EB-2007-0662

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.O.15, Sch. B;

AND IN THE MATTER OF the review by Board Staff of the Affiliate Relationships Code for Electricity Distributors and Transmitters.

COMMENTS

OF THE

SCHOOL ENERGY COALITION

1. On June 15, 2007 Board Staff published a report (the "Staff Report") on the *Affiliate Relationships Code for Electricity Distributors and Transmitters* (the "Electricity ARC"). These are the comments of the School Energy Coalition with respect to the Staff Report.

2. The Staff Report is an excellent summary of the current situation, and fairly sets out most of the considerations for and against proposed changes to the Electricity ARC. In these comments, we have followed the same format as the Staff Report, then added a further section for "Other Issues" at the end.

3. To put all of our comments below in context, in our view the Electricity ARC is designed to set limits on the actions of the utility and its employees. It is restrictive, not empowering, and that is intentional. Against that background, there are two overall goals in any affiliate relationships rules for a regulated utility:

   a. ***Fiduciary Duty.*** Ensure that the utility employees are at all times acting in the interests of the utility, and within that context in the interests of the ratepayers. This subsumes most rules relating to transfer pricing and information sharing, but it is broader than that, as we will note later.

   b. ***Market Impacts.*** Ensure that the actions of the utility, in particular in its relationships with its affiliates, do not have an adverse affect on the energy marketplace as a whole, whether that adverse affect is on competition or any other aspect of the marketplace.

4. In looking at each of the issues, the School Energy Coalition starts with a "normal business practice" test. We assume a corporate group, all of its components of which are operating in fully functional competitive markets. We also assume that each business unit is in a position to ensure that it is treated fairly within the corporate group, and that the overall corporate group

will act rationally with respect to each business unit, and the combined activities of all business units. Finally, we assume that the corporate group does not have collateral motives for business decisions (e.g. tax planning) that would change an economically rational decision to something else because of extraneous factors.

5. Having assumed in each case a market model of a corporate group, we then test each issue by asking how this model corporate group would deal with the issue internally. Our conclusions are then further tested to see if there is anything unusual in the regulated business of electricity distributors that should change the result in any way.

Utility Efficiency as a Code Objective

6. We agree with Staff that utility efficiency should be one of the factors that should be taken into account in the development and application of Electricity ARC rules. We also agree with the implicit premise in the Staff suggestion, ie. that the main goals must be fully achieved first, and it is only once they are achieved that consideration of utility efficiency is relevant. Utility efficiency is not an objective of the code, and there should be no circumstances in which, for example, ratepayer protection should be traded off against utility efficiency.

7. However, in our view utility efficiency should be applied more broadly than Staff is assuming. It is true that there is a sense in which utility efficiency is a factor that could loosen the restrictions that Electricity ARC might otherwise place on a utility. On the other hand, utility efficiency can and should also be an additional restrictive test applied to issues dealt with in the code.

8. The best example of this is Section 2.3.2 of the transfer pricing rules. That provision says that purchases of goods and services by a utility from an affiliate cannot be at a price in excess of fair market value. In our view, this is not the appropriate rule. The appropriate rule is that the price cannot exceed the lesser of the fair market value and the internal cost of the utility to generate the goods or services themselves. Many may think this is self-evident, but in fact utilities regularly justify affiliate transactions on the basis of fair market value alone. If the utility efficiency test – build vs. buy, in this example – were added, this would be a more restrictive but fairer rule.

Competition as a Code Objective

9. Schools, like all ratepayers, benefit from fully functioning competitive markets in the goods and services that they purchase. Price, quality, selection, and availability are all enhanced by market competition, and schools rely heavily on competitive markets to ensure those results. If a regulated entity acts to reduce competition in any of those markets, by definition that is harmful to schools. The same applies to all ratepayers.

10. If it is accepted that reduced competition is harmful to ratepayers, the remaining question is whether it is the responsibility of the Board (whether through Electricity ARC or otherwise) to

stop its regulated entities from acting to reduce competition. Why not leave it to the Competition Bureau, or other entities with a broader competitive markets mandate?

