EDA
The Voice Of Ontario's Electricity Distributors

March 10, 2008

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 Electricity Distributors Association (EDA) would like to provide comments on the revised Proposed Amendments to the Affiliate Relationships Code issued on February 11, 2008. The EDA has consulted with its members on the revisions, and the following comments in the attached document focus on the changes made from the September 19, 2007 version of the proposed amendments.

Yours truly,

"original signed"

Richard Zebrowski
Vice President, Policy & Corporate Affairs

Attach.

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EDA Comments on February 11, 2008 Proposed Amendments to Affiliate Relationships Code for Electricity Distributors and Transmitters EB-2007-0662

Energy Service Provider Definition

The revised proposed amendments provide an expanded definition for energy service provider. In the EDA's previous submission dated October 26, 2007, the EDA had asked for more guidance on the definition of energy service provider, and the EDA appreciates the greater clarification. However, the examples provided have now resulted in new concerns being raised by members.

The revised proposed definition of energy service provider includes the following additional services:

- street lighting services;
- sentinel lighting services;
- metering (including smart sub-metering that is the subject of the Smart Sub-Metering Code and wholesale metering); and
- billing for electricity or natural gas services.

Given that section 2.2.3 prevents sharing with an energy service provider affiliate any employees directly involved in collecting or having access to confidential information, this revised definition would effectively prevent distributors from achieving economies through employee sharing with any affiliate providing billing services.

It is EDA's understanding that an intended purpose of section 2.2.3 is to prevent energy service provider affiliates from gaining an unfair competitive advantage over other entities who provide services to the distributor's customers. This principle has been described by the Chief Compliance Officer in a Compliance Bulletin (200604 pg 3) as follows:

> *Distributors are both required and entitled to collect confidential information about current and prospective customers. That information may be of considerable value to any entity that wishes to provide unregulated products or services* ***to the distributor's customers****. As monopoly service providers, distributors are in a privileged position in this regard, and it is in my view inappropriate for an affiliate of a distributor to gain a competitive advantage by means of access to customer information. This is not to diminish the importance of maintaining the confidentiality of confidential information as a goal unto itself, which is addressed in other Code and licence provisions as a separate matter.* [bold emphasis added]

The EDA submits that there is a significant distinction to be made between energy service provider (ESP) affiliates that are consumer-oriented (i.e., those that offer products or services to residential and general service end-use consumers), and energy service provider affiliates that are utility-oriented (i.e., those that provide products and services to utilities). The issue of protecting customer-confidential information, gathered in the course of providing utility service, is pertinent

in relation to consumer-oriented ESPs but not to utility-oriented ESPs, notwithstanding that customer-confidential information must be appropriately protected in all circumstances. The converse holds for the issue of preventing undue advantages being accorded to utility affiliates in contestable markets: the issue is pertinent for utility-oriented ESPs but not consumer-oriented ESPs.

The use of one undifferentiated term, "energy service provider", and the introduction of new activities such as billing and streetlighting into the definition of ESP, lead to confusion and inappropriate restrictions resulting from desirable protections in one area (such as the protection of customer-confidential information) being misapplied to other areas in which they do not belong. For example, the EDA believes that where a utility-oriented ESP affiliate offers no services to the distributor's customers, the use of shared employees with access to confidential information would provide no competitive advantage to the affiliate and consequently that such sharing should be permitted. Clearly if the affiliate is not offering services to its affiliated distributor's customers, the affiliate would have no use for the affiliated distributor's customer information, again with no detraction from the need to protect confidential information at all times. The EDA recognizes that confidential customer information must be protected; however protecting confidential information is addressed in other ARC and license provisions as a separate matter.

The situations where an energy service provider affiliate should be considered "utility-oriented" include those where:

- the affiliate offers no services directly to end-use customers, but rather only to the affiliated distributor and/or other organizations such as utilities and municipalities;
- the affiliate offers products and/or services to end-use customers only outside the affiliated distributor's service territory.

The revised ARC should not create unnecessary restrictions, motivated by a concern to protect customer-confidential information, on employee sharing with utility-oriented affiliates when the sharing is intended to maximize benefits to ratepayers and when there is no conflict with the basic principles embedded in the ARC.

Further support for the EDA's position that the restriction in section 2.2.3 of the ARC should not apply to utility-oriented energy service providers can be found in Board staff's June 15, 2007 Staff Research Paper, where the primary purposes of section 2.2.3 were described as follows (page 21):

> *The primary purposes of the employee sharing provisions are to preclude:*
> *• customer confusion;*
> *• sharing customer information where such could provide the affiliate with an unfair competitive advantage;*
> *• sharing customer information where such could result in the affiliate soliciting utility customers in the sale of the affiliate's own services;*
> *• leveraging by the affiliate of the utility's "inherent" market power by creating the impression that the utility or the regulator endorses or controls the affiliate's business.*

None of the purposes described are relevant to the situation where an energy service provider operates exclusively outside its affiliated distributor's service area or offers no services to customers. Customers would not be confused since they would not be customers of the affiliated distributor; the affiliate would have no unfair competitive advantage; the affiliate would not solicit the affiliated distributor's customers; and the affiliated distributor would have no "inherent" market power outside its service area where the affiliate is offering services.

