

**Submission of Essex Powerlines Corporation in response to  
the Board Staff Research Paper: Affiliate Relationships Code  
for Electricity Distributors and Transmitters, dated June 15,  
2007**

Essex Powerlines Corporation (Essex) welcomes the opportunity to provide comments on this staff research paper. Essex agrees that changes are required to the Affiliate Relationships Code as the market and LDC activities have changed and evolved since the original vision of the electricity distribution industry in 1999. As stated in the OEB's staff research paper, the majority of LDC's in the province have one or more affiliates operating in the province. LDC's and their affiliates have had several years of experience to the benefit of the ratepayer.

The Ontario Energy Board's mandate is to promote economies and efficiencies in the industry that benefit ratepayers. Interpretation bulletins issued by the Chief Compliance Officer do not accept that the industry has evolved differently than originally intended and the affiliate code needs to reflect these changes to benefit ratepayers. These bulletins do not promote efficiencies and will ultimately increase costs to ratepayers. However, providing flexibility in the ARC for LDC relationships will promote efficiencies and savings to the ratepayer.

Essex supports the principles of the legislation such as:

- 1) No cross subsidization of an affiliate by the utility.
- 2) Efficiencies between an affiliate and a utility should be allowed if they benefit the ratepayer
- 3) Confidential customer information should be protected from misuse by an energy retailer affiliate
- 4) Energy retailer affiliates should not have any unfair advantage over other retailers due to the affiliate's relationship with the utility
- 5) An affiliate should not have preferential access to regulated energy services

In regard to these principles the staff research paper asks for comments on the following questions:

- 1) Does utility efficiency belong in the Electricity ARC as a code objective?
- 2) Does competition belong in the Electricity ARC as a code objective?
- 3) Should the current Electricity ARC definition of energy service provider be narrowed or eliminated entirely?

- 4) Should the current Electricity ARC treatment of “confidential information” be narrowed or otherwise changed?
- 5) Should the Electricity ARC rules on the sharing of employees between utilities and their affiliates be made more flexible?
- 6) Do the Electricity ARC provisions regarding the percentage of independent utility directors remain appropriate?
- 7) Should the current Electricity ARC rules for market or cost-based pricing of goods and services be changed?
- 8) Should the Gas ARC outsourcing provisions be included in the Electricity ARC?
- 9) Should the cost-based pricing rules for shared corporate services used in the Gas ARC be extended to the Electricity ARC?
- 10) Should the asset transfer-pricing provisions of the Electricity ARC mirror the requirements of the Gas ARC rules?
- 11) Should the Electricity ARC rules or exemption process treat small distributors differently?

To answer these questions, one needs to discuss the evolution of the industry to where we are today with respect to the Affiliate Relationship Code. The Ontario Energy Board has admitted to not anticipating that LDC's and affiliates would enter into competitive type businesses. While there were no specific rules or guidelines on corporate structures as hydro commissions amalgamated and corporatized in 1999, many of the municipal shareholders realized there were opportunities to gain efficiencies to the benefit of ratepayers and additional returns to the municipal shareholders to offset provincial downloading costs by forming other affiliated businesses. When 66 out of 85 utilities have affiliates, this must be an indication that affiliate structures are providing a benefit to the industry and the ratepayer. They also realized that energy retailing was not the type of business they would participate in as they did not have the expertise to facilitate this as a successful business. The retail market has subsequently changed significantly since 2002 and it is unlikely that there will be a substantial number of LDC's with retail affiliates entering the market in the future.

The industry's interpretation of the original ARC was to protect competition in the retail sector from any perceived unfair advantage that LDC's may have had. However as stated above, LDC's or their affiliates did not actively enter the commodity retailing market. They did enter some other markets available to them.

As the retailing of the electricity commodity was the only competitive activity that the OEB was empowered to control, it appeared that other competitive businesses should not be of concern to the OEB. As the competitive mandate for the OEB has been removed, the OEB should be neutral on what other business they are to control. The comments in the paper that removal of competition from the act represents a mandate for the OEB to promote non-competitiveness by LDC's and their affiliates is not in our opinion, the proper interpretation of the legislation. As there are other governmental bodies such as

the Competition Bureau of Ontario to control anti-competitive behaviour, the OEB should not be concerned with these activities and trying to control them.

In an effort to control these activities, the Chief Compliance Officer has attempted to use the original ARC to extend its influence on these new competitive activities and to ensure that the 5 principles of the legislation are followed. This will not benefit the ratepayers.

### **Response to OEB Questions**

1) Does utility efficiency belong in the Electricity ARC as a code objective?

The promotion of efficient utility operations is an important regulatory goal for the OEB. Too many rules that limit the interactions between affiliates and utilities will limit the efforts to gain efficiencies and may ultimately increase costs to the rate payers. We agree that adding a reference to efficiency in the purpose section of the Electricity ARC would make it consistent with Ontario legislation as set out in the OEB Act sections 1 and 73 and Electricity Act section 1.

Including this reference in the code would not eliminate or temper the other objectives such as preventing cross-subsidization, control of confidential information and preferential treatment of affiliates. Rather, the inclusion of promotion of efficiency would ensure that application of the ARC would result in the best outcome for ratepayers.

2) Does competition belong in the Electricity ARC as a code objective?

As competition in the electricity commodity retail market has been removed from the OEB legislation, it should be removed from the ARC. As stated earlier, we propose that the OEB should not be concerned with LDC's or their affiliates entering into other competitive markets. The Competition Bureau of Ontario will ensure that there is a fair competitive market and the OEB does not have the resources to control competitive activities in seemingly unlimited markets.

