

Ontario Energy Board

Affiliate Relationships Code for Gas Utilities

(Originally issued July 31, 1999)

AMENDMENTS

Section 1.1 of the Code is amended as follows:

The second sentence in section 1.1 is deleted and replaced with the following (amendments italicized):

The principal objectives of the Code *are* to enhance a competitive market while, *at a minimum, keeping ratepayers unharmed by* the actions of gas distributors, transmitters and storage companies with respect to dealings with their affiliates.

Section 1.2 is amended as follows:

Section 1.2 is amended by revoking the definition of “Director” and the definition of “fair market value”.

Section 1.2 is further amended by adding the following definitions:

“Affiliate Contract” means any contract between a utility and its affiliate, and includes a Services Agreement

“cost of gas” includes the costs of upstream transportation

“direct costs” means costs that can reasonably be identified with a specific unit of product or service or with a specific operation or cost centre

“fully-allocated cost” means the sum of direct costs plus a proportional share of indirect costs

“indirect costs” means costs that cannot be identified with a specific unit of product or service or with a specific operation or cost centre service, and include but are not limited to overhead costs, administrative and general expenses, and taxes

“market price” means the price reached in an open and unrestricted market between informed and prudent parties, acting at arm’s length and under no compulsion to act

“shared core corporate services” are business functions that provide shared strategic management and policy support to the corporate group of which the utility is a member, relating to legal, finance, tax, treasury, pensions, risk management, audit services, corporate planning, human resources, health and safety, communications, investor relations, trustee, or public affairs

“utility asset” means tangible or intangible property included in the utility’s rate base

Section 1.3 is amended by adding the following sentence at the end of the section:

Nothing in this Code in any way limits the authority of the Board, in a proceeding under section 36 of the Act, to review the prudence of actions taken by a utility and determine what costs should be recovered by a utility through rates.

Section 1.4 is amended by adding the following new section:

1.4.2 Despite section 1.4, section 2.3 of the Code does not apply to a utility that is exempt from the application of section 36 of the Act.

Section 1.5 is amended by adding the following new section:

1.5.2 The amendments to the Code made by the Board on December 9, 2004 come into effect on June 10, 2005. However, for affiliate contracts which were in place on June 3, 2004, the amendments will not apply until after the end of the initial term of any such contract.

Section 2.2.1 is amended by adding the following phrases (*italicized*):

2.2.1 Where a utility shares services or resources with an affiliate it shall do so in accordance with a Services Agreement, the *length and* terms of which may be reviewed by the Board to ensure compliance with this Code. The Services Agreement shall include *documentation of*:

- (a) the type, quantity and quality of service;
- (b) pricing mechanisms, *which shall be consistent with section 2.2.5 and section 2.3;*
- (c) cost allocation mechanisms, *which shall be consistent with section 2.3.11.3;*
- (d) *information disclosure and confidentiality arrangements, which shall be consistent with section 2.3.1.2; ...*

Section 2.2.5 is amended by adding the following sentence at the end of the section:

The transfer pricing rules set out in section 2.3 do not apply when a utility and an affiliate share services in an emergency situation; a reasonable fully-allocated cost-related price shall be determined afterwards by the parties.

Section 2.3 is revoked and replaced with the following:

2.3 Transfer Pricing and Cost Information Disclosure

Terms of Contracts with Affiliates

2.3.1 The term of an Affiliate Contract between a utility and an affiliate shall not exceed five years, unless otherwise approved by the Board.

2.3.1.2 A utility shall not enter into or renew an Affiliate Contract with an affiliate unless it contains provisions which require the affiliate to:

(a) comply promptly with all requests either made or authorized by the Board for information with respect to:

(i) the services, resources or products provided under the contract; and

(ii) the cost to the affiliate of providing any service, resource or product under the contract; and

(b) include equivalent provisions to those set out in this section in any contracts the affiliate enters into with another of its or the utility's affiliate for the purpose of providing any service, resource or product used in the provision of a service, resource or product to the utility.

Utility's Internal Cost

2.3.2 If a utility intends to enter into an Affiliate Contract for the receipt of a service, product, resource, or use of asset that it currently provides to itself, the utility shall first undertake a business case analysis.