11. At the simplest level, we believe that answer to this should be obvious: if the regulated entity is doing something that hurts its ratepayers, the Board should prohibit it. If it is an action that is related to affiliates, the logical place to prohibit it is in the code designed for that purpose, Electricity ARC. This is the reason we have included the overall goal of Market Impacts set out in paragraph 3(b) above.

12. Of course, in the real world the actual facts that have to be considered will often be more complicated. Consider this example. An LDC carries on a joint marketing program with an affiliate. The LDC markets CDM – specifically, air conditioner savings – through a rebate on an efficient air conditioner replacing an inefficient one. The affiliate markets efficient air conditioners, and offers a matching discount to the discount provided by the LDC. Marketing materials are sent out jointly, and the affiliate's installation staff have the ability to provide instant rebates for both the affiliate and the LDC amounts. Other air conditioner suppliers can offer matching rebates, but they cannot participate in the joint marketing, nor can they act as a conduit for the LDC part of the rebates. As a result, the LDC affiliate has a market advantage and other air conditioner suppliers are harmed.

13. Even though the ratepayers are not directly harmed (arguably, they are benefitted by better communications and administrative simplicity), most would agree immediately that this type of program would not be an appropriate action for a regulated utility. The market advantage to the affiliate, and the resulting harm to the competitive market, are not appropriate, and this Board's history is that it would generally not allow this kind of program.

14. The fact that this example uses an energy service provider affiliate is, it is submitted, irrelevant to the principle. Consider a second example. In this example, an LDC carries on a joint marketing program with an affiliate in the wireless internet business. The LDC says to its ratepayers that anyone who reduces their electricity consumption in the month of, say, December, by 10% over the previous year will be entitled to purchase wireless internet access from the affiliate at a discount. The primary corporate purpose of the program is, of course, to increase the affiliate's market share, but there is no harm to ratepayers. They are benefitted, in fact. If they participate in the program, they get a reward for their reduced consumption. If they are non-participants, they still benefit because there is a CDM program in which the incentive is funded by an affiliate rather than by the LDC.

15. Notwithstanding the benefits to ratepayers, it is submitted that such a program is not appropriate. Providing the affiliate with a market advantage necessarily hurts its competitors and thus reduces competition in the wireless internet market. It should not be the role of a regulated utility to do that. Not only does it hurt ratepayers indirectly by reducing competition, but it is also an abuse of the monopoly position by using it in a program the primary purpose of which is to benefit an unregulated entity.

16. Given the above, in our view Section 1.1 should be amended to delete the current (a), and in its place add the following:

a. "prohibit utilities from cross-subsidizing the activities of affiliates, whether those affiliates are in competitive, regulated, or other businesses";
b. "restrict actions of utilities and their affiliates that would have the effect of reducing competition in any competitive market in Ontario, whether that competitive market is related to energy or not".

Energy Service Provider Rules

17. The School Energy Coalition does not believe that the definition of "energy service provider" should be narrowed at this time, for the reasons cited in the Staff Report. Further, we do not believe that the restrictions on energy service providers should be reduced.

18. The issue of whether the ESP rules should be applied to all affiliates is more complex. On the one hand, as we have noted above the harm to the marketplace, and the abuse of the monopoly power, are just as real in non-energy markets as energy markets. As well, we are concerned that utility employees should not see their role as including creating advantages for affiliates in any business. They should be focusing on the utility business alone. On the other hand, there are only a few such affiliates, and there is a risk that expanding the scope of the ESP rules will increase their costs.

19. In our view, the solution for this is to expand the ESP rules to include all affiliates, but allow any LDC with an affiliate that is not in an energy-related business to, as an alternative, come forward with an affiliate-specific plan that will ensure that the goals of the Electricity ARC are met, even if the specific ESP rules are not all complied with. By way of example, if the LDC has an affiliate in the home security business the LDC could propose that it would allow qualified affiliate employees to do certain types of utility work in the home at the same time (e.g. providing CDM program information), as long as all other home security companies have the similar right to do such work if they have qualified employees.

