
Electricity LDC Consumer Security Arrangements

A Discussion Paper

Introduction

Many local distribution companies (LDCs) have instituted new consumer security deposit policies since the opening of Ontario's electricity market. A range of concerns have been raised by various parties including LDCs, large customers, residential consumers and associations representing these stakeholder groups.

It has been brought to the attention of the Ontario Energy Board that electricity LDCs have differing security policies. It appears that some LDCs require security from only *large* consumers and/or only *new* consumers, while other LDCs are considering requiring a security deposit from the majority of customers. LDCs are also calculating the security deposits based on different methodologies and are retaining the deposit for varying periods. As a result, consumers across Ontario are receiving different treatment. This has also, in turn, resulted in a lack of symmetry amongst Ontario consumers of electricity and natural gas LDCs, as well as consumers in Ontario's wholesale and retail electricity markets.

In cases where LDCs are not requiring deposits, some large consumers may remain in the retail market (i.e., not become a wholesale market participant) primarily to avoid IMO prudential obligations. This could have implications in terms of the development of a competitive electricity market in Ontario. Differing security policies across LDCs also provide an unlevel playing field for consumers, within the retail market, and, thus, could result in new plants (consumers) "locating" in certain distribution areas because that LDC does not require a security deposit. Finally, requiring only large non-residential consumers to provide security, regardless of past payment history, could provide inappropriate incentives for 'uneconomic' bypass of the distribution system, especially for those large consumers with a good payment history. A relatively consistent set of policies, across Ontario's retail electricity market, is a consideration.

Given the above, this Board staff discussion paper will provide some discussion points in the form of possible minimum requirements and general guiding principles relating to customer security deposit policies. This document is primarily intended to elicit a dialogue and input from stakeholders, initially comprised of members of a Working Group, and is not intended to represent final views on this matter.

Going forward, once the Working Group has completed its task, future process options for consideration could include: (1) Specific OEB code amendments (e.g., Retail Settlement Code [RSC]); (2) A set of Guidelines on customer security policies; or (3) the status quo. However, if OEB code amendments and/or Guidelines are recommended by the Working Group, the Working Group could then also undertake to identify whether it would be more beneficial for those code amendments and/or Guidelines to be prescriptive or non-prescriptive in nature.

The Working Group should be aware that attempting to provide an all-inclusive definition of prudence is problematic in a quasi-judicial environment as the determination of prudence is based on many factors including circumstances particular to the specific case that may be unforeseen. At the same time, the outcome of the effort may go towards providing increased guidance on this matter.

This discussion paper will also endeavour to provide a general overview of the *past and current situation* in terms of electricity LDCs and security deposits. It will also briefly discuss customer credit policies of Ontario *natural gas* LDCs, which have now been in effect for some time, as well as security policies in the *telecommunications* industry. Finally, this paper provides a summary of the policies in some *other jurisdictions*.

Electricity: Past & Current Situation

In order to provide some context for discussion of this issue, the following is a brief discussion of the past and current situation, with respect to consumer security deposits, so that all stakeholders have a general understanding of current circumstances with the opening of the market to competition.

Security requirements of customers were previously addressed by *Part 6, Section 49.4* of the *Public Utilities Act* which gave natural gas and municipal electric utilities (MEUs) the power to require reasonable security from consumers. However, these provisions ceased to apply to electricity LDCs with the passage of the *Energy Competition Act, 1998* and the incorporation of electricity LDCs, under the Ontario Business Corporations Act (OBCA), as commercial entities. In addition, prior to the introduction of competition, if a company (consumer) did go bankrupt or was unable to pay their electricity bill for any other reasons and the MEU had not required reasonable security, distributors had access to the municipal tax roll (i.e., reimbursed when the property was sold by the municipality). There were also provisions for MEUs to apply to Ontario Hydro for recovery within rates. As a result, consumer non-payment risk appears not to have previously been a significant issue.

Under the current regime, chapter 8 of the RSC establishes the maximum security requirements that a LDC may request from *retailers*. This security is intended to

provide the LDC with financial protection in the event that a retailer defaults on payments to the LDC. The provisions of chapter 8 establish the form and amount of security based on each billing option. RSC amendments have recently been made that were first proposed on December 6, 2001 to better protect LDCs against retailer financial defaults during periods of high market clearing prices. The change was made to make the market price that LDCs used, for calculating the maximum prudential obligations of retailers, the same market price — an estimate of the *monthly average* hourly Ontario energy price (HOEP) — that the IMO uses for the purposes of determining LDC maximum net exposures and prudential support obligations (as opposed to the standard supply service (SSS) fixed reference price). As a result, the amendment was also made, in part, to increase symmetry between the wholesale and retail electricity markets.