Competitive markets will develop and evolve on their own. There are parts of the utility industry that are evidence of this. Meter Reading and Forestry are two examples of utility activities that have evolved into competitive businesses and out of core utility activities. Legacy costs in LDC and affiliate business make it difficult to continue to compete effectively with other industries in the long run.

The OEB should continue to ensure that customer confidential information and cross subsidization is controlled in this environment.

Essex would also comment that providing flexibility in the LDC to achieve additional revenue streams by entering other related businesses would eliminate the need for affiliates as well as reduce the revenue requirement leading to lower rates.

3) Should the current Electricity ARC definition of energy service provider be narrowed or eliminated entirely?

Our interpretation of the original ARC was narrow and related to the commodity retailing market that we agree should continue to be closely monitored by the OEB.

We concur that the definition should include appliance sales but exempt sentinel lights. As sentinel lights are directly connected in some instances to the distribution system, they should be installed and maintained by qualified high voltage experts in the LDC and its service affiliates. There is no risk with respect to sentinel lights for the misuse of confidential customer information. There is also a limited market for sentinel lights which also minimizes the risk.

- 4) Should the current Electricity ARC treatment of “confidential information” be narrowed or otherwise changed?

Customer confidential information needs to be protected in the commodity retail and appliance sale business but this definition should be changed or interpreted to exclude information that is otherwise available to the public. The definition could be narrowed to exclude names, addresses and phone numbers but include consumption. Information regarding a customer’s service size is required by the LDC or its service affiliate for affecting repairs or upgrades. This information would also have to be available to a third party contractor. There is limited risk in the misuse of this information. Written authorization of the release of confidential information could be required to abate concerns by the OEB.

- 5) Should the Electricity ARC rules on the sharing of employees between utilities and their affiliates be made more flexible?

Essex agrees that the sharing of employees between utilities and their affiliates should be made more flexible. As in many industries, a large portion of LDC costs are labour and related benefits. The ability to share employees with affiliates reduces the number of employees required for day to day activity and increases the number of employees available for emergency and special situations. There are ways to ensure that the sharing of employees does not compromise the release of confidential customer information. This can be achieved by confidentiality agreements and limits on what type of employees can be shared. The current ARC section 2.2.4 is applicable if the definition of energy service provider is narrowed to include the retailing of electricity only. Otherwise, this definition will limit the ability to share employees and ultimately increase costs to the ratepayer. What is the harm if an employee is installing underground services for an affiliate in the morning and then is required to assist the LDC in the afternoon to operate the system to restore power during an outage? They do not have direct contact with the customer and therefore there should be no customer confusion or access to confidential information. This example offloads costs for this employee in the morning to the affiliate but provides the opportunity to reduce outage time in the afternoon by taking advantage of the larger available workforce.

- 6) Do the Electricity ARC provisions regarding the percentage of independent utility directors remain appropriate?

The current percentage of independent directors is adequate. If raising the percentage of the independent directors would result in less stringent transfer pricing rules, Essex would support that decision.

- 7) Should the current Electricity ARC rules for market or cost-based pricing of goods and services be changed?

Essex suggests that the current ARC rules be changed to include other methods of determining market value. A valid tendering process is one indicator of market value but is a very time consuming and expensive exercise for all activities broken down to the finest detail according to the CCO. How often tendering should occur has also not been indicated in the code or by the CCO which makes it difficult for the LDC to determine what is appropriate. Bundling of some activities do provide benefits to the ratepayer due to reduced tendering costs. Market value can be provided by other methods such as “like” job comparisons, tendering on a required percentage of work, LDC review of affiliate costs and financial statements. Thresholds for required tendering to determine market value would reduce tendering costs to the ratepayer (eg. >\$100,000). Pricing based on fully allocated costs plus a mark up no greater than allowed in the LDC cost of capital ensures that the price is not substantially more that would be incurred if the LDC performed the work directly.

The paper refers to an objective of the code is to protect third-party service providers from anti-competitive behaviour resulting from ratepayer subsidy of competitive operations. As stated previously, controlling various competitive markets is not the mandate of the OEB. Will the OEB define what markets they intend to control? This may be an onerous task for the OEB as there are limitless markets that LDC and affiliates may choose to operate in. The OEB can ensure that cross-subsidization is not occurring but they should not be concerned with anti-competitive behaviour. This is the responsibility of the Competition Bureau of Ontario.

- 8) Should the Gas ARC outsourcing provisions be included in the Electricity ARC?

Essex proposes that this not be included in the electricity ARC. Outsourcing decisions are the responsibility of the Board of Directors of the LDC. All outsourcing decisions are supported by a business case and are not justifiable otherwise. The OEB’s involvement at this level is micro managing the LDC which goes against the principle of light handed regulation.

- 9) Should the cost-based pricing rules for shared corporate services used in the Gas ARC be extended to the Electricity ARC?

Essex proposes that rules in the Gas ARC should not be extended to the electricity ARC. As there has been direction provided by the CCO that shared corporate services can be priced on a cost-plus basis and this is an acceptable industry standard, Essex supports not changing the code as it will introduce additional costs to be born by the ratepayers.

- 10) Should the asset transfer-pricing provisions of the Electricity ARC mirror the requirements of the Gas ARC rules?

Essex proposes that the current asset transfer rules are adequate. The Gas ARC rules require transfer at the higher of market value or book value. There may be a benefit or a detriment to the ratepayer if market value is utilized and depending on the direction of the transfer. Market value can be a subjective issue requiring additional

scrutiny from the OEB. Book value is a fair value to use and requires less overview from the OEB.

11) Should the Electricity ARC rules or exemption process treat small distributors differently?

There should not be special rules for different sized distributors. If required a distributor can apply to the OEB for a special ruling or exemption.

Essex also supports the comments included in the EDA submission on the research paper.