Confidential Information

20. Confidential information is an issue that arises in affiliate transactions in two ways: as a privacy issue, and as a benefit/advantage issue. In our view, the current provisions of the Electricity ARC do not adequately distinguish between those two issues, and in fact focus too much on privacy and not enough on benefits to affiliates.

21. In our view, the simple test of whether confidential information should be provided to an affiliate should be whether, if the affiliated company were instead an arms-length third party, the LDC could (legally) and would (from a business point of view) provide the same information on the same terms. We see no circumstances in which an LDC should be able to provide any information, whether customer specific or otherwise, to an affiliate that it would not provide on the same terms to another company in the same business as the affiliate.

22. SEC is concerned that the current definition of "confidential information" in the Electricity ARC is flawed in three important ways:

a. It is limited to information relating to specific customers. In the case of schools, it would therefore apply to information on a specific school, its load profile, equipment, etc. However, it would not apply to aggregated information relating to schools in the LDC's franchise area. For example, in its CDM programs a utility can develop detailed load and equipment models for the schools in its franchise area. It is likely that, with an average of about 50 schools in each LDC's area, they will be able to draw inferences as to the likely equipment, CDM, and other needs of those schools generally. In our view, sharing that information with an affiliate in the equipment business, for example, should not be allowed. While we understand that Section 2.6.3 effectively deals with aggregated customer information, this merely points out the fact that the current definition focuses on the privacy side of the issue and does not include the benefit side.

b. It is limited to information gathered in the course of providing "current or prospective utility service". This is no longer appropriate, because it excludes past utility service. For example, an LDC could provide its database on past CDM rebates given to ratepayers, so that an affiliate in the equipment business could target those customers with the appropriate equipment.

c. It is limited to customer information. All corporations spend considerable amounts of money developing information which gives them market advantages. They keep that information confidential because it has value. It is not appropriate for a utility to spend ratepayer dollars developing information, then share it with an affiliate without getting full value for it. An example might be detailed end-use load data. If a utility develops a database of projected load data (what types of equipment, what types of uses, etc, split out by geographic area or customer type or any number of other categories), that information could be very valuable. The utility should not be allowed to give it to an affiliate, and it should not be allowed to affect the competitive markets by selling it to an affiliate, even at fair market value, without offering it to other market participants.

23. We therefore propose the following definition" "Confidential information is any information gathered, developed, or otherwise in the possession of the utility that is not readily available to the public in the form in which it is held by the utility". In our view, "readily available to the public" means published on the utility website, or otherwise made available in an easily accessible way to all persons who seek to have it.

24. If information is "confidential information" as so defined, then it is submitted that the appropriate rules in the Electricity ARC are:

a. ***Privacy Rule.*** Information that contains customer-specific data (or data relating to a retailer or marketer) should not be released to any person outside the utility, whether or not an affiliate, except where the LDC is ordered to do so by a court or tribunal of competent jurisdiction, or with the written consent of the customer, retailer or marketer. In our view, aggregated data relating to a specific customer group, such as schools, should be included in this category.

b. ***Market Advantage Rule.*** Subject to (a) above, all confidential information can be provided to an affiliate only if it is made available in a non-discriminatory way to all of the affiliate's competitors on the same terms.

<u>Sharing of Employees</u>

25. It would be useful in dealing with changes to the employee sharing rules to look at specific examples of situations in which employees a) cannot currently be shared, but should be, or b) can currently be shared, but should not be (or should be restricted in some way).

26. We have reviewed the current rules, in light of the comments in the Staff Report, and we have not been able to identify any specific utility employee roles that could be shared with any specific affiliate employee roles, but are currently prohibited by the Electricity ARC. It would be useful if parties commenting on the Staff Report, or Board Staff themselves, would provide a list of such roles, so that the Board's process of "drawing the line" can be informed by a more detailed factual foundation.