Similarly, chapter 7 of the RSC addresses *consumers* with respect to non-payment risk and security deposits. Under SSS and distributor consolidated billing, the RSC is general in stating that the LDC may impose an amount and type of security requirement on a consumer depending on the LDC's individual assessment of the consumer's likely risk. Under retailer-consolidated billing, consumer non-payment risk is shifted to the retailer. There are also provisions for an LDC to disconnect a consumer only if *competitive or non-competitive costs* are overdue.

One pertinent section of the RSC is important to highlight for these discussions. Section 7.4.3 specifically states "*A distributor may use any risk mitigation options available under law to manage consumer non-payment risk. A distributor may impose an amount and type of security requirement on a consumer depending upon the distributor's assessment of the consumer's likely risk of non-payment. A distributor shall not discriminate among consumers with similar risk profiles or risk-related factors.*" In addition, the Distribution System Code (DSC) requires that an LDC's security deposit policy be specified in its Conditions of Service. Also important for these discussions is the second objective of the *OEB Act* which provides for "*non-discriminatory access to transmission and distribution systems.*"

Natural Gas and Telecommunications: Current Status

Natural Gas

With respect to natural gas, in general, the policies appear to be consistent amongst natural gas LDCs in that they all require a security deposit only from: (1) a new customer without a credit history; and (2) an existing customer with a poor record of paying natural gas bills.

For *residential* customers, the *amount* of security generally ranges from a minimum of the highest one month's charges to a maximum of the three highest consecutive months. For *non-residential* customers, it ranges from the two to three highest consecutive months' charges (within the past 24 months).

For *residential* customers, deposits are *refunded* to customers who have demonstrated financial stability, which entails not missing any payments for a *one year* period. For *non-residential* customers, good payment history, over a *five year* period, is required for security to be returned.

Telecommunications

In terms of the telecom industry, Bell Canada cannot require security deposits from a customer at any time unless the customer: (1) has *no credit history* with Bell and will not provide satisfactory credit information; (2) has an *unsatisfactory payment history* with Bell within the past 2 years; or (3) clearly presents an *abnormal* risk of loss.

Bell must inform the customer of the specific reason for requiring a deposit and that alternatives to cash are accepted (i.e., letter of credit or a written letter of guarantee from a third person that has established a satisfactory credit rating with Bell).

A deposit cannot exceed three months' charges. However, in this instance, three months' charges includes all *non-regulated* (e.g., long distance) as well as regulated charges.

All deposits earn interest as specified in Bell's tariff.

Bell must show the total amount of the deposits held (with accrued interest) on each customer's monthly account.

Bell is also required to review the appropriateness of deposits at six month intervals and must immediately refund the deposit (with interest) when service is terminated.

Other Jurisdictions: Credit Agreement Arrangements

Information was also collected regarding some other jurisdictions, but did not include the U.S. because their market designs and electricity markets are generally quite different from Ontario's. For example, most U.S. utilities are still integrated and some still have bundled bills (i.e., include a generation and transmission component). In such instances, it is unlikely that the distribution arm of a utility will need to put up security in case it failed to pay its generation arm. In addition, most U.S. states have retail rate caps, similar to California's, which can have significant security requirement

implications. It is likely that security deposit requirements may need to be more stringent, in such cases, as retail rate caps can potentially drive a utility into bankruptcy as was the case in one U.S. state. As a result, the following covers jurisdictions that have more comparable market designs to Ontario's and also have a great deal of experience with competitive electricity markets.

In the United Kingdom (UK), each retail supplier must comply with standard *license condition 45: security deposits*. There is a requirement that each supplier specify in its Code of Practice if and how their security policy differs for *new and existing* customers. The Code of Practice also must explain that security arrangements may include the requirement to pay by direct debit, bank guarantee or monetary deposit. If security has been required, each supplier must return/repay the deposit with *interest* within 14 days where the customer has *paid each bill in full for 12 consecutive months* (i.e., if 1 year of good payment history, security can no longer be required). The amount of the deposit is based on 1.5 times the value of *average quarterly (3 months) consumption*. It also explains that if the customer opts for a prepayment meter, a security deposit cannot be requested at all. Finally, each supplier must submit its Code of Practice to the regulator (Ofgem) for approval.

