July 10, 2003

Mr. Paul B. Pudge
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2601
Toronto, ON
M4P 1E4

Dear Mr. Pudge:

**RE: Consumer Security Deposit Policies – RP-2002-0146**

The EDA has reviewed the proposed changes to the Distribution System Code to address consumer security deposits and has received feedback from many of our LDC members on the same. The EDA was pleased to participate in the consultation process the OEB led on this issue, and we appreciate the opportunity to offer the following additional comments.

In considering this issue, the EDA believes that it is very important for the OEB to remember where LDCs were on this issue just a few short years ago; namely that LDCs had the ability to recover through municipal tax liens unpaid electric bills incurred by homeowners and businesses that owned their premises. As a result, many LDCs had security deposit policies that required:

- security deposits only from tenant customers that took into account the billing period plus a collection period, normally 3 months for residences and 2 months for businesses; and
- no security from customers who owned their premises.

This policy resulted in yearly write-offs to bad debts in the order of less than one half of one percent of revenues. However, things have certainly changed.

First, the tax roll lien capability for owner arrears is no longer available, and many consumers (even after Bill 210) still receive a volatile spot price, which creates a fundamentally new backdrop from which to assess deposit policy amendments.

Second, LDCs now bear significantly increased amounts of commodity risk as a result of the payment-default risks they bear from all end-users and retailers, and the 100% payment obligation they bear to the IMO mid-way through each month, prior to collection from the retail market.

The practical effect of these risks and obligations is that when customers do not pay, the LDCs are still responsible for 100% of the costs even though on average only 20% of the costs arise from distributing electricity.

Third, consumers and LDCs both have experienced over the last year the realities of payment-default risk in a competitive market. As the price of commodity increased over the summer and fall of 2002, the financial risk to LDCs inherent in serving end-users and retailers under the rules that govern the competitive market dramatically increased, with no corresponding capability to guard against payment-default risk. As well, during the Bill 210-imposed moratorium on disconnection of consumers for non-payment of bills, LDCs across the province experienced increases in arrears from 30%-400%, representing over $150 million uncollected from consumers yet which LDCs were still obligated to pay to the IMO.

And fourth, until 2006 LDCs do not possess the automatic right to apply to the OEB to adjust rates to recover losses incurred as a result of payment defaults, despite having acted "prudently". Indeed, it appears highly unlikely that rate adjustments for this purpose (or any other, for that matter) will be allowed. The practical effect of this situation is to require LDCs to absorb all losses due to payment defaults for at least the next three years.

The EDA had hoped that the Deposit Policy Working Group would have taken the above contextual points into consideration and developed recommendations to fit this new and challenging financial environment. Other stakeholders, including the CFIB, shared our hope. However, the Working Group took a very narrow approach when considering issues, and has produced recommendations which do not adequately reflect the untenable position that LDCs are in, and will continue to be in, until at least 2006.

(It is worthy of note that this narrow approach is indicative of the existence of a broader "seams" issue that exists between the regulatory scope of the OEB (which regulates the retail market) and the IMO (which regulates the wholesale market). The effect of this regulatory "seam" is quite negative as it continues to confound attempts by distributors to comprehensively resolve issues which overarch both the retail and wholesale markets. The EDA advocates that the OEB remove this seam once and for all by asserting its legislative authority and taking responsibility for the resolution of issues that cut across both markets.)

This paper contains the EDA's feedback on the specific code amendments proposed by the OEB. As well, it contains the following suggestions of additional regulatory actions that we feel are required to effectively address the extremely challenging situation that LDCs face now, and will continue to face for the foreseeable future.

**Broad Comments on the Proposed Amendments**

The EDA continues to strongly urge the OEB to provide LDCs with a clear definition of prudence. Declaring that compliance with the RSC, once amended through this process, represents "prudence" could effectively accomplish this goal. The rationale for this is simple: if LDCs are expected to live up to a standard of "prudence" when guarding against payment default risk, then it is reasonable for LDCs and consumers to expect that standard to be clearly and openly defined.

