydro One suggests that another exception within this section is warranted for those instances where outsourcing of work is required. Such outsourcing is undertaken where Hydro One Networks chooses to outsource to complete a task. Proposed wording would take the form:

"(e) to third party service providers (which may include affiliates of the utility) to perform services on the utility's behalf provided the utility gives only confidential information necessary to perform those services that the utility has contracted them to provide."

Editorial Suggestions

Section 1.6 Amendments to this Code and Determinations by the Board

Section 1.6.3 - the words "was in place in June 15, 2007" should probably read "was effective on June 15, 2007" to capture any agreements that were made after June 15, 2007 but effective prior to that date; we think these words are clearer than "was in place"

Section 2.3 – Transfer Pricing

In Section 2.3.2 it references contracts for "a product" or for "the use of an asset" - but Section 2.2 doesn't - should they not be consistent? Does this mean that a contract for the use of an asset or a product does not fall within section 2.2? This should be clarified, as it is not clear what the distinction is between the agreements in 2.2.1 and "outsourcing contracts in section 2.3.2 assuming that for any Services Agreement, the requirements in section 2.3.2 apply.

2.3.4 Where No Market Exists

Section 2.3.4.3 - should refer to "service, product, resource or use of asset" for consistency. Would a "sale of an asset" be considered "sale of a product or resource"? This should be clarified because this phrasing will determine whether a "Services Agreement", as described in section 2.2, will be required; Hydro One would normally have an agreement of purchase and sale for this circumstance.

Clause 2.3.6.3 What do the words "or obtains the transfer of an asset" mean - how is it different from "purchases"?