

July 20, 2007

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Board Secretary
Ontario Energy Board
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**Subject: OEB Staff Research Paper on the Electricity Affiliate Relationships Code
File No.: EB-2007-0662**

In follow-up to the Ontario Energy Board's ("the Board") letter of June 15, 2007 with respect to the preliminary Staff Research Paper analyzing the application of the Ontario Affiliate Relationships Code for Electricity Distributors and Transmitters (the "Electricity ARC") in the current electricity market, the Coalition of Large Distributors ("CLD") consisting of Enersource Hydro Mississauga, Horizon Utilities, Hydro Ottawa, PowerStream, Toronto Hydro-Electric System and Veridian Connections, wishes to offer the following comments.

The CLD members welcome the Board staff initiative to review and invite stakeholder comments on the objectives and application of the Electricity ARC as it relates to the existing electricity market. In responding, the CLD has focused on the eleven (11) issues presented in terms of their relevance to the objectives of the Electricity ARC and meeting the associated compliance requirements. The CLD has also reviewed the submission put forth by the Electricity Distributors Association ("EDA") and supports the EDA's position.

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

Response:

The *Ontario Energy Board Act, 1998* ("OEB Act") sets out only two objectives for the Board, and one of them is: "*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.*" For this reason the Board should ensure that all of its codes are directly aligned to the objectives of the OEB Act, including the Electricity ARC.

Economic efficiency is not the primary purpose of the Electricity ARC. However, the Electricity ARC should support an LDC in achieving economies and efficiencies.

The EPCOR affiliate code of conduct reference of “providing an environment in which inter-affiliate economies and efficiencies can legitimately occur for the mutual advantage of both a Utility’s customers and its shareholders” incorporates the goal of efficiency while ensuring the core objectives are satisfied.

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

Response:

No. The *OEB Act* sets out two objectives for the OEB in relation to electricity. The first is: “*To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.*” The second objective on economic efficiency was discussed in the response to Question 1. Furthermore, Section 1 of the *Electricity Act, 1998* lists a variety of purposes including: “*to promote economic efficiency and sustainability in the generation, transmission, distribution and sale of electricity*”.

The current objective of the Electricity ARC to “*enhance the development of a competitive market*” is inappropriate and has no basis in legislation. The Board has a legitimate role to oversee competitive behaviour in the market in which it has a legislated mandate, namely the electricity commodity market. However, there is no legislative basis to oversee competitive behaviour in other markets. These are dealt with by other agencies, such as the federal Competition Bureau. While it is appropriate that the development of a competitive commodity market be a consideration for the Electricity ARC, this should not be a principal objective of the code. More importantly, the Board needs to consider whether an activity is in any way detrimental to an LDC’s customers, which is the first of the Board’s objectives, according to the current version of the *OEB Act*.

The EPCOR code addresses many of these issues by including a clause to “avoid uncompetitive practices between Utilities and their Affiliates, which may be detrimental to the interests of Utility customers.”

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

Response:

Yes. To expand the definition would expose LDCs and their affiliates to increased administrative burdens to no apparent benefit. Narrowing the definition on the other hand would support the Board’s objective of promoting economic efficiency by allowing greater sharing of employees. Certainly references to businesses in which the OEB has no legislated mandate should be removed from the ESP definition if it remains and the name changed to reflect the new definition (e.g “competitive commodity provider” or simply “retailer”). If the

definition is removed altogether, this should be done in conjunction with changes to the code that lessen the restrictions on affiliate transactions to promote economic efficiency rather than imposing greater restrictions on affiliates that are not an energy services provider under the current definition.

4) **Question:** Should the current Electricity ARC treatment of "confidential information" be narrowed or otherwise changed?

Response:

Yes. Information that is, otherwise, available to the public should not be included in the electricity ARC definition of confidential information. While it is agreed that only information that could be of commercial value needs to be restricted, it would be difficult to define all potential sources and ensure consistency of application. The use of Non-Disclosure Agreements is one effective means of protecting customer information.

LDC Electricity Distribution Licences include significant protections for information including the following sections.

"15.1 The Licensee shall not use information regarding a consumer, retailer, wholesaler or generator obtained for one purpose for any other purpose without the written consent of the consumer, retailer, wholesaler or generator.