In Australia, for the most part, separation (competitive/non-competitive) has been implemented. The major difference, relative to Ontario, is that there appears to be no customers on default supply with a distributor. Instead, it appears that all customers are with a retailer. The initial retailer is referred to as a retailer of 'last resort' or 'host' retailer. Consequently, the security arrangements discussed below are between retailers and consumers. Retailers may require security from customers if there is a perceived risk of non-payment. In Victoria, the maximum security deposit is equal to the average bill for 4 months, coupled with no undue discrimination amongst customer classes. The guidance provided also discusses circumstances commonly used in other jurisdictions for requiring security from consumers. These include: (1) customer left a previous residence without settling on all electricity charges and amounts remain outstanding; (2) customer used electricity illegally; and (3) customer refused to produce acceptable identification. It also notes that disconnecting supply for non-payment is only to be used as a last resort. Finally, retailers are also required to "report" to the regulator *"the number and percentage of customers required to provide security deposits (non-residential & residential)"*, as a customer service quality measure. The intent is to provide insight into broader trends such as what effect various security policies have had and how effective they have been.

It is also worth noting some of the comments made by the Victorian regulator (Essential Services Commission). Within the ESC's final decision document, *Guidance: Credit Support Provisions*, the ESC stated, *"This Guidance is not binding on the parties. Rather it will be used more to inform the Commission's decision making on questions of unreasonable discrimination and the application of credit support ... The Commission believes that publication of Guidance, rather than requiring resubmission of default*

agreements, is the preferred means to resolve this matter ... The Commission notes that a number of finer details may be required to be resolved to implement such a scheme, and is therefore of the view that the precise wording of UoSA [agreement] clauses supporting these arrangements is something best left to the parties.”

Also in Australia, the New South Wales (NSW) regulator (IPART) took a different approach. IPART made security deposits, as well as late payment charges and fees for dishonoured cheques, a regulated retail charge (separate from regulated retail tariffs). The three circumstances noted above, by the ESC, were generally the conditions also adopted by the NSW regulator for residential customers, but IPART added that security can be requested if the customer “*does not have a satisfactory credit history in the reasonable opinion of the standard retail supplier or cannot demonstrate satisfactory credit history with another retail supplier... and the standard retail supplier has offered an instalment plan or other payment option (e.g., pay as you go by instalments, direct debit) and the small retail customer has refused or failed to agree to the offer.*” For business customers, the conditions are the same, but also includes a clause stating “*is a new business.*” In the June 2002 Determination, with respect to refunds, the supplier must inform the customer, in writing, of the amount that is refundable and the security deposit must be returned (account credited) within **10 days** of demonstrating good payment history — residential (1 year) and business (2 years). Finally, IPART recognized that retail suppliers have different billing cycles and, therefore, the maximum charge is identified as either:

- 1.5 times average *quarterly* electricity account, or
- 1.75 times average *2-monthly* electricity account, or
- 2.5 times the average *monthly* electricity account.

The IPART Determination also notes that the retail supplier may not levy interest on a security deposit.

General Guiding Principles for Discussion

Symmetry Amongst the Markets

A possible option for the Working Group’s consideration is that an underlying objective build on the most recent RSC amendments and attempt to bring about greater symmetry between: (1) “wholesale” and “retail” electricity markets; (2) electricity LDCs themselves; and (3) “electricity” and “natural gas” LDCs. At the same time, symmetry is not desirable where it is impractical or not appropriate. The most recent RSC amendments — change of price used in calculation of retailer prudentials and proposed reduction in the settlement gap for interval-metered customers — were made, in part, to bring about greater symmetry between the “wholesale” and “retail” electricity markets. It

specifically noted, in the December 6th OEB letter, that *“the Board expects these changes to make the security arrangements for the retail market more responsive to current and expected market conditions and **provide symmetry between the wholesale and retail market prudential requirements.**”* In addition, with respect to the policies of the “natural gas” LDCs, there have been relatively few complaints from consumers in recent times and those policies have been in place for some time.

As noted, recently proposed amendments to the RSC would reduce the current settlement gap (about 2 weeks), relative to when the IMO bills LDCs, for interval-metered customers. The Board is considering this amendment to reduce cash flow mismatches for LDCs as well as increase symmetry with the wholesale market. Another consideration is that such a change could allow the amount of security deposits required from interval-metered customers to be reduced, since the LDC would be carrying the interval-metered customer(s) for a shorter duration of time. If the Board approves this code amendment, such a change could be taken into consideration in consumer security deposit policies.