27. We particularly note the suggestion a couple of times in the Staff Report that "joint utility/affiliate CDM activities" might be an appropriate exception to the current rules. In our view, this is a very good example of something that should be tightly restricted, not exempted. It is in the public interest, and in the interests of the ratepayers, to expand the competitive market for CDM goods and services in Ontario. If a utility has an affiliate competing in that market, it is submitted that any action by the utility to favour that affiliate will reduce the availability of CDM goods and services by competitive companies, and thus be contrary to the public interest.

28. We have suggested, earlier in these submissions, that utilities should have the right to propose compliance plans that do not specifically follow the rules, but achieve the spirit of the Electricity ARC in a better way. In our view, that could apply here as well. However, loosening the rules across the board does not appear to us to be a good idea.

29. On the other side, we have been able to identify numerous situations in which a utility employee who does not gather confidential information (as currently defined) and is not on the utility's front lines would still, if associated with the affiliate, be potentially providing that affiliate with a substantial unfair advantage.

30. It is for this reason that we find the idea put forth in the Staff Report relating to employee responsibility is interesting and attractive. As set forth in the FERC rules, the idea is that shared employees would, in effect, personally agree not to be a conduit for confidential information. We would go somewhat further, and have each shared employee sign an agreement, filed with the Board, that:

a. The employee will use their best efforts to minimize customer confusion by clear communications with all customers with which the employee has contact;

b. The employee will not provide confidential information of the utility (the new broader definition described earlier in these submissions) to affiliate employees, nor use utility confidential information in the affiliate's business, except in compliance with the Electricity ARC.

c. The employee will not participate in any actions that give customers the impression that the utility or the regulator endorses or controls the affiliate's business.

These three terms track the goals of the employee sharing rules as set out on page 21 of the Staff Report.

31. The reason this idea is so attractive is that we have seen the impact of personal responsibility in corporate governance in recent years. In many public corporations, the rules were clear, but the corporation, not the individuals, was responsible for compliance. Because the public could not see the inner workings of those public corporations, the rules were often either ignored or very liberally interpreted. No-one was in a position to review those interpretations and correct the inappropriate behaviour that was resulting.

32. More recently, new corporate governance rules have required specific corporate officers to certify compliance with certain rules of behaviour, and have placed a positive responsibility on directors, senior officers, and others to ensure that rules are complied with. In our experience, this has dramatically changed how corporations operate on a day to day basis. Individuals charged with carrying out the corporate goals regularly assess (and discuss openly with their peers and superiors) whether they are personally in compliance with the rules of appropriate behaviour, and as a result there is considerably less room for the "wink-wink, nudge-nudge" approach to internal decision-making.

33. In our view, giving shared employees – and particularly senior employees – direct responsibility for their own actions could be a significant step towards making the current employee sharing rules work more effectively.

Independent Directors

34. The Staff Report asks whether the current one-third independent directors requirement is appropriate for LDCs. The School Energy Coalition has many times in the past expressed its view that LDCs should be required to have a majority of independent directors, and optimally 100%. That continues to be our view.

35. The test of whether this makes sense starts with answering the question: Why do corporate groups in the private sector ensure their subsidiaries have controlled boards? The reason: to ensure that the operating subsidiaries align their policies and operating decisions with the interests of the corporate group as a whole.

36. In our view, as long as LDCs have a majority of non-independent directors, the practical result is that the policies and operating decisions of the LDC will not be driven first and foremost by the interests of the utility, but will be driven by the interests of the corporate group. This is not appropriate in the case of a regulated entity. A utility, holding a public monopoly franchise, should be operated in a manner that gives primacy to the interests of the utility and its customers. While the interests of the shareholder are also included, those interests are largely fixed, and should not include the shareholder's interest to maximize profits from utility affiliates.

