EDA
The Voice Of Ontario's Electricity Distributors

October 26, 2007

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

Dear Ms. Walli:

Re: EB-2007-0662 Proposed Amendments to Affiliate Relationships Code for Electricity Distributors and Transmitters

The EDA appreciates the opportunity to comment on the Board's proposed amendments to the Affiliate Relationships Code for Electricity Distributors and Transmitters.

The EDA has reviewed the proposed code amendments, has consulted with its members and is pleased to present the Board with its comments. Our comments are outlined in the EDA document attached to this letter

Yours truly,

"original signed"

Richard Zebrowski
Vice President, Policy & Corporate Affairs

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Attach.

Part 1

The Board's jurisdiction

Sections 70.1 to 70.3 of the OEB Act authorize the Board to issue codes and to incorporate those codes by reference as conditions of a licence. The OEB Act does not explicitly set out the scope of the subject matter that can be addressed in codes. Therefore, it is necessary to apply the rules of statutory interpretation to determine the scope of the subject matter that falls within the jurisdiction of the Board when it is developing a code.

Section 70.1 of the OEB Act expressly refers to section 70 of the OEB Act, which is the section that authorizes the Board to impose conditions in licences. Section 70 (1) provides as follows:

> A licence under this Part may prescribe the conditions under which a person may engage in an activity set out in section 57 and a licence may also contain such other conditions as are appropriate having regard to the objectives of the Board and the purposes of the *Electricity Act, 1998*.

This means that when the Board wishes to incorporate by reference a code as a condition of license, the content of that code must be "appropriate having regard to the objectives of the Board and the purposes of the *Electricity Act, 1998*."

The objectives of the Board are set out in section 1(1) of the OEB Act:

> The Board, in carrying out its responsibilities under this or any other Act in relation to electricity, shall be guided by the following objectives:
>
> 1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
>
> 2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Section 1(1) makes it mandatory for the Board to be guided by the two stated objectives.

The purposes of the *Electricity Act, 1998* are set out in section 1 of that Act:

> The purposes of this Act are,
>
> (a) to ensure the adequacy, safety, sustainability and reliability of electricity supply in Ontario through responsible planning and management of electricity resources, supply and demand;
>
> (b) to encourage electricity conservation and the efficient use of electricity in a manner consistent with the policies of the Government of Ontario;

(c) to facilitate load management in a manner consistent with the policies of the Government of Ontario;

(d) to promote the use of cleaner energy sources and technologies, including alternative energy sources and renewable energy sources, in a manner consistent with the policies of the Government of Ontario;

(e) to provide generators, retailers and consumers with non-discriminatory access to transmission and distribution systems in Ontario;

(f) to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service;

(g) to promote economic efficiency and sustainability in the generation, transmission, distribution and sale of electricity;

(h) to ensure that Ontario Hydro's debt is repaid in a prudent manner and that the burden of debt repayment is fairly distributed;

(i) to facilitate the maintenance of a financially viable electricity industry; and

(j) to protect corridor land so that it remains available for uses that benefit the public, while recognizing the primacy of transmission uses.

The content of the two mandatory objectives in the OEB Act is included in the purposes of the *Electricity Act, 1998* in clauses (f), (g) and (i).

Section 70(2) sets out examples of the types of conditions that may be included in licences. Section 70(2) (d) authorizes conditions:

governing the conduct of the licensee, including the conduct of,

(i) a transmitter or distributor as that conduct relates to its affiliates,

(ii) a distributor as that conduct relates to a retailer,

(iii) a retailer, and

(iv) a generator, retailer or person licensed to engage in an activity described in clause 57 (f) or an affiliate of that person as that conduct relates to the abuse or possible abuse of market power.

Based on section 70.1, such conditions can be accomplished through the development of a code which can then be incorporated by reference as a condition of licence.

Section 71 provides that a distributor shall not carry on any business activity other than the distribution or transmission of electricity, except through an affiliate. Section 73 imposes further

restrictions on the type of business activity that may be carried on by an affiliate of a distributor, where that distributor is owned by a municipal corporation. However, those restrictions do not limit the activities of the municipal corporation itself, as stated in section 73 (3). This is an important exception since the municipal corporation is, by definition, an affiliate.