Some consumers could also be financially disadvantaged for remaining retail customers or being located in a certain LDC’s territory. For example, it appears that some LDCs require the equivalent prudential support, as the IMO, in the form of a cash payment. Such customer(s) would be disadvantaged because similar customers (and LDCs), in the wholesale market, have their “soft” prudentials (i.e., credit rating, good payment history, etc.) taken into account (credited) which reduces their “hard” prudential obligations (e.g., cash) to the IMO. To bring about true parity, with the wholesale market, does not necessarily mean allowing an LDC to collect 70 days coverage, all in the form of cash or what is termed as “hard” prudentials. True parity would suggest also allowing consumers, in the retail market, to use “soft” prudentials, such as good payment history and credit ratings, to reduce their cash security obligations to LDCs.

While it is IMO policy to collect from virtually every wholesale consumer, it may not be a practical option to simply amend the RSC so that all LDCs would be similarly required to collect security from all retail consumers. Many retail consumers have excellent payment histories (i.e., never defaulted and/or missed a payment). In addition, most LDCs have significantly more consumers to deal with relative to the IMO. Therefore, a further reason is that it may not be cost-effective collecting from all retail consumers, especially low volume customers that have never defaulted before (i.e., low risk — high cost/minimal benefit). Also, a move in this direction would likely also result in significant unnecessary customer care costs for LDCs in terms of being forced to deal with numerous customer complaints.

Electricity and natural gas LDCs also face different circumstances. In most cases, electricity LDCs purchase virtually all of the electricity they require from the spot market, while natural gas LDCs make their commodity purchases primarily through fixed price contracts. Electricity LDCs are also required to post substantial prudentials with the

IMO, while natural gas LDCs do not face a similar financial requirement. The Working Group could take such differences into account in deciding what degree of symmetry with natural gas LDCs is practical and appropriate.

Consistency Across Ontario's Electricity LDCs

LDCs are also using different prices to calculate security deposits, such as the SSS *Fixed Reference Price* and a forecast of the *monthly average hourly Ontario energy price (HOEP)*. The Board changed the price used to a forecast of the *monthly average HOEP*, in the LDC's calculation of retailer prudential obligations, to benefit the LDCs in terms of cash flow. Therefore, a consideration is that LDCs treat their customers in manner that is consistent with this change and use the same monthly average HOEP estimate in all security calculations. Alternatively, all LDCs could use the fixed reference price or another price if it is deemed to be more appropriate.

With respect to the issue of a possible common methodology to calculate security deposits, there is also the issue of the appropriate *base* upon which the calculation is made. For example, if it based on one month's charges, should those charges include *all charges* appearing on the consumer bill or *every charge except the distribution charge*? Consequently, the appropriate base is also an issue for discussion by the Working Group. Regardless of which base is decided upon, it may also be appropriate for LDCs to clearly state in security deposit policies which specific charges (i.e., base) have been used in the security deposit calculation.

As noted in the introduction, LDCs are using different methods to calculate the required deposit. Some include credit for good payment history, credit ratings, etc. while others do not. Some LDCs use the SSS reference price while others use the estimated monthly average HOEP. As a result, the Working Group might wish to discuss whether there is a need for a specific inputs or a formula to have security deposits calculated in relatively consistent manner for consumers of all LDCs.

Non-Discriminatory Treatment of Customers

There are many elements to a security deposit policy and the treatment of customers. Within this context, a number of questions arise including:

- Should there be different treatment in terms of "new" versus "existing" customers?
- After what period of time does a "new" customer cease to be a "new" customer (and become an "existing" customer) for the purpose of security deposit requirements?

- Once a customer has met a waiver threshold, specified in an LDC's security deposit policy, what is an appropriate period of time for the deposit to be returned? For example, as noted above in the UK, the supplier must return the deposit within *14 days* once the waiver threshold has been met. Similarly, in New South Wales (NSW), the deposit is returned within *10 days*.
- What is the appropriate rate of interest for Ontario electricity LDCs to pay on consumer security deposits? For example, one LDC include a provision to pay interest on a monthly or annual basis (e.g., at Prime Rate less 2%).
- If a company has existing facilities in various Ontario LDC territories and, subsequently, builds a new facility in a different LDC territory, should the owner of the new facility be treated as a new customer or should the payment history in the other LDC territories (where the owner has existing facilities) be taken into account?
- In other industries (e.g., telecom) and other jurisdictions such as NSW (e.g., electricity), the specific "reason" must be provided to each consumer for requiring a security deposit. Should the specific "reason" be provided by each Ontario electricity LDC?