37. In addition to proposing a majority independent board, we propose that each member of the board of director of an LDC be required, in each annual filing of the LDC, to sign a certificate of compliance with the Electricity ARC. For the same reasons as set forth in the previous discussion on shared employees, this change would ensure that the goals of ARC are being internalized at the LDC.

Transfer Pricing Rules

38. We have two submissions with respect to transfer pricing.

39. First, as we have noted earlier in these submissions the tests in 2.3.1 and 2.3.2 are not sufficiently thorough, in our view. Those tests should be revised to read as follows:

   a. *2.3.1 – Where a utility provides a service, resource or product to an affiliate, the utility shall ensure that the sale price is no less than <u>the greater of the cost to the utility to provide the service, resource or product, and</u> the fair market value of the service, resource or product. [added words underlined]*

   b. *2.3.2 – In purchasing a service, resource or product from an affiliate, the utility shall pay no more than <u>the lesser of the cost of the utility to provide the service, resource or product from internal resources, and</u> the fair market value. For the purpose of purchasing a service, resource or product a valid tendering process shall be evidence of fair market value.*

   In both of these cases, the change is essentially the application of the "no harm to ratepayers" test, and so should be non-controversial. The practical effect is only that the utility must show that both parts of the price analysis have been done before proceeding with the affiliate transaction.

40. Second, the question has been raised whether the more detailed Gas ARC rules, already largely applicable to electricity distributors through Compliance Bulletin 200604, should be imported into the Electricity ARC. In our view, they should. While there may be circumstances in which they are too stringent in particular cases, those cases can be handled by way of exemption, while ensuring that the general rules are tight enough to deliver the goals of the Electricity ARC.

Outsourcing Utilities Activities to an Affiliate

41. Outsourcing core utility activities to an affiliate has always, to SEC, been a problematic activity. It is especially problematic where the utility is a "virtual" utility, and essentially all activities have been outsourced.

42. There is often merit in a utility considering outsourcing specific core utility activities to a third party, because in the competitive marketplace some activities have become commoditized, and thus can be purchased more cheaply than the internal cost. Metering services is a good example. Recently, call centre services have also attracted a number of competitive companies.

43. In theory, if an LDC had as its affiliate Olameter, or Honeywell, or a similar company, it would be reasonable to allow that affiliate to participate in a bidding process to provide outsourced services to the utility. That is not, however, the case anywhere in Ontario.

44. The reality in Ontario is that all utility affiliates engaged in outsourcing provide the bulk, or in some cases all, of their services to the utility. Any economies of scale, or independently developed functional expertise, is minimal. The same results would obtain if the activities were carried out within the utility, as in many cases they were in the past. It is submitted that the only logical reason for such a structure is to reduce the regulatory oversight of the outsourced activities. That reduced oversight could come in the form of reduced information filings in rate cases, or reduced application of Electricity ARC or other codes.

45. This is not acceptable, and the Board should take strong action to reverse this situation where it exists. We propose that the following rules and principles be put in place:

a. Unless a utility makes a case for a specific exemption, the basic principle should be that all core utility functions must be carried out by employees of the utility or of a group of utilities. This is already the case with the gas utilities.

b. Where utility functions are outsourced to an affiliate, the affiliate must provide to the Board in any proceeding in which the utility is a party the same information as the utility would have been required to provide if the functions had been carried out internally at the utility. This includes responding to interrogatories, supplying witness panels, etc., and in this context claims of confidentiality and/or competitive sensitivity should be the exception, not the norm.

c. The Electricity ARC should apply, mutatis mutandis, to any affiliate to which core utility functions are outsourced, with respect to those functions and the staff who provide them.

46. The Staff Report asks three additional questions.

47. ***Business Case.*** We are at a loss to know why an LDC would resist doing a business case if it wants to outsource to an affiliate. Any well-run business does a business case before embarking on any significant outsourcing activity. Even small companies do that. That should be particularly important in the case of a regulated entity, which must be concerned in any case with public scrutiny of its outsourcing arrangements in a prudence review.