The OEB Staff Research Paper, in describing the purpose of the definition of energy service provider, recognized the connection between an energy service provider's market and its affiliated distributor's service area:

> *The current Electricity ARC definition of "energy service provider" is based on the principle that the close relationship with distribution services warrants mitigation of the potential for an affiliate to draw undue advantage of the utility's monopoly position. This is because the Ontario electricity distributors and their energy service provider affiliates operate almost exclusively in the same territory, which has the tendency to magnify the risk of customer confusion and inherent competitive advantage in a number of areas…*
>
> and
>
> *Narrowing the definition of ESP could provide more flexibility to the distributors to achieve greater efficiencies through sharing of resources with their affiliates. However, as discussed in the role of competition section above,* ***depending on the market of the affiliate****, narrowing the energy service provider definition could provide an unfair competitive advantage to the utility affiliate relative to its competitors.* [page 17 emphasis added]

Given the proposed expanded definition of energy service provider with the additional services, the EDA submits that section 2.2.3 should be amended to avoid the harmful and unnecessary restriction described above. To that end, the EDA proposes the following amendment:

> 2.2.3 A utility shall not share with an affiliate that is an energy service provider employees that are directly involved in collecting, or have access to, confidential information, <u>if that affiliate offers any unregulated products or services to consumers within the utility's service area</u>.

Billing Services in the Definition of Energy Service Provider

The EDA also has specific concerns with the inclusion of billing in the proposed definition of energy service provider. Billing services are back-office services where the end-use customer is unaware of the billing service provider's identity. As a result there is no opportunity for customer confusion resulting from the use of an affiliated or third-party billing service provider. With respect to confidential customer information, an affiliate providing only billing services would have no use for that information since the client would be a distributor, and no services are provided directly to customers.

The EDA believes the inclusion of billing services in the proposed definition of energy service provider serves no purpose and offers no additional protection to customers, when a billing services affiliate is providing no services directly to the affiliated distributor's customers. In situations where a billing services affiliate does provide services to the distributor's customers, then it would be an energy service provider and would be covered in the definition of energy service provider by the other additional services listed.

As a result the EDA believes billing services should be removed from the proposed definition of energy service provider as follows:

> "energy service provider" means a person, other than a utility or a municipal corporation, involved in the supply of electricity or gas or related activities, including retailing of electricity, marketing of natural gas, generation of electricity, energy management services, demand-side management programs, street lighting services, sentinel lighting services, metering (including smart sub-metering that is the subject of the Smart Sub-Metering Code and wholesale metering), ~~billing for electricity or natural gas services~~ and appliance or water heater sales, service and rentals;

Exemptions for Specific Circumstances

The EDA notes that in the OEB's February 11, 2008 notice summarizing the proposed amendments, on page 5 it indicates that the Board is prepared to provide an exemption to section 2.2.3 (re: sharing of employees with confidential information), under particular circumstances, such as situations where a distributor uses confidentiality agreements and can demonstrate no harm to ratepayers, no customer confusion, and no cross-subsidization of the affiliate. The EDA suggests that the criteria for the exemption eligibility should be specified as a new section 2.8, to provide clarity to distributors considering their unique situations. EDA members have indicated that they have many situations where an exemption would appear to be appropriate and codifying the criteria will provide long-term certainty and reduce the potential for unnecessary extensive reorganizations. The EDA respectfully proposes the following wording:

Section 2.8 (new) Exemptions

> Upon application by a utility for an exemption and where it can be demonstrated in particular circumstances that such an exemption would result in no harm to ratepayers, no customer confusion and no cross subsidization of the affiliate, such applications will be approved by the Board.

Transfer Pricing Where Market Exists

In the EDA's October 26, 2007 submission, the EDA argued that section 2.3.3.6 needs to be amended to reflect the principle that a utility should charge no less than fully allocated costs, regardless of whether a reasonably competitive market exists. The revised amendments have incorporated this by requiring a distributor to charge no less than the greater of the market price or the distributor's fully allocated costs. Regrettably, the EDA had not fully discussed with its members the implications of using fully allocated costs as a minimum in all situations. Members

have indicated that the preferred approach would be to set the direct costs as the minimum when a market exists. As defined in the ARC, directs costs are costs that can reasonably be identified with a specific unit of product or service or with a specific operation or cost centre. Distributors use direct costs in setting charges for certain specific services provided to certain customers. The EDA believes direct costs would be appropriate in setting the minimum for service fees where a market exists.