These statutory provisions, along with the powers of the Board to set rates for distributors, establish the framework for the Board's jurisdiction to issue a code relating to affiliate relationships and incorporate it by reference as conditions of licence.

Collectively, these statutory provisions give rise to the following principles which underpin an appropriately constituted Affiliate Relationships Code (ARC):

(a) cross-subsidization of an affiliate by a utility's ratepayers is to be avoided;

(b) a utility should be able to achieve economies and efficiencies for the benefit of its ratepayers in its relationships with its affiliates;

(c) the confidentiality of information collected by a utility in the course of providing utility service to its customers should be protected;

(d) an affiliate retailer or gas marketer should not have an unfair advantage over non-affiliate retailers and gas marketers as result of its relationship with a utility; and

(e) no one, including an affiliate, should have preferential access to regulated utility services.

In the context of the ARC, the Board's jurisdiction is limited to the conduct of the licensed LDC as it relates to its affiliates. This means that the Board can impose rules relating to the protection of confidential information and relating to the pricing of services provided to or received from an affiliate. It is important to remember this when the Board comes to consider attempts by stakeholders to limit the ability of affiliates to compete in non-utility markets when confidential information is properly protected and there are no cross-subsidies from the utility's ratepayers to the affiliate. The Board has no statutory role to play in competitive markets outside the gas and electricity commodity markets and even if it did, the task would be to protect the competitiveness of those markets, rather than to protect some of the competitors as some stakeholders would have the Board do.

LDCs have entered into arrangements with their affiliates that result in more efficient use of utility resources and lead to lower rates for their customers. The fact that such arrangements may make affiliates more competitive in other markets does not make those arrangements unfair. In the absence of an affiliate abusing a dominant position in those other markets or engaging in anti-competitive behaviour such as predatory pricing, they are contributing to the competitiveness of those markets while at the same time, the LDCs are meeting a primary statutory objective of the Board.

Furthermore, where an affiliate does engage in behaviour that affects the competitiveness of another market, there are effective remedies available, as evidenced for example by the Enbridge Services case relating to hot water tank rentals that was addressed by the Competition Tribunal. The Board had a long history of addressing the cross-subsidy issue relating to hot water tank rentals but it was the Competition Bureau that took up the competition issue. This makes sense since the Board clearly has jurisdiction to address the cross-subsidy issue but did not and does not have jurisdiction to address the competition issues.

Part 2

The proposed ARC amendments

(a) Introduction

The Board has issued a notice of proposal setting out proposed amendments to the ARC. Some of the amendments provide additional detail and clarity with respect to transfer pricing and shared corporate services. Other amendments remove some unnecessary requirements from the existing ARC and provide some additional flexibility to distributors in relation to the services they may provide to affiliates. However, the Board has introduced some new requirements that will serve as new sources of uncertainty if adopted and has maintained the status quo with respect to matters that fall outside the Board's jurisdiction. The EDA's submissions on the proposed amendments are set up below and are organized in the same order in which the proposed amendments are addressed in the Board's notice.

(b) Section 1.1 - Purpose of the Code

In its notice, the Board states that the purpose section of the ARC "serves an important role as the expression of the Board's objectives in establishing the provisions of the Code." The Board then goes on to discuss the elimination of some of the existing objectives and the incorporation of some new objectives.

Regardless of what objectives are removed or inserted in the ARC, the Board's jurisdiction is still determined by the provisions of the OEB Act. The requirement to be guided by the objectives of the OEB Act and the purposes of the Electricity Act is not affected by the removal or insertion of objectives in the ARC. Whatever objectives the Board proposes to include in the ARC must be consistent with the objectives set out in the OEB Act in the purposes of the Electricity Act. Furthermore, regardless of the objectives that may be stated in the ARC, the rules that are set out in the ARC must be consistent with the objectives of the OEB Act and the purposes of the Electricity Act.