15.2 The Licensee shall not disclose information regarding a consumer, retailer, wholesaler or generator to any other party without the written consent of the consumer, retailer, wholesaler or generator, except where such information is required to be disclosed"

Based on these license conditions, an LDC is already prohibited from providing confidential information regarding a consumer, retailer, wholesaler or generator to an affiliate unless the affiliate is using the information on behalf of the LDC for the purpose for which it was obtained. It is unclear why further protections are required within the Electricity ARC.

It is further noted that LDC licences as well as provincial and federal legislation (*Municipal Freedom of Information and Protection of Privacy Act* (MFIPPA) and *Personal Information Protection and Electronic Documents Act* (PIPEDA)) all prohibit the disclosure of personal information other than for the purposes for which the information is collected, unless consent is granted by the individual. While the CLD questions the need to include additional confidentiality provisions in the Electricity ARC when provisions already exist elsewhere, if a "confidential information" definition remains in the Electricity ARC it should be modified to be consistent with these other requirements (licence, MFIPPA, PIPEDA). This would mean changing the definition to reflect the "purpose" for which the information was collected. The EDA has proposed a modification to the definition that captures this point.

Additionally, the LDC license conditions noted above are based on a “use” principle rather than the “access” principle employed by the Electricity ARC that restricts sharing of employees with access to confidential LDC customer information. All contemporary privacy legislation, referred to below, similarly adopts a “use” principle restricting the use of confidential information despite access. The restrictions of the Electricity ARC on sharing employees with “access” to confidential information does not support the *economic efficiency and cost effectiveness* objective of the *OEB Act* as it unduly limits the opportunities to optimize resources across an affiliated group of companies. There are significant cost benefits available to LDCs and their customers from sharing management and operational costs. We suggest that the Electricity ARC be modified to require LDCs not to “use” confidential information for any purpose other than which the information was collected or the customer has otherwise allowed. We further recommend that the Electricity ARC remove the prohibition on sharing employees with “access” to confidential information. The onus will be on LDCs to establish proper controls to ensure that customer information is used for its intended purpose.

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

Response:

Yes. The primary goal of Section 2.4.2 should be to strike a manageable balance between the efficiency gains that can be achieved when employees with certain skills can apply those skills to both an LDC and its affiliates and the need to ensure that confidential information is not used to the detriment of utility customers or to interfere with the competitive commodity market.

The first issue is that the concept of a “shared” employee is somewhat of a misnomer. Employees are typically in the employ of only one company. They may also provide a service to another company under the terms of a Services Agreement. An employee does not generally report to both companies and therefore cannot be truly “shared” and the Electricity ARC should reflect this reality.

The concept of having different rules on using employees for both an LDC and an affiliate based on the nature of the affiliate’s activities (e.g. Commodity Retail Affiliate) is supported. However, current prohibitions should be modified to provide greater flexibility. In many instances, there is no confidential information involved at all. In other instances the confidential information cannot be used to the detriment of an LDC’s customers, or to interfere with the competitive commodity market. In either scenario there should be no outright prohibition on any employee doing work for both an LDC and the affiliate. The current requirement that prohibits the sharing of employees involved in the “day-to-day operation” of the distribution network or employees who have access to confidential information, captures many employees that have no ability to influence the competitive

commodity market and have either no access or very restricted access to confidential information. In that way, current restrictions are too broad. For example, a stations technician whose principal job is the construction and maintenance of distribution stations should not be prohibited from working on the generating plant owned by an affiliate. Similarly, a billing employee who has access to confidential information should not be prohibited from doing billing work for an affiliate, as long as there are prohibitions and safeguards on the sharing of confidential information.

Many LDCs have holding companies that provide strategic direction or corporate services to LDCs and their affiliates. These arrangements provide economies of scale that benefit the LDC's customers and do not interfere with the competitive commodity market. If these arrangements require that some confidential information be released to the holding company it must be used only for the purposes for which the information was gathered and could furthermore be protected through the use of non-disclosure agreements if required. Therefore, there should be no prohibition on this type of employee sharing.

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

Response:

The CLD agrees that the intent of the clause requiring that at least one-third of the directors of an LDC do not sit on the Board of an affiliate provides an acceptable balance between associated costs and benefits. This is also consistent with good and contemporary corporate governance provided by the Canadian Securities Administrators for public issuers. However, the clause in the Electricity ARC needs to be modified to clarify the word "independent" since the definition of this is not clear. The EDA has recommended a modification to 2.1.3 that clarifies this requirement.

