Assurance of Voluntary Compliance

Pursuant to section 112.7 of the
Ontario Energy Board Act, 1998

INNPOWER CORPORATION
(Licence No. ED-2002-0520)

EB-2019-0090

April 26, 2019

I. Background

In response to concerns raised about InnPower Corporation's compliance with the *Affiliate Relationships Code for Electricity Distributors and Transmitters* (ARC) in the course of the hearing of InnPower's last cost-of-service rates application, the Ontario Energy Board (OEB) decided to "undertake an audit of InnPower's affiliate transactions to ensure its allocation of costs and approach to costing and applicable revenue complies with the *Affiliate Relationships Code*."[1]

The OEB's Audit and Investigations staff conducted an audit of InnPower's affiliate transactions for the 2017 calendar year. The audit focused on the transactions at issue in the rates case. Following the audit, InnPower agreed to provide this Assurance of Voluntary Compliance (Assurance) to the OEB under section 112.7 of the *Ontario Energy Board Act, 1998* (OEB Act).

II. Statement of Facts

InnPower is a licensed electricity distributor that operates a distribution system in the Town of Innisfil and parts of the City of Barrie. InnPower is owned by the Town of Innisfil. InnPower provides certain services to two affiliate companies, also owned by the Town of Innisfil: InnServices Utilities Inc. (which provides water and wastewater services in the Town of Innisfil) and InnTerprises Inc. (which provides electricity-related products and services such as rentals of sentinel lighting and communication towers). These services comprise accounting/financial services (e.g. preparation of financial statements) and billing services (e.g. bill issuance and collections). In addition, InnPower rents office space to InnServices. The charges for these services are set out in service agreements between InnPower and its affiliates. All three companies share the same CEO.

The ARC specifies how a distribution or transmission utility must charge an affiliate for a service. Where "a reasonably competitive market exists" for the service, the utility must charge no less than the greater of (i) the market price of the service and (ii) the utility's fully-allocated cost to provide the service.[2] Where, on the other hand, a reasonably competitive market does <u>not</u> exist for the service, the utility must charge no less than its fully-allocated cost.[3] Finally, with regard to shared corporate services, fully-allocated

[1] Decision and Order, March 8, 2018 (EB-2016-0085), p. 17.
[2] ARC, section 2.3.3.6.
[3] ARC, section 2.3.4.2.

cost-based pricing may be applied between a utility and an affiliate in lieu of applying the market-based transfer pricing provisions of ARC.[4]

InnPower acknowledges that for billing services, it did not perform an analysis to determine whether a reasonably competitive market exists.

InnPower further acknowledges that it did not determine the fully-allocated cost of providing services to its affiliates, or charge its affiliates on that basis. As defined in the ARC, "fully-allocated cost" means the sum of direct costs plus a proportional share of indirect costs. Indirect costs are costs that cannot be identified with a specific unit of product or service or with a specific operation or cost centre, such as overhead, administrative and general expenses. Article 340 of the OEB's *Accounting Procedures Handbook for Electricity Distributors* stipulates that the methods used in the allocation of costs should be documented and reviewed on a regular basis.

In particular, Audit and Investigations staff found – and InnPower does not dispute – that:

- InnPower's methodology for calculating and allocating overhead costs was:
  - not properly documented or substantiated
  - did not take into account depreciation expenses on InnPower assets such as computer and office equipment
  - erroneously used a mix of budgeted and actual costs to calculate allocable information technology costs
- InnPower's methodology for calculating the cost of the billing services provided to InnServices did not reflect a reasonable allocation of all direct and indirect billing costs (it simply split in half the total billing costs for electricity and water bills)
- InnPower did not include any return on invested capital in its calculation of fully-allocated cost, as required under section 2.3.4.2 of the ARC

InnPower further accepts staff's findings that:

- InnPower's affiliate service agreements do not include all the terms specified in section 2.2.1 of the ARC; in particular, the agreement with InnServices does not include cost allocation mechanisms, and the agreement with InnTerprises does not include cost allocation mechanisms, confidentiality arrangements, apportionment of risks, or a dispute resolution process
- InnPower has not established any management processes to ensure ongoing compliance with the ARC; in particular, InnPower does not perform periodic

[4] ARC, section 2.3.5.1.

compliance reviews and monitor its employees' compliance with the ARC, as required under section 2.7.1 of the ARC

Recently a new management team took over at InnPower and it has been working diligently to address the issues regarding affiliate transactions.

In the cost-of-service proceeding, InnPower acknowledged that its forecasted affiliate transactions for 2017 were initially based on incremental costs rather than fully-allocated costs. In its reply submission, InnPower provided an estimate of $166,230 in overhead costs to be allocated to InnServices (resulting in an additional revenue offset of $166,230). The OEB approved InnPower's revised forecast of affiliate services revenue of $757,539 (which included the $166,230 of overhead), but directed InnPower to create two new variance accounts effective January 1, 2018 – one to record the difference between the $757,539 and "appropriate actual" revenues determined as a result of the OEB audit, and the other to record the difference between the approved forecast of affiliate services expenses ($704,939) and the fully-allocated costs as determined by the audit.

InnPower recalculated the affiliate services revenues and expenses for 2017 in accordance with the ARC and staff's findings above. Appropriate affiliate revenues were $920,410 and appropriate affiliate expenses were $800,357. As a result, InnPower will record $162,871 in the variance account for affiliate revenues as of December 31, 2018, and $95,418 in the variance account for affiliate expenses. The net impact for 2018 is a credit amount of $67,453 in additional revenue offsets. That amount will be refunded to customers, subject to OEB approval to dispose of the variance accounts in another proceeding. Staff confirmed its acceptance of these calculations in its audit closure letter of April 9, 2019.

III. Assurance

InnPower hereby assures the OEB that it will take the following measures to remedy the contravention of the ARC (namely, sections 2.2.1, 2.3.3.6, 2.3.4.2 and 2.7.1), and to prevent a contravention of those provisions.

1. Within 60 calendar days of the date this Assurance is accepted by the OEB, InnPower will provide the OEB with a letter:

    a. confirming that InnPower has amended its agreements with its affiliates to include all the terms specified in section 2.2.1 of the ARC
    b. confirming that InnPower has established a process to ensure ongoing compliance with the ARC, including the elements required by section 2.7.1 of the ARC, and describing that process

2. Within 14 calendar days of the date this Assurance is accepted by the OEB, InnPower will pay the OEB an administrative monetary penalty in the amount of $25,000. Payment should be made by cheque or electronically with notice sent to the Board Secretary.

IV. Failure to Comply

InnPower acknowledges that this Assurance has the same force and effect as an order of the OEB pursuant to section 112.7(2) of the OEB Act.

V. Execution of Assurance

I have the authority to bind InnPower to the terms set out in this Assurance.

Name: Walter Malcolm

Title: President & CEO

Signature: W J Malcolm

Dated this 26rd day of April, 2019