On the specific objectives set out in the proposed amendments, the EDA makes the following submissions:

a) protecting ratepayers from harm that may arise as a result of dealings between a utility and its affiliate;

This is an appropriate objective.

b) preventing a utility from cross-subsidizing competitive or non-monopoly activities;

This objective should be clarified to reflect that it is a utility's ratepayers that should not be cross-subsidizing the activities of affiliates. Furthermore the prevention of cross-subsidies should apply to all affiliate activities and not just competitive or non-monopoly activities.

c) protecting the confidentiality of information collected by a utility in the course of provision of utility services;

This objective should be clarified so as to apply to information that is not otherwise publicly available.

d) ensuring there is no preferential access to utility services;

This is an appropriate objective.

e) preventing a utility from acting in a manner that provides an unfair business advantage to an affiliate that is an energy service provider*;* and

In principle, this is an appropriate objective. However, the reality is that many stakeholders take the position that any business advantage is, by definition, unfair. There has been no discussion in the notice or the Board staff research paper that preceded the notice on what actually constitutes an "unfair" business advantage. The ability of a distributor to provide services to an affiliate at a fully allocated cost may provide that affiliate with a business advantage over its competitors in certain circumstances but that does not make it unfair. For example, if a distributor jointly markets a conservation program with an affiliate, that affiliate may have a business advantage over others who may want to market a similar conservation program. However, both distributors and affiliates are authorized to carry out conservation programs and such activities are in furtherance of Provincial policy objectives. To the extent that joint marketing reduces the cost of the delivery of the program, this is an economic benefit that ought not to be prevented by the ARC. In fact, this example is no different from the joint marketing activities that the Ontario Power Authority (OPA) itself is currently engaging in with distributors. The OPA is also engaging in private sector programs and this simply underlines the importance of the need for the Board to remain focussed on its statutory role and not to make

rules that result from the examination of one aspect of a market that the Board does not actually regulate.

A business advantage can make an affiliate more competitive without making it anti-competitive. It is important that the Board recognizes this well-developed principle and ensures that the ARC reflects this.

f) preventing customer confusion that may arise from the relationship between a utility and its affiliate.

In principle, this is an appropriate objective.

Additional comments regarding ARC objectives

In its notice, the Board has indicated that it does not believe that "the addition of a reference to utility efficiency or cost-effectiveness as an objective of the Electricity ARC is necessary." Given the central importance of this objective and the fact that it is a primary objective that the Board is to be guided by in everything that it engages in, it is not clear why the Board would be reluctant to include such an objective in the ARC. The objectives that are set out in the ARC will assist in the interpretation and application of the rules that are contained in the ARC and should include an objective that acknowledges that, where appropriate, a distributor should pursue utility efficiency and cost-effectiveness.

(c) Section 1.2 - Definitions

The Board is proposing a number of new definitions and has made adjustments to several definitions for housekeeping purposes. The EDA does not take issue with any of the proposed new definitions except for "strategic business information". The EDA's concerns regarding this definition are addressed in (g) below as part of the comments on the proposed new section 2.6.4. Submissions on existing definitions and the new definition for shared corporate services follow below.

(c.1) "confidential information"

The definition of confidential information, as currently set out in the ARC, should be restricted to information that is not otherwise publicly available. This would be consistent with privacy legislation and there is no need to protect information that is otherwise publicly available. When information is publicly available to an affiliate, it makes no difference whether that information comes from a utility or some other source.

(c.2) "energy service provider"

The Board is proposing to maintain the current definition of "energy service provider". The current definition includes “energy management services” and "demand-side management programs". The Board has been charged with ensuring that there are no unnecessary barriers to the delivery of conservation and demand management (CDM) programs. Furthermore, the OEB Act has been amended specifically to authorize distributors to carry out CDM activities. CDM programming is a key component of the Province’s energy policy and distributors have been identified as key delivery agents. By including CDM activities in the definition of "energy service provider", the ARC rules as they relate to the relationship between a distributor and an "energy service provider" create a considerable risk that the uncertainty created by the bulletins released by the Compliance Office will continue, to the detriment of CDM programming.