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

Response:

Any changes to these provisions need to balance the additional costs of administration against the additional benefits that more complex pricing rules might attain. The CLD supports pricing that permits either a market price or a cost based price depending on the circumstances. For example, pricing for the sharing of core corporate services, such as accounting or human resources, may be on a cost basis, whereas pricing for non-core services could be market based. An independent evaluation of tenders should not be required because it can be costly and the requirement for detailed recording of affiliate transactions provides

opportunities to audit, if deemed necessary. Furthermore, there are other methods of determining a market price beyond that of a tender (e.g. prices for fibre services approved by the Canadian Radio-television and Telecommunications Commission (“CRTC”) or published lease prices for rental facilities), and these should also be permitted.

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

a) Mandatory Business Case

Response:

No, distributors that outsource services to an affiliate are seeking efficiencies and, in doing so, have satisfied their internal procurement requirements, according to internally established thresholds. These policies are filed as part of rate applications and therefore available for public review. To engage in further administrative justifications does not appear to provide any other benefit.

b) No-Harm Versus Positive Benefits Approach

Response:

The “no harm” principle was appropriately adopted by the Board on August 31, 2005 in relation to applications for mergers, acquisitions, amalgamations and divestures (“MAAD applications”) as required under Section 86 of the *OEB Act*. In making this Decision to adopt the “no harm” principle the Board stated that:

“The Board is of the view that its mandate in these matters is to consider whether the transaction that has been placed before it will have an adverse effect relative to the status quo in terms of the Board’s statutory objectives. It is not to determine whether another transaction, whether real or potential, can have a more positive effect than the one that has been negotiated to completion by the parties.”

While this Decision was in relation to applications under section 86 of the *OEB Act*, the CLD submits that there is no reason to adopt a different principle for affiliate transactions.

c) Length of Affiliate Contract

Response:

The CLD does not oppose a maximum contract term of five (5) years, provided that this period can be exceeded when the type of goods or services provided involve long-term assets.

d) Market Tendering

Response:

No. As noted in our response to the mandatory business case proposal, existing procurement practices would include scanning market conditions and, as required, tendering, according to the nature and threshold of the good or service being outsourced. Making this requirement mandatory, through the Electricity ARC, would add further administrative burdens without any foreseeable benefit.

Furthermore, the rate setting process requires evidence of prudence in outsourcing decisions, thereby obligating distributors to prove due diligence in expenditures of this nature.

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

Response: The CLD agrees that pricing corporate services on a cost-based method would achieve stakeholder and regulatory certainty. The definition of corporate services should include as a minimum HR, IT, Finance, Accounting and Treasury, Legal, Regulatory, Internal Audit, Risk Management, Governance, Corporate Communications and Executive Management.

As noted in Question 8, the code rules should be administered from the ‘no harm’ perspective. Assessments of the appropriateness of the costing model should be addressed in the rate setting process.

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

Response: The CLD does not see the rationale for a change to this provision for tangible assets. If the Board does adopt the requirements under the Gas ARC, it would be appropriate to set a materiality limit so that market assessments are not required for assets whose book value is less than the LDCs normal materiality limit so that unnecessary costs are not incurred for immaterial amounts.

Transfers involving intellectual property may be more difficult to value. Adoption of this rule into the electricity ARC should include further direction on the methodology required for demonstrating an objective valuation of intellectual property.

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

Response: The concept of applying electricity ARC rules to all LDCs should be maintained for consistency, therefore, a provision for exemption requests based on an LDC's size should not be considered. Likewise, the proposal of setting two-part thresholds for establishing LDC compliance obligations (i.e., costs versus customer benefit) undermines the principle of consistent customer treatment and protections and therefore the CLD does not support this proposal. Exemptions applications should be dealt with on a case-by-case basis.

Conclusions:

It is important that the Electricity ARC reflect the current objectives set out for the Board in the *OEB Act* and therefore the Electricity ARC must not provide a barrier to affiliate transactions that increase an LDC's efficiency and effectiveness. The principal objective of the Electricity ARC should be to prevent transactions between an LDC and an affiliate, that are detrimental to the LDC's customers, while still promoting economic efficiency and cost effectiveness and ensuring that no barriers are created to the development of a competitive commodity market.

Thank you for the opportunity to comment. Three (3) paper copies, along with electronic Adobe Acrobat (PDF) and Word files accompany this submission.

Yours truly,



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(On behalf of the Coalition of Large Distributors)