2.3.3 For purposes of section 2.3.2, the business case analysis shall contain (a) description of relevant utility needs on a per-service basis, (b) identification of the options available internally or externally from an affiliate or third party, (c) economic evaluation of all available options including the utility's current fully-allocated cost (which may include a return on the utility's invested capital equal to the approved weighted average cost of capital), (d) explanation of the selection criteria (including any non-price factors to be taken into account), (e) estimate of any benefits to the utility's Ontario ratepayers from outsourcing, and (f) justification of why any separate items were bundled together when considered for outsourcing.

2.3.3.2 If a utility wishes to continue to receive from any affiliate a service, product, resource, or use of asset, the business case analysis described under section 2.3.2 must be repeated at least once every five years.

Where a Market Exists

- 2.3.4 Where a reasonably competitive market exists for a service, product, resource or use of asset, a utility shall pay no more than the market price when acquiring that service, product, resource or use of asset from an affiliate.
- 2.3.5 A fair and open competitive bidding process shall be used to establish the market price before a utility enters into or renews a contract with an affiliate.
- 2.3.6 Despite section 2.3.5, where satisfactory benchmarking or other evidence of market price is available, a competitive tendering or bidding process is not required to establish the market price for contracts with a value of less than \$100,000 or 0.1% of the utility's revenue net of the cost of gas, whichever is greater.
- 2.3.7 Where the value of a proposed contract exceeds \$300,000 or 0.3% of the utility's revenue net of the cost of gas, whichever is greater, a utility shall not award the contract to an affiliate before an independent evaluator retained by the utility has reported to the utility on how the competing bids meet the criteria established by the utility for the competitive bidding process.
- 2.3.8 The Board may, for the purposes of sections 2.3.6 and 2.3.7, consider more than one contract to be a single contract where it has been entered into for the purpose of setting the contract values at levels below the threshold level set out in section 2.3.6 or 2.3.7.
- 2.3.9 Where a reasonably competitive market exists for a service, product, resource or use of asset, a utility shall charge no less than the market price of the service, product, resource or use of asset when selling that service, product, resource or use of asset to an affiliate.

Where No Market Exists

- 2.3.10 Where it can be established that a reasonably competitive market does not exist for a service, product, resource or use of asset that a utility acquires from an affiliate, the utility shall pay no more than the affiliate's fully-allocated cost to provide that service, product, resource or use of asset. The fully-allocated cost may include a return on the affiliate's invested capital. The return on invested capital shall be no higher than the utility's approved weighted average cost of capital.
- 2.3.11 Where a reasonably competitive market does not exist for a service, product, resource or use of asset that a utility sells to an affiliate, the utility shall charge no less than its fully-allocated cost to provide that service, product, resource or use of asset. The fully-allocated cost shall include a return on the utility's invested capital. The return on invested capital shall be no less than the utility's approved weighted average cost of capital.

Shared Core Corporate Services

2.3.11.2 Despite sections 2.3.4 and 2.3.9, for shared core corporate services, fully-allocated cost-based pricing (as defined under sections 2.3.10 and 2.3.11) may be applied between a utility and an affiliate.

2.3.11.3 Reasonable cost allocation shall be applied to all shared corporate services. The methodology for this calculation shall be documented under section 2.2.1(c).

Transfer of Assets

2.3.12 If a utility sells or transfers to an affiliate a utility asset, the price shall be the greater of the market price or the net book value of the asset.

2.3.13 Despite section 2.3.12, the utility may sell or transfer to an affiliate a depreciable utility asset with a net book value of less than \$10,000 at a price equal to that net book value.

2.3.14 Before selling or transferring to an affiliate a utility asset with a net book value that exceeds \$100,000 or 0.1% of the utility's revenue net of the cost of gas, whichever is greater, the utility shall obtain an independent assessment of its market price.

2.3.15 If a utility purchases or obtains the transfer of an asset from an affiliate, the price shall be no more than the market price.

2.3.16 Before a utility purchases or obtains the transfer of an asset from an affiliate with a net book value that exceeds \$100,000 or 0.1% of the utility's revenue net of the cost of gas, whichever is greater, the utility shall obtain an independent assessment of its market price.

Section 2.5.4 is amended as follows:

The word "Director" in clause (c) is deleted and replaced with "Board".

Section 2.8.2 is amended as follows:

The second clause (b) is deleted and replaced with:

(c) the utility's specific costing and transfer pricing guidelines, bidding procedures and Services Agreement(s).

Amendments approved by Board on December 9, 2004