The concern expressed regarding using fully allocated costs as a minimum when a market exists arises when the market price is below fully allocated costs, but above the direct costs that a utility incurs to provide a service.

A distributor recovering more than its direct costs would provide a net benefit to its customers. To maximize the benefit and ensure the business is obtained, a distributor would typically offer services at the market price and only when the market price exceeds the direct costs.

If distributors were required to offer services only when market prices exceed the fully allocated costs, distributors would lose the opportunity to obtain additional net revenues and the additional benefits to ratepayers when the market price exceeds the distributor's direct costs.

The EDA believes that distributors should be given the flexibility to match market prices when they exceed direct costs. As a result the EDA proposes the following as the revised section 2.3.3.6:

> 2.3.3.6 Where a reasonably competitive market exists for a service, product, resource or use of asset, a utility shall charge no less than the greater of (i) the market price of the service, product, resource or use of asset or (ii) the utility's <u>direct costs</u> to provide service, product, resource or use of asset, when selling that service, product, resource or use of asset to an affiliate.

Competitive Bidding Process and Use of Independent Evaluator

The EDA would like to provide further comments on the use of an independent evaluator for competitive bidding processes. The EDA understands that the requirement to use an independent evaluator is consistent with current requirements in the Gas ARC. The EDA feels it is important to highlight that there are some concerns with these provisions which have not yet been fully tested in the more mature Gas industry and applying them to the Electricity ARC.

In order to implement these provisions of the ARC, it is likely that utilities will have to make significant changes to internal policies and processes. Given the varying corporate structures and size of the electrical utilities, the time required to identify and contract for the services of an independent evaluator, and the fact that different rules will apply once it has been determined whether a market exists, does not exist, or the definition of shared corporate services applies to the outsourced service, product, resource or use of asset, it is impractical to accomplish what is required within the three-month timeframe.

While the Board has suggested in the February 11, 2008 Notice, that most (if not all) utilities would be able to make the necessary changes within three months to comply to the new transfer pricing amendments, the EDA, after discussions with its members, respectfully requests that the Board re-examine this timeline. 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 a distributor's processes, procedures, workflow, and possibly the corporate organization of the distributor and its affiliates to obtain compliance with the ARC. A one-year period is a more appropriate timeframe to allow distributors to negotiate agreements, obtain legal advice and management and board of director approvals for whatever changes may be required to comply with the new ARC provisions for competitive bidding. A longer period will also reduce the need for exemption requests that will inevitably be sought by distributors.

Restriction on Provision of System Planning Information

The EDA appreciates the OEB's efforts to address distributor concerns regarding the proposed restriction on provision of strategic business information to energy service affiliates by more clearly defining the nature of the information to which the restrictions apply and replacing it with the term 'system planning information'. However, EDA members have identified new concerns, especially regarding practical implementation issues.

The revised discussion of system planning information provides more specific examples and includes plans for equipment acquisitions, work management, billing systems and call centre operations. The EDA members do not believe that sharing information with affiliates in all these areas would provide an unfair business advantage. During ongoing work with affiliates that have existing contracts to provide services to the distributor, distributors must and routinely do share planning information that assists these contractors in carrying out their work. Members believe the only situation in which information could present an unfair advantage for affiliates would be when the distributor plans to outsource these functions and when there is a market for the service. However, Section 2.3.3.2 requires distributors to use a fair and open competitive bidding process when there is a market, and to ensure it is fair, distributors would ensure the same system planning information would be available to all bidders.

Distributors are concerned that they will be burdened with unnecessary or premature requests for system information. Distributors are concerned about potential misuse of the information given that the system planning information would be changing over time. Distributors raised a number of other practical concerns.

As a result of the issues raised by members, the EDA believes that further consultation is required on the proposed restriction on provision of system planning information. The EDA believes a technical conference involving all stakeholders and OEB staff would be of assistance in understanding stakeholder and OEB staff concerns, and distributor concerns regarding the sharing and public availability of system planning information.

Shared Corporate Services Definition

The definition of "shared corporate services" should be amended to ensure that the list of services is not exclusive. Though the list is long, it is possible that there are other functions (e.g. fleet management, stores and supplies management, mailroom) that fall into the general character of the listed items. The OEB, through its Compliance Office, is charged with protecting consumers' interests by evaluating these additional functions according to the general character of the listed items. Therefore, the paragraph should read:

> "shared corporate services" means business functions that provide shared strategic management and policy support to the corporate group of which the utility is a member, including legal, regulatory, procurement services, building or real estate support services, information management services, information technology services, corporate administration, finance, tax, treasury, pensions, risk management, audit services, corporate planning, human resources, health and safety, communications, investor relations, trustee, or public affairs;"