The EDA proposes that the reference to “energy management services” and “demand-side management programs” be removed. The rules relating to transfer pricing and the prevention of cross-subsidization are sufficient to protect ratepayers in relation to the delivery of CDM programs. The OPA is working with distributors and other companies to deliver a number of CDM programs and a distributor should be in a position to work with its affiliates to deliver these programs, along with any CDM programs that are approved by the Board, without unnecessary rules in the way. The OPA is also working with non-utility parties to deliver other CDM programs. This context must be taken into account by the Board to ensure that programs delivered by distributors, directly or through their affiliates, can be done in an economical and efficient fashion and in a manner that will maximize the benefits of such programs. There is a real risk that inappropriate ARC restrictions will produce negative unintended consequences for the OPA's CDM program.

The definition of "energy service provider" is also problematic because it is open-ended. A significant issue for distributors has been the fact that the Compliance Office has expanded the definition in its bulletins to include other activities such as services relating to street lighting and sentinel lighting. In its notice, the Board identified that one of its objectives was to create greater certainty with respect to the rules set out in the ARC. This definition is one of the places where greater certainty can be achieved if the Board simply identifies the specific activities which fall within the scope of what the Board is permitted to regulate under the statute. If there is a pressing need to add a new activity to the definition, this should be done through a proper process that respects the right of affected parties to be heard before decisions are made and to see those decisions made in accordance with the statute rather than through a compliance bulletin. A compliance bulletin has no legal status and the addition of new activities to the definition through bulletins, not previously considered by the Board, and in the absence of the right to make submissions, achieves very little other than the creation of uncertainty for distributors and other stakeholders. LDCs recognize that such bulletins can provide useful interpretation advice but they are not the appropriate vehicle for making material changes in rules.

(c.3) "shared corporate services"

The EDA does not take issue with the definition. However, it should be expanded to include specific reference to information services, regulatory, procurement, building services, and corporate administration to better reflect the range of shared corporate services that utilities are involved in.

(d) Section 2.1 - Degree of Separation

The EDA welcomes the removal of the requirement for physical separation between a distributor and an energy service provider affiliate.

(e) Section 2.2 - Sharing of Services and Resources

The EDA also welcomes the removal of the prohibition against a distributor using its operating employees to provide services to an energy service provider affiliate.

However, it is necessary to make an exception to allow the use of utility employees for billing and customer service purposes. While such employees will by necessity have access to confidential information, they will not be sharing that information with an affiliate; they will simply be providing customer service and billing service. Distributor consolidated billing is already permissible in the context of electricity retailing and gas marketing regardless of whether the marketer or retailer is an affiliate and an LDC should be able to continue to provide customer service and billing services to its affiliates, even if they are energy service providers.

In addition, section 2.2.3 should be amended to reflect the legal fact that when a utility provides services to an energy service provider affiliate, pursuant to a services agreement, it uses its own employees to provide that service as opposed to sharing those employees with the affiliate. The reference to sharing employees suggests that a utility is releasing its employees to an affiliate but in fact this is not the case. The employees that a utility may use to provide a service to an affiliate remain at all times the employees of the utility, under the direction of the utility. The Board's proposed change to section 2.2.3 should read "A utility shall not use employees directly involved in collecting, or have access to, confidential information to provide a service to an affiliate that is an energy service provider."

(f) Section 2.3 - Transfer Pricing

The Board is proposing to adopt the transfer pricing provisions currently set out in the Gas ARC. In general, the EDA is of the view that these provisions are appropriate but there are some changes that should be made for purposes of clarity and to ensure that the transfer pricing rules are consistent with the need to avoid cross-subsidization by the distributor's ratepayers. The

Board should also consider the financial burden that the new rules will impose, particularly on smaller utilities.

Subsection 2.3.3.2 needs to be amended so that it is clear that the bidding process referred to is to be carried out by the utility when it seeks to obtain a service from an affiliate. As it currently reads, it would appear that an affiliate would also have to carry out a bidding process before it could acquire a service from a utility. The Board has jurisdiction over how a distributor provides a service to an affiliate but not over how an affiliate may acquire such a service.