Next, a mechanism must be created to allow LDCs, once prudent practices can be shown to have been followed, to automatically recover losses incurred by payment defaults, even between now and 2006. It is simply wrong to require LDCs, for whom the OEB's own SSS Code indicates the commodity is intended to be a "pass-through", to absorb all defaults that occur for the next three years in order to keep the IMO (and therefore producers of the commodity) whole. This is an absolutely unfair allocation of risk onto LDCs and their shareholders, which are not supposed to be bearing "any significant" financial risk in

delivering the commodity. Several mechanisms exist to better allocate these risks, and have been discussed with regulatory staff and stakeholders. One should be chosen and implemented now.

As well, just as the proposed RSC amendments will have the effect of reducing the burden of deposits on end-users, the OEB should insist upon parallel reductions in the prudential burden being borne by LDCs to the IMO. As examples, the proposed RSC amendments require LDCs to pay interest to end-users on their deposits, and return completely the deposits after a particular period of time. Despite a 100-year old "good payment history" the LDC industry gets no interest on the approximate $1 billion it has posted in prudentials with the IMO, nor is there any schedule to drop LDCs' prudential posting obligation after a fixed period of time. Either the rules for LDCs should be relaxed, or the deposit rules in the retail market should be just as demanding as those faced by LDCs in the wholesale market.

**Specific Comments on the Proposed Code Amendments:**

"disconnect/collect trip"

This definition should be amended to read "…distributor to demand payment of an outstanding amount *or* to shut off distribution of electricity to the consumer failing payment." This change reflects the fact that payment collection and disconnection visits are frequently separate.

2.4.6.1 In the last item related to an LDC's Conditions of Service, the "method of enforcement for a deposit not paid" should state that disconnection is one of the allowable methods. We believe that it is better to be clear from the outset that disconnection is permissible, which is consistent with LDCs' right to disconnect after reasonable notice under section 31 of the Electricity Act.

2.4.9 Most rental terms for residential tenants are for one year. If a tenant decides to skip out during the thirteenth month, with a one-year retention period, the deposit may have already been returned yet arrears may have accumulated. It is our recommendation that the deposit retention period be extended to at least two years for residential tenants. As well, for general service class customers, especially those >50kW, the 7-year retention period is much too short. Indefinite retention is recommended for deposits on these accounts due to the simple fact that they have the potential to dramatically affect LDC viability. Large consumers in financial trouble may leave many suppliers unpaid and collecting arrears, especially after bankruptcy, can be extremely difficult if not impossible. Most importantly, LDCs' monthly payment guarantees to the IMO (and therefore, generators) are precariously large for large consumers. The combination of these two factors have the potential to be catastrophic for LDCs, and under the current obligations facing LDCs, justify the indefinite retention of the deposit

2.4.10 The definition of good payment history (GPH) should be strengthened. By the definition provided, a chronically late-paying customer with many late payment charges in one year would qualify for GPH. We do not believe that this is the intent.

2.4.11 While the notion of confirming GPH may be valid, some LDCs have the ability to charge the customer via a miscellaneous charge for a GPH reference letter while other LDCs have no approved charge. Does this render 2.4.11(a) meaningless for LDCs without the approved charge or must customers opt only for 2.4.11(b)? The Board should consider adopting an across-the-board approved miscellaneous charge in order to standardize the process, lessen the confusion, and make it fair.

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For greater accuracy, the letter of confirmation of GHP should refer specifically to the definition of good payment history in section 2.2.10.

2.4.12 Billing Cycle factors are at odds with LDCs' other commercial transactions. In order to mirror the commercial relationship LDCs have with their own suppliers, it would be necessary to decrease the billing cycle factors available to the LDCs. To leave the factors at this level means that LDCs are exposed for a much longer time (even up to a month), until their residential customers settle with them.