48. The only argument against a business case appears to be the cost, particularly for smaller utilities. In our view, this argument cannot be sustained, for two reasons:

a. First, it is the LDC's choice to be small. There are tradeoffs involved in that choice, one of which is that regulated businesses sometimes have compliance costs that have significant economies of scale. If the Board accepts that a smaller LDC should not have to justify affiliate outsourcing properly, the same reasoning would justify limiting regulatory oversight of a smaller LDC to reduce regulatory costs.

b. Second, the LDC that outsources to an affiliate will, of course, incur the costs of lawyers and accountants, and perhaps other advisors, to implement the outsourcing arrangement. This would create the counter-intuitive situation in which all transaction costs would be spent – and recoverable from ratepayers – except the cost of figuring out whether the transaction was a good idea in the first place.

49. ***Positive Net Benefits.*** This is another one of those inexplicable arguments that fails in the light of simple reasoning. As the Staff Report correctly points out, the Board must ask the question: Why would utility managers enter into an outsourcing arrangement if there is no net benefit to the utility (and hence the ratepayers)? Business people make changes in how they are doing things to achieve benefits. If there are no such benefits, a good business person doesn't make changes.

50. So, under what circumstances would a utility manager outsource and get no benefit? The answer can only be to achieve a benefit to the unregulated activities of the corporate group. This leads to the obvious question: Should utility managers be making decisions that have as their purpose benefitting affiliates? In our view, utility managers should be working for the utility, and should have the utility's interests at the core of their decisions, not the interests of affiliates. You have to know who you work for.

51. It is therefore submitted that the Board should require a positive benefit, because the "no harm to ratepayers" test creates the dangerous situation in which the Board is sanctioning utility managers working to benefit affiliates instead of the utility.

52. ***Length of the Contract.*** We do not believe that there must be a hard and fast limit on the length of outsourcing contracts. The length of a contract depends on the nature of the service being provided, the structure of the pricing including changes over time, and the nature of the benefits being sought by the utility. This is true whether the company providing the outsourced service is an affiliate or an arms-length third party.

53. However, this lack of a contract term limit is justifiable, in our view, only if affiliate outsourcing arrangements are approved in advance by the Board. This is, we believe, the best way to achieve the goals of the Electricity ARC. A utility that wishes to outsource to an affiliate should be required to file an application for approval of the contract. The application would have to show:

a. Pricing compliance (both internal costs and fair market value, with details of the public tender, etc. used to set FMV)

b. Benefits to ratepayers (in the form of a detailed business case)

c. Alternatives reviewed

d. Appropriate contract length and terms

<u>Shared Corporate Services</u>

54. At a basic level, we do not believe that it is in the interests of the ratepayers for utilities to be managed by senior managers who also manage competitive affiliates. Most shared corporate services come within that category, and that is in our view the most problematic category. Utilities should be run by managers whose job is to run the utility well, to keep costs down, and to provide the best possible service to the ratepayers. If managers are instead focussed on generating profits from competitive businesses (and particularly if their compensation is driven substantially by those profits), it is in our view inevitable that the operation of the utility will suffer. (We note, by the way, that in the vast majority of cases utility managers do focus on the best interests of the utility. The Electricity ARC is not directed at them. It is directed at the few situations in which managers have dual or confusing allegiances.)

55. On the other hand, we recognize that the existence within the corporate group of businesses other than the utility gives the utility the ability to hire a higher calibre of senior management, because there is more opportunity for top people to advance within the organization.

56. We believe the solution to this is a) require that the utility have an independent board, and b) require that management of the utility be separate from management of the related businesses, and report, not to the parent company management, but to the utility board.

57. We accept that there are some support services, like IT, or treasury, or taxation, that are most efficiently shared within a corporate group, just as is the case with corporate groups that are not regulated. For those services, we agree with the Staff Report that importing the Gas ARC rules into the Electricity ARC is a good approach, creating certainty within the electricity sector and providing consistency in the Board's rules for both gas and electricity distribution.