Subsection 2.3.3.6 needs to be amended to reflect the principle that a utility should charge no less than the fully allocated cost of a service, product, resource or use of an asset provided to an affiliate, regardless of whether a reasonably competitive market exists. As it currently reads, if the market price was less than the utility's fully allocated cost, the ratepayers would be subsidizing the affiliate, which is inappropriate.

(g) Section 2.6 - Restriction on Provision of Strategic Business Information

The Board is proposing a new rule that prohibits the provision of "strategic business information" to an energy service provider affiliate. Such a restriction does not exist in the Gas ARC and it is not clear why such a prohibition is required in the electricity ARC. There is no evidence available to suggest that such a restriction is required.

The definition of strategic business information includes confidential information for which there are already adequate provisions in the ARC. The definition also envisages other information, in addition to confidential information. However, the definition is so broad and open-ended as not to be capable of providing any reasonable direction to a distributor who would be required to comply with this rule pursuant to its licence.

The Board, in its notice, points to examples of the kind of information it is referring to. This appears to be information that would generally be available in a distributor's rate filings and therefore publicly available to anybody who wished to have it. Furthermore, distributors are subject to the Municipal Freedom of Information and Protection of Privacy Act. The proposed restriction encompasses publicly available information.

There is no discussion in the notice or in the Board staff research paper as to how such information would provide an advantage to an affiliate, and even if it could, how that would be inappropriate. There appears to be an implicit presumption that any business advantage is inherently unfair, confusing competitiveness with anti-competitive behavior.

Finally, the restriction is entirely incompatible with the fact that LDCs and their affiliates are permitted to have common directors, subject to a requirement that one-third of them be independent. The restriction is also entirely incompatible with the fact that LDCs and their affiliates are also permitted to have shared corporate services for the purpose of providing strategic management and policy support.

This section should be removed to eliminate unnecessary regulatory uncertainty.

(h) Miscellaneous matters

Section 1.5 should be amended to add "or any Board order" at the end of the section to ensure that Board orders also prevail over the ARC.

Subsection 2.2.2 should be amended to remove the requirement to carry out a review that complies with the provisions of the CICA Handbook. To date, distributors have been informally relieved of the obligation to comply with this requirement as long as sufficient computer data management and data access protocols and contractual provisions are in place. The largest concern is the expense associated with carrying out such a review in the absence of any demonstrated need for it. A full review would be difficult to undertake without considerable time, effort, and a level of cost which could be prohibitive especially if required on an annual basis in order to self-certify compliance with the ARC. Given that the Board has not been requiring compliance with this requirement, it is not appropriate to continue to keep it as a formal requirement in the ARC. Alternatively, the Board should consider changing the requirement so that such a review only needs to be done when requested by the Board or establishing a schedule that recognizes that these are expensive processes to carry out. This would allow the Board to focus on specific cases of concern.

Subsection 2.5.5 is not necessary. Utilities are already under a statutory obligation to provide utility services only in accordance with a rate order and subsection 2.5.5 does not add anything to this obligation.

(i) Implementation issues

The Board has proposed a three month period for implementing any changes that may be made at the end of this code amendment process. A three month period does not allow sufficient time for the work that is involved when changes have to be made to an LDC's processes, procedures, workflow, and possibly the corporate organization of the LDC and its affiliates to obtain compliance with the ARC. A one year period is a more appropriate timeframe to allow LDCs to negotiate agreements, obtain legal advice and management and board of director approvals for whatever changes may be required to comply with a new ARC. A longer period will also reduce the need for exemption requests that will inevitably be required in relation to the three month period, and avoid adding to the regulatory burden of both the Board and LDCs.

The Board also proposes to grandfather service agreements in existence as of June 15, 2007. Given that the Board's notice was not issued until September 19, 2007 and the results of the Board's process will not be known for some time, this represents a retroactive regulatory change. The Board has no statutory authority to engage in retroactive regulation. The law is clear that a regulator cannot engage in retroactive regulation in the absence of clear statutory authority. The OEB Act does not provide the Board with such authorization.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

October 26, 2007

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per Patrick Moran