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September 3, 2004

To: All Interested Stakeholders

**Re: Revised Amendments to Affiliate Relationship Code for Gas Utilities (“ARC”)  
RP-2004-0140**

On June 3, 2004, the Board issued proposed amendments to the ARC, as well as an accompanying draft Background Policy Paper, for public consultation. All comments received were posted on the Board's web site.

Having considered the comments, the Board proposes several changes to the previously proposed amendments and has decided to re-consult with interested parties. The revised proposal, as well as a redlined version identifying the changes, are available on the Board's web site.

**Changes to Proposed ARC Amendments**

The proposed changes are summarized below.

Two significant policy changes have been made to the proposed amendments.

- The utility's internal cost test in new section 2.3.2 has been revised to require an assessment of the costs of internal and external options at the time outsourcing is first considered. Utilities will be required to document their initial outsourcing decision with a contemporaneous business case.

It is anticipated the redrafted amendments will provide more guidance to utilities, while providing ratepayers with enhanced assurance as documented evidence will be available on the merits of outsourcing.

- Cost-based pricing alone is to be allowable (see section 2.3.11.2) for core shared corporate services as defined under section 1.2. The long-standing practice that reasonable cost allocation for shared corporate services must take place has been codified (section 2.3.11.3). It is also made explicit that the other new ratepayer-protection rules of enhanced cost information disclosure, maximum five-year term generally, supporting business analysis needed when first outsourcing, apply to all shared corporate services.

It is anticipated that application of cost-based pricing will benefit utilities by permitting continued common provision of senior-level corporate management functions, while the other proposed terms will benefit ratepayers by promoting the subsequent prudence review.

The Board is cognizant of recent significant increases in shared corporate services charges. The policy intent is that the exemption from tendering for core shared corporate services not become so broad that Ontario ratepayers fail to gain the benefits expected from testing affiliate prices against current market prices in areas such as engineering services, environmental services, facilities management, and information technology management.

Several other changes are proposed to the draft amendments, including:

- The amendments will come into effect six months after Board approval (see section 1.5.2).
- Affiliate agreements in place on June 3, 2004 are grandfathered until the end of their initial terms (see section 1.5.2).
- The regular transfer pricing rules do not apply to emergency services provided between a utility and its affiliate; instead, a reasonable cost-based price would be calculated afterwards (see section 2.2.5).
- It is explicitly stated that an affiliate contract can exceed five years with Board approval (see section 2.3.1).

### **Proposed Changes to Accompanying Policy Guidance**

The Board is not reissuing the draft Background Policy Paper at this time. Following the conclusion of the consultations, the Board will consider in what format it may prove most convenient to issue the planned policy guidance. Below are the contemplated revisions:

- *Add interpretative guidance that competitive bids will be treated “confidential”*

Stakeholders argued that keeping bids confidential would encourage wider participation. The Board's general confidentiality rules and policies will apply.

- *Add interpretative guidance that there may be special circumstances where the Board will grant an exemption from mandatory independent evaluation of significant contracts tendered, as stipulated in proposed section 2.3.7.*

Utilities commented that in the case of spot markets, the procurement process can be approved once and applied to future transactions without the need for further review. The Board will consider such an exemption on application.

- *Add interpretative guidance on how the threshold test will be applied to multiple contracts, as stipulated in proposed section 2.3.8.*

The Board agrees with stakeholders' suggestion the Policy Paper clarify that the new section 2.3.8 anti-avoidance rule applies only to multiple contracts for a similar service from the same provider.

The Board notes that some stakeholders raised questions or concerns over the discussion in the draft Policy Paper about review, in future rates cases, of transfer prices paid to non-affiliates that have economic links to the utility. The Board believes that concerns over possible non-arm's length terms remains a potential rates issue in such circumstances.

The Board would further caution that where a market clearly exists for a significant business service but a utility chooses to not tender but makes use of the cost-based pricing option for core shared corporate services proposed under section 2.3.11.2, a panel in a future rates case may still review the reasonableness of the costs sought to be recovered from ratepayers.

### **Further Stakeholder Comments**

If you wish to provide comments on the proposed changes outlined above, please forward three (3) hard copies and an electronic copy (in WordPerfect or Word) to the Board Secretary by September 20, 2004. If possible, also provide an electronic version in PDF format. Your written comments should quote file number RP-2002-0140.

Any comments received will become part of the public record.

Yours truly,

John Zych  
Board Secretary