58. We do not, however, understand why the "no harm to ratepayers" test would be appropriate here. Shared corporate services should only make sense for the utility if there is an efficiency gain, ie. costs go down. As we have noted in our earlier discussion of this concept, you

outsource (including sharing services) only if there is a benefit to be achieved. If there is no benefit, why would you do it?

59. Further, we note that the Board should specifically state that the shared employees rules should apply to shared corporate services as well. In particular, the certificate of compliance approach can ensure that the goals of the Electricity ARC are still achieved, even though some services are being shared with competitive affiliates.

Asset Transfer-Pricing Provisions

60. We agree with the Staff Report that the Gas ARC asset transfer rules should be imported into the Electricity ARC, for the reasons set forth in the Report.

Exemption Process and Small Distributors

61. We agree with the Board's current practice, ie. not providing exemptions to small utilities on the basis that they are small. As we have noted earlier, running a regulated business entails certain compliance obligations, and you should not be in that business if you are not willing and able to meet those obligations. It is not appropriate to say you are too small to do so. That is, by implication, a statement that you are too small to carry on a regulated business.

62. We also note two other considerations militating against special treatment of small distributors:

a. First, the main reason the Board has the Electricity ARC is to protect the ratepayers. By giving exemptions to small distributors, the Board would be implicitly saying that their ratepayers are entitled to less protection than the Board has already determined is appropriate. If a small distributor wants an exemption, its primary justification should be that it is able to protect the ratepayers just as much as the Electricity ARC rules, but using a different method. If the small distributor succeeds in demonstrating that, in our view an exemption should be granted, but not because the distributor is small. The exemption should be granted because the distributor is achieving the goals of Electricity ARC in a more appropriate way for that distributor.

b. Second, it is in the broader interests of the electricity sector to achieve enhanced efficiency through consolidation, co-operative activities, and similar actions. Many utilities are doing just that. The Board's policies should not undermine that goal by saying: Instead of meeting your regulatory obligations through co-operation and increased efficiency, we'll let you "meet" those obligations by simply reducing the obligations.

63. One thing the Staff Report does not discuss is whether there should be specific considerations by the Board in determining whether an exemption – whether for a small distributor or otherwise – should be allowed. We propose that two considerations be expressly included in the Electricity ARC relating to exemption applications:

a. The application should specifically enumerate the Electricity ARC goals brought into play by the rule for which exemption is sought, and should meet a heavy onus of showing that those goals will be met by the utility despite the exemption.

b. The application should benchmark all costs of the utility that could be affected by the exemption to similar costs in comparable LDCs, and should make commitments that those costs will, in the future, be at a specific level relative to the appropriate benchmarks. This could be either i) by way of showing that a change in practice as a result of the exemption sought will bring high costs more into line with benchmarks, or it could be ii) by way of showing that an existing practice (sought to be regularized by the exemption) is not pushing the utility's costs out of line with benchmarks.

Other Issues

64. ***Corporate Opportunities.*** In the general law of fiduciaries there is a doctrine called the "Corporate Opportunities Doctrine". Simply put, if in the course of acting as a fiduciary, a person receives a business opportunity, that opportunity must be given to the fiduciary's beneficiary, and not taken personally or diverted to someone else.

65. At the simplest level, this should apply to electricity distributors on the basis that, if a utility manager identifies a business opportunity, it should go to the utility. For example, if a utility manager sees that shifting a call centre from Barrie to North Bay would save 10% of the cost, the obligation should be to make that change within the utility, so that all of the savings accrue to the benefit of the utility and ultimately its ratepayers. Conversely, it should not be acceptable for the utility manager to direct that opportunity to an affiliate, that then sets up a North Bay call centre and sells the services to the utility at the old price, keeping the incremental profit or even some of it. This is just an application of the general law to LDCs.