NOTE: If a customer switches to a retailer that uses retailer consolidated billing, non-payment risk then resides with the retailer. It is an OEB code requirement to return the security deposit to the customer under such circumstances. It may be beneficial to clarify this in security deposit policies.

Balancing LDC Financial Viability & Consumer Protection and Maintaining Consistency with the Legislation

As noted, some LDCs have included a clause that indicates that the LDC may disconnect customers who do not meet the LDCs' security request. The RSC does not appear to currently make specific provisions for disconnection when a consumer fails to provide the requested security deposit. The authority to disconnect appears to be limited solely to non-payment of *competitive and non-competitive electricity charges*. Some may argue that a security deposit is a non-competitive charge. However, at least one LDC has requested the authority to disconnect for non-payment of a security deposit because that LDC felt it did not have that authority under the current RSC provisions or any other OEB regulatory instruments. It is also notable that no LDC rate schedules currently include security deposits.

In coming to a recommendation on this issue, it is suggested that section 31 of the *Electricity Act* be taken into consideration, as it states that a distributor may disconnect "*if any amount payable ... for the distribution or retail of electricity ... pursuant to section 29 is overdue*". A further consideration is the statement by the Board, in the letter of August 14, 2002, regarding security deposits. In that letter it notes, "*Of immediate*

concern to the Board is the issue of disconnection of service for non-payment of a security deposit requested by an LDC. The Board is of the view that disconnection of service is a grave matter, and that any LDC should seriously consider the consequences of such potentially harmful action. The Board has not made a determination on whether non-payment of a consumer security deposit is grounds for termination of service pursuant to section 31 of the Electricity Act, 1998.”

Other Possible Guiding Principles

The other circumstances used in most jurisdictions, which were referenced by the Victorian regulator in their Guidance document, also appear to be pragmatic. Those included if a: (1) customer left a previous residence without settling on all electricity charges and amounts remain outstanding; (2) customer used electricity illegally; and (3) customer refused to produce acceptable identification. These could be included as part of the Working Group’s considerations.

Is there a need for Minimum Requirements?

If the Working Group determines that it would be beneficial to establish a set of minimum requirements for electricity LDC security deposit policies, the Working Group could discuss and attempt to come to agreement on a certain set of minimum requirements. The following is a listing of security deposit policy components incorporating many of the general principles discussed above. Consideration could be given to the following to determine which, if any, minimum requirements may be appropriate:

- a list of all the potential *types* of security that will be accepted;
- a detailed description of how the *amount* of security is *calculated*;
- the *limits* on the *amount* of security required;
- if and how the security policy differs for *new and existing* customers;
- the planned *frequency, process and timing* for *updating* the security arrangements;
- description of how *interest* payable to consumers on deposits is determined;
- *criteria* which the customer must meet to have the security deposit *waived and/or returned* (e.g., for what period of time must a new customer maintain good payment history);
- conditions of *default*;
- the *specific reason* to each consumer for requiring a security deposit; and
- a *copy* of its security policy to the Board and any other person, *if requested*.

In applying its security policy in a *non-discriminatory* manner, each electricity LDC could also take into account:

- the *type* of security;
- the *credit-worthiness* of the customer; and
- the magnitude of *exposure*.

The Distribution System Code (DSC) requires each LDC to have a *Conditions of Service* document and to include the LDC's deposit and prudential requirements in it. Such a set of minimum requirements could assist in increasing consistency amongst electricity LDCs and ease the burden on LDCs in terms of determining what may be appropriate to include in their security deposit policies. "Minimum Requirements" may not be the most appropriate terminology, in this instance, since the above could be included within a set of Guidelines.

Conclusion

These are only preliminary considerations for the Working Group. The potential *guiding principles* and *minimum requirements* discussed above are included for discussion purposes only. As such, it is intended that the Working Group use this paper as a basis for further discussions and ultimately developing a set of recommendations. If it is felt that any additional principles are appropriate, such principles could be brought forward for the Working Group's consideration. Further issues/options can also be brought forward for discussion. Input is also sought on whether it is felt that the RSC or any other OEB code (e.g., DSC) requires specific amendments and/or Guidelines are necessary. As noted, if OEB code amendments and/or Guidelines are deemed necessary, the degree of prescriptiveness could also be discussed. Again, the Working Group may find it beneficial to identify and discuss any potential implementation issues that may arise.

Stakeholders are also reminded that this particular consultation is to focus exclusively on customer security deposit policies. In other words, this consultation does not involve other broader issues such as those associated with retailers (and security) and working capital levels.