In addition, it is proposed that a class average amount for deposits be used. This amendment actually reverses a Retail System Code amendment of April 5, 2002 which permits a distributor to calculate the security requirements on an individual customer basis and reverts to the original version of the RSC which required LDCs to calculate the maximum security deposit based on the average load for the class. Using previous usage at a particular location as a basis for calculating deposits is a much more accurate method than using the average for the class. Also, using the average for a class of customers will inevitably result in some customers paying too much or too little. The current rules should remain in place.

2.4.14 In order to obviate the need for future amendments to the RSC, the reference to 4.3 cents/kWh price for low volume consumers should be replaced with a generic reference to the rate used by the IMO, or any fixed price that applies to low volume customers as a result of government legislation or regulation.

2.4.21 This proposed amendment on the payment of interest (at Prime) to consumers on their deposit is the extremely contentious and unfair. The simple fact is that LDCs do not earn the Prime Business Rate. Generally, they earn a much lower bank interest amount. This obligation, if created, would result in LDCs subsidizing the interest rate earned by customers on their deposits. As well, there is an internal inconsistency with this proposal and the OEB's Retail Settlement Code, Section 8.3 which suggests that the interest that a distributor must pay a retailer "shall be the lesser of the rate that a distributor earns from any security deposits provided by consumers and the prime rate charged by the distributor's bank." Finally, creating the ability to pay out interest will require costly system changes and considerable administrative effort and cost. A more convenient and less costly way is to accrue the interest annually and credit the customer and apply it to the amount of security deposit. Unstated is whether there is a requirement to send a T5 to the customer for income tax purposes if the interest exceeds a threshold amount.

2.4.24 This amendment poses a major problem for LDCs in that as noted, annual review may result in a requirement to increase the deposit amount. If the customer is found to be in arrears during the annual review, should the customer be disconnected for not increasing his security deposit? Further, it must be noted that there will be considerable costs to accomplish the annual deposit review for all customers

2.4.25 In the event of a bankruptcy, the right of set-off may be overridden by court protection. Often, these are larger dollar amounts and the LDC, even though it may have prudently managed the security for the account, could be left with no usable deposit.

2.4.27 There are many cases where general service customers (both >50kw and <50kw) are also seasonal customers. By deeming them to be residential customers for purposes of establishing

the deposit amount and the retention period, the proposed amendment weakens the ability of the LDC to protect itself from customer default among these customers.

## Other Specific Considerations for Proposed Amendments

There is confusion over what definition describes a 'customer' and what definition constitutes a 'consumer.' A clear, concise definition should form part of the establishment of a Consumer Security Deposit Policy. The Retail Settlement Code defines a consumer as "a person who uses, for the person's own consumption, electricity that the person did not generate". A consumer can also be a person or persons contracting for the supply of electric service or energy, such as a landlord, a business, or an Incorporated Company (separate legal entities). For example, it is quite common for a person who owns several businesses to set up commercial hydro accounts in different names. An LDC is legally prohibited from requiring an owner of a Limited Company to be liable for the arrears of that company. Therefore it is the company (or 'entity') which must establish a good payment history or provide a satisfactory credit check to avoid paying a deposit (not the owner), otherwise an LDC would be exposed to non-payment risk.

### Implementation Costs/Timeframes

It must be recognized that many of the proposed code amendments require costly billing system changes in order to be compliant with the changes. There is no accompanying mechanism for these costs to be recovered upfront. Consideration must be given to this issue.

On a related front, the time-frame for compliance with the proposed changes is much too short. Given the implementation process in each LDC which will at least include Conditions of Service changes, LDC Board approval, system changes and customer notification and education, 3 months should be extended to one year.

## Conclusion

In closing, the EDA thanks the OEB again for the opportunity to provide this input. Continuing dialogue through working groups is a helpful process of understanding the complex issues that are so often at play. We look forward to a positive result from this process.

Yours truly,

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Senior Finance Analyst

per: Anton Krawchenko
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