66. There are two extensions of this that are also appropriate.

67. First, utility managers should be under a positive obligation to seek out opportunities to reduce costs or enhance service for the utility. It should be an integral part of their jobs. The vast majority of utility managers know that and act on it, but any loosening of affiliate rules could justify utility managers saying: I'll just let my outsourcing affiliate look for cost reductions and keep the profits. This is, again, just an application of the general law, in this case the normal rules requiring employees to do their job to the best of their ability for the benefit of their employer.

68. Second, shared employees, particularly those at the executive level, are in a more complex fiduciary role, because they have fiduciary obligations to both the utility and the affiliate. In our view, in order to prevent problems with these conflicts between duties, it should be a condition of allowing employees to be shared that any opportunity they identify which could benefit the utility should prima facie be treated as a corporate opportunity belonging to the utility, and the above rule should apply. Only if the opportunity could not benefit the utility, or

if there are other factors requiring sharing of the opportunity to obtain fairness (and those factors are proved to the Board in an application), should a shared employee be entitled to direct an opportunity to anyone other than the utility. Once more, this is an application of the general law of fiduciaries to this specific case, and mirrors the rules that courts already apply to trustees, directors, and others with similarly conflicting duties.

69. ***Branding and Indirect Benefits from Utility Association.*** A more difficult issue is the use by an affiliate of the same brand name as the utility. On the one hand, it is hard to justify preventing an affiliate from using the corporate name of its parent, even if its sister company, the utility, is also using the same corporate name. This is common in the marketplace, and "leveraging the brand" is a standard technique for building new businesses. On the other hand, it is difficult to see how in that situation the public would distinguish between them, and in particular how the utility or regulator endorsement is not implied.

70. In our view, at least in this early period where electricity distributors are feeling their way in the competitive markets, it would be better for the Board to require that competitive affiliates have completely different brands from the utility. This will mean that the competitive activities stand on their own two feet, rather than being propped up by association with the utility, and the competitive markets are not adversely affected by unfair competition from the affiliate. As the competitive electricity services market adjusts to the participation of LDC affiliates, it may be possible to relax this "no common branding" rule, but in our view the potential negative impact on the marketplace at this early stage is too great to allow this to take place.

71. ***Market Control Activities.*** In the recent Enbridge Gas Distribution 2007 rate case, the issue of a program called EnergyLink was much debated. This issue had two key components: a) use of the monopoly utility brand and reputation to exercise control over competitive markets (allegedly for utility purposes), and b) whether the utility was indirectly benefitting a financing affiliate. The Board in the end decided, based primarily on the first issue, that the EnergyLink program should be prohibited. Prior to the Board's consideration, however, the Board through the Chief Compliance Officer had been asked to look at the program, and had concluded that it did not offend the Gas ARC.

72. In our view there should be a general rule, included in the Electricity ARC (and in the Gas ARC, for that matter), providing that if a utility is engaged or proposing to engage in an activity that will indirectly benefit an affiliate, then whether or not it complies with the specific rules in the ARC, it should be open to any person to apply for an order compelling the utility to cease the activity. The Board should set out the considerations relevant to such an application (ie. the various goals of the Electricity ARC), and should expressly include in those considerations whether the activity has or will have an adverse affect on any competitive market for goods or services in Ontario.

Conclusions

73. We have noted earlier that we believe the Staff Report is an excellent base document for this important discussion about affiliate relationships. In many cases, we have agreed with the conclusions of Board Staff, and in other cases we have proposed additional issues that we believe can be usefully addressed by the Board.

74. The School Energy Coalition appreciates the opportunity to participate in this consultation, and we hope that our input will assist the Board in considering these issues. If there are further steps in this process, or any followup process, we request the opportunity to participate in those steps or process as well.

All of which is respectfully submitted on behalf of the School Energy Coalition as of the 20^{th} day of July, 2007.

SHIBLEY RIGHTON LLP

Per: ______________________

Jay Shepherd